The Future of Foreign Investment in Southeast Asia

Edited by Nick J. Freeman
and Frank L. Bartels

Also available as a printed book
see title verso for ISBN details

The Future of Foreign Investment in Southeast Asia

This book portrays the dynamics that currently lie behind Southeast Asia's foreign investment activity, and seeks to identify the region's future options in reviving its reputation as an attractive host for foreign investors. Each chapter focuses on a key element, and in concert they combine to portray Southeast Asia's foreign investment profile and prospects. By bringing these key interlocking elements together under a single cover, the book aims to provide a more profound understanding of the challenges that currently face Southeast Asian countries in their ongoing attempts to attract new foreign investment inflows, as well as continuing to host substantial existing foreign-invested assets.

Nick J. Freeman is an economic consultant based in Vietnam, and an Associate Senior Fellow of the Institute of Southeast Asian Studies in Singapore. He is also Honorary Visiting Fellow at the Bradford University School of Management.

Frank L. Bartels is a Senior Industrial Development Officer, United Nations Industrial Development Organization (UNIDO), Vienna, Austria.

RoutledgeCurzon international business in Asia series

1 **The Future of Foreign Investment in Southeast Asia**
Edited by Nick J. Freeman and Frank L. Bartels

The Future of Foreign Investment in Southeast Asia

Edited by Nick J. Freeman and Frank L. Bartels

RoutledgeCurzon
Taylor & Francis Group
LONDON AND NEW YORK

First published 2004
by RoutledgeCurzon
11 New Fetter Lane, London EC4P 4EE

Simultaneously published in the USA and Canada
by RoutledgeCurzon
29 West 35th Street, New York, NY 10001

This edition published in the Taylor & Francis e-Library, 2004.

RoutledgeCurzon is an imprint of the Taylor & Francis Group

© 2004 selection and editorial matter, Nick J. Freeman and
Frank L. Bartels; individual chapters, the contributors

All rights reserved. No part of this book may be reprinted or
reproduced or utilised in any form or by any electronic,
mechanical, or other means, now known or hereafter
invented, including photocopying and recording, or in any
information storage or retrieval system, without permission in
writing from the publishers.

British Library Cataloguing in Publication Data
A catalogue record for this book is available
from the British Library

Library of Congress Cataloging in Publication Data
A catalog record for this book has been requested

ISBN 0-203-16556-X Master e-book ISBN

ISBN 0-203-34143-0 (Adobe eReader Format)
ISBN 0–415–30841–0 (Print Edition)

Disclaimer
The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of UNIDO concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. The responsibility for opinions expressed rests solely with the authors, and publication does not constitute an endorsement by UNIDO of the opinions expressed. The views expressed in this document do not necessarily reflect the views of the Secretariat of UNIDO. Any indication of, or reference to, a country, institution or other legal entity does not constitute an endorsement.

Contents

List of figures vii
List of tables ix
List of contributors xi
Preface xiii

1 Introduction to foreign direct investment in Southeast Asia 1
FRANK L. BARTELS AND NICK J. FREEMAN

2 The challenges of the new economy for multinational firms: lessons for Southeast Asia 15
PETER J. BUCKLEY

3 The political economy of foreign direct investment in Southeast Asia: economic security perspectives 32
CHRISTOPHER M. DENT

4 An examination of the impact of AFTA on Southeast Asian foreign direct investment 49
AMALE SCALLY AND JAYASINGHE WICKRAMANAYAKE

5 The future of intra-regional foreign direct investment patterns in Southeast Asia 80
FRANK L. BARTELS

6 Foreign direct investment and the rise of cross-border production networks in Southeast Asia 104
AXÈLE GIROUD

7 The impact of China's WTO accession on Southeast Asian foreign direct investment: trends and prospects 125
ADAM R. CROSS AND HUI TAN

8 The future of cross-border mergers and acquisition activity in Southeast Asia 155
FRANK L. BARTELS

9 The prospects for foreign direct investment in the transitional economies of Southeast Asia 170
NICK J. FREEMAN

10 The future of foreign portfolio investment in Southeast Asia 188
NICK J. FREEMAN

11 ASEAN investment cooperation: retrospect, developments and prospects 201
KEE HWEE WEE AND HAFIZ MIRZA

12 Foreign investment and Southeast Asian economic development: issues and challenges 255
HAL HILL

Bibliography 268
Index 283

Figures

1.1 FDI inflows for the world, the industrialised countries, and Southeast Asian countries compared, 1980–2000 4
1.2 FDI inflows to Southeast Asian countries compared, 1980–2000 5
2.1 Linkages between the activities of the firm 16
2.2 The new value chain 17
2.3 Global and local oppositions 23
2.4 ‘Hub and Spoke’ strategies: an example 25
4.1 Nominal FDI flows to ASEAN-5 member countries, 1968–98 52
4.2 Real FDI flows to ASEAN-5 member countries, 1968–98 53
4.3 FDI flows per capita for ASEAN-5 countries, 1968–98 54
4.4 Real FDI flows per capita for ASEAN-5 countries, 1968–98 54
5.1 Host country perspective of IR FDI flows, from 1995 to first half of 1999 92
5.2 Source country perspective of IR FDI flows, from 1995 to first half of 1999 92
5.3 Cumulative intra-Southeast Asian manufacturing FDI flows, from 1995 to first half of 1999 96
7.1 Annual inflows of utilised FDI into China, 1984–2001 130

Tables

1.1	Distribution of global FDI inflows, 1986–2001	3
1.2	Regional FDI flows compared, 1980–2000	4
1.3	Foreign investment stock in Southeast Asia, 1980–2001	6
5.1	Ranking of ‘openness’ of Southeast Asian economies, 1982–99	82
5.2	Structure of industrial output and exports in selected East Asian countries	83
5.3	The changing profile of intra-Southeast Asian exports, 1977–97	88
5.4	Southeast Asian trading partners, by export share, 1996	88
5.5	Stocks of inward FDI in Southeast Asian countries in 2000	89
5.6	Intra-ASEAN cumulative net FDI flows	90
5.7	Sources and hosts of net IR FDI flows for Southeast Asia, 1995 to first half of 1999	91
5.8	Comparative spatial distribution profile of intra-regional source of firms	93
5.9	Comparative ASEAN international firms’ host country preferences	94
5.10	Cumulative intra-regional manufacturing FDI, 1990–98	95
5.11	Comparative spatial distribution profile of intra-regional manufacturing FDI, 1990–98	95
5.12	Intra-regional FDI flows for select manufacturing sectors, 1999–2001	97
5.13	Source and hosts of intra-regional FDI in the manufacturing sector	97
5.14	Net intra-regional FDI flows, 1997–99	97
5.15	Intra-regional FDI to the manufacturing sector, 1996–2000	98
5.16	Indochina-4 countries as hosts to net intra-regional FDI, 1995–2000	98
7.1	FDI policy in China and some inward investment trends, 1979–99	128
7.2	Accumulated FDI stock in China, by home country and region	131
7.3	Global FDI inflows, by host region and economy, 1989–2000	133
7.4	Contracted FDI in China, by sectors, as at end-1998	134
7.5	China’s WTO accession obligations and commitments	137
7.6	Location attractiveness rankings for China, Hong Kong and the ASEAN-5	143
7.7	Survey results of the FDI regimes in China and the ‘ASEAN-5’	145

7.8	Transaction cost-related barriers to FDI in China and the 'ASEAN-5'	146
7.9	Measures of Asian FDI attractiveness: inward FDI Index, by host economy, 1988–90 and 1998–2000, and FDI per capita	147
8.1	Cross-border M&A activity in Southeast Asia, by sales and selected economy of seller, 1991–98	157
8.2	Profile of the largest intra-regional cross-border M&A deals in Southeast Asia, from July 1997 to March 1999	160
8.3	Intra-Southeast Asian cross-border M&A activity, ranked by acquirer and acquired, cumulative figures from 1999 to first half of 2001	160
8.4	Intra-ASEAN cross-border M&A activity, ranked by acquired company's business sector	161
8.5	Cross-border M&A sales in Southeast Asia, 1990–2000	161
8.6	Top ten industries for Southeast Asian cross-border M&A sales, 1998–2000	163
9.1	FDI stock per person in Indochina compared, 2000	175
9.2	Inward FDI stock as percentage of GDP in Indochina compared, 1990–99	175

Contributors

Frank L. Bartels is a Senior Industrial Development Officer at the United Nations Industrial Development Organization (UNIDO), Vienna, Austria.

Peter J. Buckley is Director of the Centre for International Business, University of Leeds (CIBUL), UK.

Adam R. Cross is Senior Lecturer in International Business at the Centre for International Business, University of Leeds (CIBUL), United Kingdom. He is also Deputy Director of the Centre for Chinese Business and Development at Leeds University Business School.

Christopher M. Dent is Director of the Institute for Pacific Asia Studies, University of Hull, UK.

Nick J. Freeman is an economic consultant based in Vietnam and an Associate Senior Fellow of the Institute of Southeast Asian Studies, Singapore.

Axèle Giroud is Lecturer in International Business at Bradford University School of Management, UK.

Hal Hill is the H.W. Arndt Professor of Southeast Asian Economies, Division of Economics, Research School of Pacific and Asian Studies, Australian National University, Canberra, Australia.

Hui Tan is Lecturer in Chinese Business and Management at the Centre for International Business (CIBUL) and at the Centre for Chinese Business and Development (CCBD), University of Leeds, UK.

Hafiz Mirza is Professor of International Business at Bradford University School of Management, UK.

Amale Scally is an Assistant Lecturer at the Department of Accounting and Finance, Monash University, Melbourne, Australia.

Kee Hwee Wee is Economic Affairs Officer at United Nations Conference on Trade and Development (UNCTAD), Division on Investment, Technology and Enterprise Development, Investment Issues and Analysis Branch, Geneva, Switzerland. He was previously Assistant Director in charge of investment matters at the ASEAN Secretariat in Jakarta, Indonesia.

Jayasinghe Wickramanayake is a Lecturer at the Department of Accounting and Finance, Monash University, Melbourne, Australia.

Preface

The main purpose of this volume on the future of foreign direct investment (FDI) in Southeast Asia is to provide a concise and insightful view of the current profile and future trajectory of cross-border investment activity in the region. The book does not aim to span every aspect of foreign investment into and within the region; nor is it intended to present a comprehensive history of such activity. Rather, the contributions that follow seek to identify and illuminate the main features of regional investment activity, with a view to future prospects. The increasing spatial distribution of multinational enterprises and the burgeoning of international production networks are highlighted as presenting important new challenges for Southeast Asian countries, both individually as nation-states and collectively as members of the Association of Southeast Asian Nations (ASEAN). This volume also depicts the threats and opportunities arising from the growing contention between Southeast Asia and China for FDI inflows, in which the latter appears to be making significant gains. It is our hope that the community of academic researchers and business executives with an interest in contemporary Southeast Asia will find the analysis that follows to be valuable and illuminating.

Nick J. Freeman
Frank L. Bartels
March 2003

1 Introduction to foreign direct investment in Southeast Asia

Frank L. Bartels and Nick J. Freeman

1.1 Introduction

The wider context for the subject of this book is best provided by a twenty-year perspective on the trajectory of global business activity, as represented by flows of foreign direct investment (FDI). Recorded FDI flows have demonstrated remarkable global growth, from under US$60 billion in 1980 to over US$1,400 billion in 2000.[1] Over that same period, the total stock of FDI in Southeast Asia has grown from roughly US$24.7 billion to almost US$270 billion (ASEAN, 2002). Section 1.2 of this introductory chapter, on the underlying factors for the growth in foreign investment, briefly identifies the two main driving forces responsible for vigorous FDI activity in Southeast Asia. Section 1.3 sketches out world, regional and Southeast Asian FDI patterns, and profiles the trajectory of FDI flows and their regional distribution. Section 1.4 briefly outlines the issues addressed by each of the chapters that follow.

1.2 Underlying factors for growth in FDI

Since 1980, two related developments have helped determine the industrial organisation of multinational enterprises (MNEs) and the global increase in FDI activity. The first has been the on-going process of policy liberalisation by host countries towards foreign investment, as a result of multilateral trade agreements and pressures for structural adjustment, as well as intensive competition between host countries seeking to capture and harness the beneficial impacts of FDI (Oman, 2000). This liberalisation process has resulted in decreasing costs of both cross-border trading and investment activity. Clear evidence of the liberalisation of the policy environment and its regulatory framework is provided by the increasing number of pro-FDI changes in the investment regimes of many host countries.[2] The second development has been the geographical spread of international production and service networks in different locations, apparent in both industrialised and developing countries, and especially within Southeast Asia (UNCTAD, 1993b, 2001). This spatial distribution, driven in large part by MNEs' seemingly continual search for efficiency gains to counter both increasing production costs and price competition, and the perils of exogenous shocks (such as the 1973/74 and 1979/81 oil price shocks), is hallmarked by the strategic

integration of MNE headquarters, subsidiaries and affiliates. As Abonyi (2000) notes, this has arisen in part from 'revolutionary changes in the nature of global production and competition', and adds that:

> Technological and organizational innovations allow a 'slicing up' of industry and firm value chains across borders to produce goods in a number of stages in different locations, adding value at each stage. Advances in management technology then permit firms to knit together intricate multi-country sourcing, production and distribution networks, simultaneously taking advantage of and shaping shifts in comparative advantage in diverse locations. … These new production networks have dramatically transformed patterns of regional trade and investment – and the development options of Asian economies. Development used to be about supporting national industries within a country's borders. But in an increasingly integrated regional and globalizing economy, development is now about 'membership in networks'.
>
> (Abonyi, 2000)

With specific regard to Southeast Asia, this integrated networking and spatial distribution has also had distinctive trade characteristics, exemplified by 'vertical intra-industry trade' (VIIT) and export activity in a relatively narrow range of product categories.[3] The VIIT dimension of the spatial distribution of international production is determined on the one hand by the relative differences in factor endowments between host countries (Fukao *et al*., 2002), and on the other hand by the 'componentisation' of production processes, which represents an increasing division of labour in the processing and trading of intermediate goods (Kimura, 2001). This new reality has major implications for all host countries to FDI, including those in Southeast Asia.

Since around 1980, Southeast Asia's integration in the global economy has been characterized by export trade-led economic growth, correlated with successive waves of inward FDI flows from Japan, North America and Europe, and more recently intra-regional FDI flows (sourced primarily from Singapore). In general, Southeast Asian policy makers' undoubted success in attracting FDI inflows has been due in large part to a model of economic development – including resource allocation and decision-making structures – that has been significantly influenced by the state (World Bank, 1993). The fact that a recalibration of the economic development model to changing circumstances did not occur at a sufficiently rapid pace to avert the Asian economic crisis of 1997–98 does not invalidate the success of this 'East Asian model' in successfully attracting substantial and sustained levels of FDI inflows over the last twenty years or more (Freeman and Hew, 2002; Yusuf, 2002).

1.3 Profile of world, regional and Southeast Asian FDI patterns

The distribution of FDI shows a significant growth of foreign investment flows to developing countries, of just below US$50 billion in 1990 to just below

US$200 billion in 2001 (UNCTAD, 2002b). Table 1.1 shows Asia Pacific's average share of global FDI flows fluctuating considerably over the last two decades, increasing from 10.6 per cent in the 1986–90 period to 21.2 per cent in the 1993–98 period, before contracting to 9.2 per cent in 1999–2000, and 13.9 per cent in 2001. Not only has Asia Pacific's share of the total FDI 'pie' changed, but also the size of the 'pie' itself has grown. Between 1980 and 1990, global FDI inflows remained below US$200 billion annually, but between 1991 and 2000 they burgeoned from US$154.5 billion to a staggering US$1,436 billion (see Table 1.2). While global FDI flows have steadily expanded – from US$52 billion in 1980 to US$679 billion in 2001 – South and East Asia's share grew from a mere US$2.5 billion (or 4.75 per cent of global flows) in 1980 to US$17 billion (or 8.4 per cent) in 1990, and peaking at US$54.5 billion (or 22.7 per cent of global flows) in 1994, before collapsing to US$31.6 billion (or 4.7 per cent) in 2001.[4]

The twenty-year perspective on FDI activity in Southeast Asia, portrayed in Figures 1.1 and 1.2, indicates two particular phases of dynamism. The first phase, from 1985 to 1990, saw global annual flows rise sharply, from roughly US$55 billion to US$202 billion, and during this first phase of steady growth in global FDI flows, Southeast Asia's share expanded nearly five-and-a-half times, from US$2.2 billion to US$12.1 billion. Consistently, as shown in Table 1.2, the lion's share of the region's FDI inflows were destined for the city-state of

Table 1.1 Distribution of global FDI inflows, 1986–2001 (%)

Region	*1986–90*	*(1991–92)*	*1993–98*	*1999–2000*[a]	*2001*
Developed countries	82.4	66.5	61.2	80.0	68.4
Western Europe	38.4	46.0	33.7	51.9	45.7
European Union	36.2	45.3	32.1	50.2	43.9
Japan	0.2	1.2	0.3	0.8	0.8
United States	34.6	12.7	21.7	22.6	16.9
Developing countries	17.5	31.2	35.3	17.9	27.9
Africa	1.8	2.2	1.8	0.8	2.3
Latin America and the Caribbean	5.0	11.7	12.3	7.9	11.6
Asia and the Pacific	10.6	17.4	21.2	9.2	13.9
Central and Eastern Europe	0.1	2.2	3.5	2.0	3.7
Least developed countries	0.4	1.1	0.6	0.4	0.5

Sources: UNCTAD, 2002b, FDI/TNC database.

Notes
a A period characterised by exceptionally high cross-border mergers and acquisition activity in developed countries.
The shaded years are FDI trough periods, while non-shaded years are FDI growth periods, reflecting world economic cycles.

Table 1.2 Regional FDI flows compared, 1980–2000 (US$ million)

Region	*1980*	*1985*	*1990*	*1995*	*2000*
World	52,197	55,526	202,193	319,998	1,436,189
Industrialised countries	46,479	41,694	172,239	223,929	1,231,476
South and East Asia	2,480	4,387	15,984	52,521	124,607
Southeast Asia (exc. Brunei)	2,253.5	2,226.66	12,140.90	21,380.97	11,913.46
Cambodia	—	—	—	150.80	125.72
Indonesia		310.00	1,093.00	4,346.00	(4,550.00)
Laos	—	—	6.00	95.10	—
Malaysia	933.90	694.71	2,332.46	4,178.24	3,787.63
Myanmar	—	—	161.15	277.20	254.79
Philippines	(106.00)	12.00	530.00	1,478.00	1,241.00
Singapore	1,235.75	1,046.75	5,574.74	8,787.65	6,390.33
Thailand	189.86	163.20	2,443.55	2,067.98	3,365.99
Vietnam	—	—	—	—	1,298.00

Source: UNIDO statistics, compiled from the IMF's International Finance Statistics.

Note
— denotes not available.

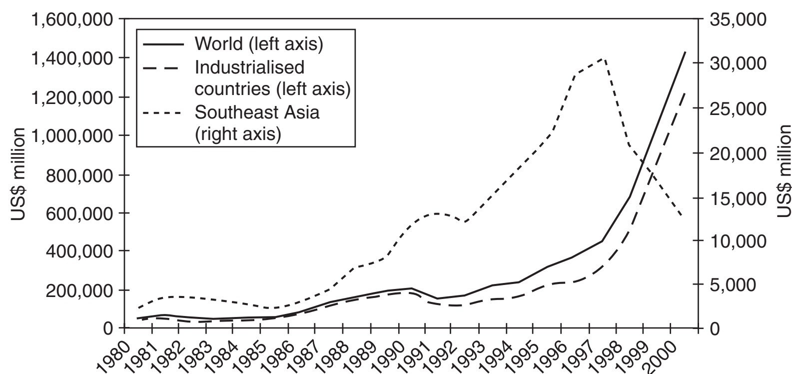

Figure 1.1 FDI inflows for the world, the industrialised countries, and Southeast Asian countries compared, 1980–2000 (US$ million).

Source: International Finance Statistics (from International Monetary Fund).

Note
Data for Brunei Darussalam not available in IFS database.

Singapore – 55 per cent of the regional total in 1980, 46 per cent in 1990, and 54 per cent in 2000 – while Indonesia, Malaysia and Thailand took most of the remainder. Thailand's performance in attracting FDI was most dramatic, with its share of regional flows growing from 8.4 to 28.3 per cent during this period. FDI

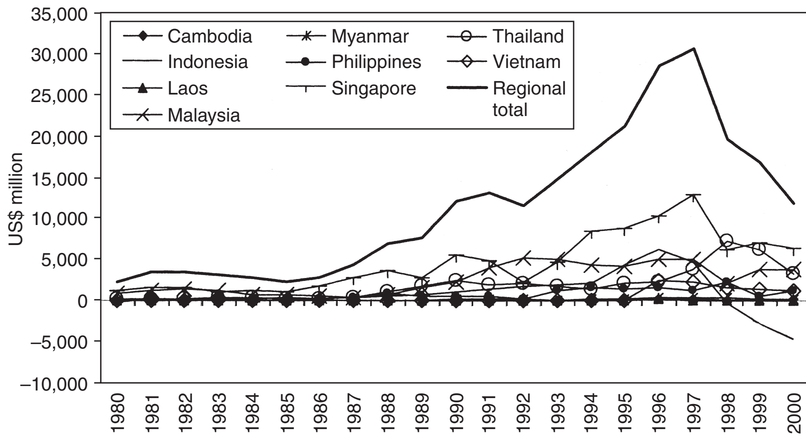

Figure 1.2 FDI inflows to Southeast Asian countries compared, 1980–2000 (US$ million).

Source: International Finance Statistics (from International Monetary Fund).

Note
Data for Brunei Darussalam not available in IFS database.

flows to Southeast Asia in this first phase represented the continuing international relocation of production, following the second oil price shock that induced an inflationary phase in the industrialised countries during the early 1980s.[5] Those Southeast Asian countries with relatively well-calibrated FDI regulatory frameworks, geared towards the provision of attractive host country investment environments, were able to capture considerable gains from FDI inflows, as various studies on Southeast Asia have indicated. And during this period, the region's FDI inflows broadly paralleled the global trend of rapidly rising FDI flows.

The second distinctive phase for Southeast Asian FDI flows, following a relatively slower pace of global FDI flows in the recessionary period of the early 1990s, was from 1995 to 2000. This second period was a time of very robust FDI growth in global terms (and at near exponential rates between industrialised countries), during which world FDI flows grew from US$320 billion to US$1,436 billion. This rate of growth in global FDI flows, of approximately US$223 billion per annum for the period 1995–2000, greatly overshadows the earlier growth rate of approximately US$30 billion per annum for the period 1985–90. Yet, in almost complete contrast to both the global FDI picture and the region's earlier performance in attracting foreign investment activity, hitherto buoyant FDI flows into and within Southeast Asia almost halved during the latter half of the 1990s, from US$21.4 billion in 1995 to US$11.9 billion in 2000.[6] No longer was Southeast Asia the star performer in the global and developing countries FDI growth 'story'. The region was now somewhat of a laggard.

Table 1.3 Foreign investment stock in Southeast Asia, 1980–2001 (US$ million)

	1980	*1985*	*1990*	*1995*	*2000*	*2001*
Brunei	19	28	23	631	3,756	3,999
Cambodia	38	38	38	356	1,551	1,664
Indonesia	10,274	24,971	38,883	50,601	60,638	57,361
Laos	2	1	13	205	550	574
Malaysia	5,169	7,388	10,318	28,732	52,748	53,302
Myanmar	746	746	913	1,831	3,191	3,314
Philippines	1,281	2,601	3,268	6,086	12,440	14,232
Singapore	6,203	13,016	28,565	59,582	95,714	104,323
Thailand	981	1,999	8,209	17,452	24,468	28,227
Vietnam	9	64	260	5,760	14,623	15,923
Regional total	24,772	50,852	90,490	171,236	269,679	282,919

Source: ASEAN, 2002.

Undoubtedly, the outstanding performer in consistently attracting (and holding) foreign investment, both during the FDI growth years as well as the years of regional decline, has been the city-state of Singapore (see Table 1.3). Indeed, during the period of declining FDI inflows to Southeast Asia, Singapore managed to increase its lion's share of the region's FDI flows, from 41.1 per cent in 1995 to 53.6 per cent in 2000. Malaysia also managed to emulate its small neighbour, by increasing its share of regional FDI flows, from 19.5 per cent in 1995 to 31.8 per cent in 2000, and Thailand performed relatively well by increasing its share from 9.7 per cent to 28.3 per cent over the same period. In contrast, Indonesia suffered the sharpest losses, experiencing disinvestments (i.e. FDI outflows) of US$4.5 billion in 2000, according to official figures. And the transitional economies of Cambodia, Laos and Vietnam, as debutants on the global and regional FDI scene, saw their healthy FDI inflow figures for the first half of the 1990s falter during the latter part of the decade.

In 2001, global FDI flows collapsed dramatically – from US$1,436 billion in 2000 to US$679 billion in 2001, representing a fall of 53 per cent – largely as a consequence of a very rapid deceleration in cross-border merger and acquisition (M&A) deal flow between the 'triad' industrialised economies of the US, Japan and Europe.[7] And initial data suggests that there was no marked improvement in 2002. Given this unappealing global backdrop, what are the prospects for FDI activity in Southeast Asia? Any attempt to envisage the future of FDI activity in the region needs to be considered both in the context of past trends, and through the new lens afforded by China's recent record in attracting very significant volumes of FDI inflows; up from US$14.8 billion in 1998 to US$61.9 billion in 2000.

With the benefit of hindsight, we can see that the forces that drove the international relocation of production and services, as well as the FDI reception regimes of Southeast Asia and their inherent factor characteristics, were quite well matched during the 1980s and 1990s. It is therefore not surprising that East Asia as a whole successfully netted the bulk of FDI flowing to developing countries

from 1980 to the mid-1990s, and that Southeast Asia faired very well in this asymmetric distribution of FDI flows to the developing world. However, increasing similarities in the industrial landscape of the Southeast Asian region now represent an undesirable mix of both overcapacity in some industry sectors and insufficiently differentiated factor conditions between countries, particularly in terms of export products and export markets. This poses serious structural adjustment policy challenges for Southeast Asia, as it simultaneously engages with the opportunities of becoming a 'single market' through the ASEAN Free Trade Area (AFTA) and ASEAN Investment Area (AIA) frameworks. Without significant adjustment at the policy level, Southeast Asian economies may increasingly find that evident capacity weaknesses will hinder both their collective and national abilities to revive currently anaemic FDI inflows, and attract higher levels of value-added FDI. These capacity weaknesses comprise a wide range of issues, including: inadequate corporate governance standards and weak regulatory oversight of business; insufficient levels of entrepreneurialism and innovation; and slow adjustment to the on-going transformation of international production into both equity and non-equity based networks (World Bank, 2003a).

Until the hiatus of the Asian financial crisis, Southeast Asia's intermediation with the world economy, predicated in large part on factor-intense export-oriented manufacturing FDI, was very advantageous. However, the change of economic gear towards more innovation-driven growth requires a reconfiguration of Southeast Asia's location-specific advantages, shifting away from conventional notions of low cost labour and assembly-oriented mass-manufacturing, and towards more capital-intense manufacturing. This not only requires a good standard of 'hard' infrastructure, but also a more robust 'soft' infrastructure of human capital, research and development skills, intellectual property rights, and so on. Although conventional concepts of location-specific advantages will continue to attract some FDI inflows to the region given, China's recent success in attracting substantial FDI inflows in areas that Southeast Asia had come to regard as its strength, there is a very real danger that the level of foreign investment in the region will not be revived, unless new strategies are identified and adopted.

The lens of China's performance in attracting FDI provides a sobering view of the challenge now confronting Southeast Asian countries (UNCTAD, 2002d). While there is some controversy over China's actual FDI inflow figures (Krugman, 1994; Zhan, 1995; UNCTAD, 2001: 24–25), there is little doubt about the relocation of a significant volume of world production capacity to China since the 1990s. With China capturing almost 50 per cent of total FDI flows to East Asian economies between 1987 and 1998; and conservative FDI inflow projections for China in the decade leading up to 2010 of between US$40 billion to US$65 billion per annum (OECD, 2002), clearly Southeast Asia faces some stiff competition. The above notwithstanding, two aspects of China's performance are worth keeping in mind. First, China's sources of FDI are predominantly Hong Kong SAR and other newly industrialised economies in East Asia, which were responsible for approximately 66 per cent of China's total FDI inflows between 1983 and 1999 (OECD, 2002); whereas investors in Southeast Asia

are much more broadly distributed across the globe. Secondly, China's trade imbalance with Southeast Asia presents a fairly unique opportunity for the selective targeting of FDI to supply China's growing import appetite.[8] The initiative of a free trade arrangement between the Association of Southeast Asian Nations (ASEAN) and China suggests mutual recognition of this potential complementarity.

1.4 This book

Having provided a brief backdrop, we can now shift our focus to centre stage. This volume attempts to better understand the dynamics that lie behind Southeast Asia's current foreign investment activity, and based on this, extrapolate the likely future options and scenarios for the region in attempting to revive its relatively consistent – but recently tarnished – track record as an attractive host to foreign investors. Without attempting to be all-embracing, the chapters that follow each focus on critical elements which combine to make up Southeast Asia's overall foreign investment 'picture' and prospects. By bringing these key interlocking pieces together under a single cover, it is intended that this book will provide a more profound understanding of the challenges that currently face Southeast Asian countries in their on-going attempts to attract new foreign investment inflows, and equally important, to continue to host existing substantial foreign-invested assets.

In Chapter 2, Peter Buckley depicts how the 'new economy' and the forces of globalisation have begun to radically alter the business strategies of MNEs, including those operating in Southeast Asia. The consequences are profound, as Southeast Asian countries must reconfigure their foreign investment policy frameworks to better accommodate the technological revolution underway inside the kinds of foreign companies they probably most wish to attract and sustain. In particular, the region's investment agencies need to adopt a long-term view of both the foreign market servicing strategies and sourcing strategies of MNEs, and better understand the 'hub and spoke' operations of large investors. A more sophisticated approach to forms of foreign investment is also required (including cross-border M&As), as the era of new 'greenfield' FDI projects designed for export-oriented production may be passing. This is due in part to the recent rise of China as Asia's leading destination for FDI activity and a magnet for more footloose foreign investment. Consequently, Southeast Asian policy makers need to develop more flexible and sophisticated foreign investment policies, which in turn necessitate keeping informed of – and 'up to speed' with – multinational companies' evolving thought processes and business strategies.

Following on from Buckley, in Chapter 3 Christopher M. Dent conducts a political economy analysis of FDI activity in Southeast Asia's larger economies, using the conceptual framework of economic security. He notes that although FDI has posed a series of economic security challenges for Southeast Asian countries over the years, the potential opportunities offered by FDI were broadly perceived to outweigh the potential threats. However, the adverse impact of the Asian financial crisis has served to emphasise the extent to which investment interlinkages

created by MNEs' burgeoning international systems of production and distribution pose new challenges, and the resulting need for a wider regional agenda to manage these new economic security predicaments in Southeast Asia. Also in recent years, 'economic nationalists' and the fast-growing 'anti-globalisation' movement in the region have questioned the desirability of foreign investment. Consequently, Southeast Asian countries will need to both individually and collectively upgrade various aspects of their policies towards foreign investment, if the new economic security implications of FDI are to be successfully addressed.

One area where collective policy activity has been most evident in Southeast Asia has been the establishment of a regional free trade area. In Chapter 4, Amale Scally and Jayasinghe Wickramanayake undertake a detailed analysis of the impact that the AFTA initiative has had on FDI inflows in the Southeast Asian region. For the original ASEAN members, AFTA became operational at the beginning of 2003, although some of the regional grouping's newer members will only start to fully comply with the terms of AFTA in 2006. The authors find that AFTA will probably not trigger a new tranche of FDI inflows into Southeast Asia, and will only be successful in attracting new foreign investment to the region if it is a catalyst for increased market size and growth. Their analysis also suggests that Malaysia and Singapore may be the primary beneficiaries of AFTA. However, other economic and financial factors will also play an important role in this regard, and a lack of progress in other areas of Southeast Asian regional integration – including the removal of other barriers to trade and investment – could potentially discount much of what AFTA aims to achieve. Amongst the various policy recommendations provided by Scally and Wickramanayake, it is suggested that the scope of AFTA should be extended beyond the strict confines of lowering tariff rates, and that ASEAN should explore the establishment of trading arrangements with countries beyond the Southeast Asian region, such as China, Australia and New Zealand.

In Chapter 5, Frank Bartels looks at the rise and fall of intra-regional FDI flows within Southeast Asia, and identifies structural characteristics in the spatial distribution of production. In general, he finds that the dynamic pattern of intra-regional investment that emerges is moulded by: the asymmetry in global FDI flows; the changing rates of FDI; the organisational relationships of MNEs; and the mosaic of local business ownership. Bartels indicates firstly the asymmetric and trichotomous morphology of intra-regional FDI, which is skewed towards Singapore as both the dominant host to, and source of, Southeast Asian FDI flows. Secondly, this asymmetry contrasts with the relatively homogenous investment assets across the region, notably in terms of the production of export-oriented electronic components. Thirdly, in the presence of somewhat persistent obstacles to FDI, intra-regional FDI flows have declined, with the sharpest declines occurring in intra-regional manufacturing FDI. The author points to the challenges ahead for policy-makers in recalibrating their investment regimes, not only to moderate the potential for Singapore to decrease its provision of regional FDI in the future, but also so as to complement FDI flows to China within the context of a reconfigured division of labour between Southeast Asia and China.

Echoing the sentiment of the previous chapter, Bartels sees the move to a 'single market' as crucial in reversing the declining trend in intra-regional flows.

In Chapter 6, Axèle Giroud profiles cross-border production networks (CPNs) in Southeast Asia, and examines companies that network their operations and inter-firm relationships on a regional basis, across both functions and locations. In general, the main actors in the development of CPNs in Southeast Asia have been MNEs headquartered outside the region, such as Japan. However, the activities of Japanese subsidiaries operating in Southeast Asia are changing, with increased specialisation and localisation of operations becoming more apparent. Giroud argues that MNEs will seek to further develop both forward and backward linkages between their subsidiaries and local firms in the region, in order to deepen existing CPNs, and thereby continue to realize competitive gains. However, much depends on local companies in Southeast Asia making advances in their own levels of competitiveness, and past progress in this regard has not been adequate. Giroud therefore calls for the adoption of a regional, collaborative industrial policy that will allow Southeast Asian countries to improve their competitiveness, and begin to promote the region (rather than individual countries) as a production base.

In Chapter 7, Adam Cross and Hui Tan assess the significance of China's accession to the World Trade Organisation for the Southeast Asian countries, and discuss what the consequences are likely to be for their present and future capacity to attract FDI inflows. The chapter suggests that China's entry into the WTO will have both a quantitative and qualitative effect on FDI flows to Southeast Asia. Not only will China attract FDI inflows from the major 'triad' economies, but also potentially divert intra-regional foreign investment flows. The initial impact is likely to be felt in service-related foreign investment, where specific obligations attached to WTO entry are resulting in various business liberalisation measures, but it may subsequently be felt in the manufacturing sector as well, as the general business environment in China improves, again stemming from reforms made as part of WTO accession obligations. In order to combat this trend, the authors recommend that Southeast Asian countries should collaborate to enhance the attractiveness of the region as an investment location, relative to China, and that greater regional integration will be an important element of the policy solution. They also suggest that Southeast Asian countries, both individually and as a group, should seek to bolster their business, economic and political links with China. This may allow them to hitch a ride on the anticipated China growth phenomenon, rather than simply be victims of China's economic expansion.

In Chapter 8, Frank Bartels examines an often over-looked element of FDI activity in Southeast Asia – cross-border M&A, in which the difficulties of accounting for what constitutes cross-border M&A activity are also identified. The recent increase and subsequent decline in this form of FDI activity in the 'triad' countries are profiled and contrasted, not only with the low incidence of activity in the region, but also the relatively narrow range of target industries in Southeast Asia. The author signifies that the skeletal pattern of cross-border M&A reflects general asymmetries in regional FDI activity, with Singapore firms

dominating the region in purchasing activity, while crisis-hit countries have been prominent in seller activity. The underlying reasons for the low incidence and narrow sectors for targets – a combination of legal constraints and industrial organisation – are explored in terms of the fairly shallow depth of productive sectors and the 'thin' instrumental capacities of regional financial markets. Regional cross-border M&A activity is shown to have decelerated quite rapidly since the peak of the Asian financial crisis in the few sectors targeted and the suggestion is that, without substantial progress made on regional trade and investment agreements, industrial consolidation through cross-border M&A is unlikely to accelerate in the near future. Finally, Bartels points to the specific circumstances of the Asian financial crisis that stimulated cross-border M&A deal flow and their policy implications, in which Southeast Asia is seen as not possessing in full measure several ingredients necessary for more ebullient cross-border M&A activity.

In Chapter 9, Nick Freeman looks at the prospects for FDI activity in the transitional economies of Southeast Asia, which are less experienced at attracting and hosting foreign investors than some neighbouring countries, and have been on a steep learning curve over the last decade or so. Nonetheless, foreign-invested companies now represent a fairly substantial proportion of the corporate sector in countries like Vietnam, and have helped to some extent in developing a domestic private sector. Having seen a strong initial wave of foreign investment inflows into these countries, following their initial opening up to foreign capital in the late 1980s and early 1990s, these flows have generally not been sustained in recent years. The author attributes this to a number of constraints, including difficulties in integrating FDI policies with the wider business liberalisation and economic reform agendas. These transitional economies have also generally sought to model their FDI policies on tried-and-tested methods previously used, to good effect, in more experienced Southeast Asian countries. However, as previously noted by Buckley in Chapter 2, this approach may not be appropriate for the international business environment of today, where more conventional FDI activities – such as 'greenfield' manufacturing projects – are no longer the dominant form they once were. The author therefore suggests that these countries need to become more cognizant of both current international business practices and their own comparative advantages, so as to better tailor their FDI policies to suit the changing demands of foreign firms.

In Chapter 10, Nick Freeman examines the various difficulties posed for foreign portfolio investors by Southeast Asia's lacklustre stock markets, which have largely failed to recover from the impact of the Asian financial crisis in 1997–98. The author suggests that attempts made thus far to revive these equity markets have not had the desired impact, and that policy-makers may need to better appreciate changes in the way institutional investors go about allocating their funds in global and emerging markets. The chapter suggests that stock markets can play a useful supporting role to FDI activity, notably in terms of financing long-investment activity, at a time when cross-border M&A and other forms of FDI are increasingly blurring the line that divides direct investors from portfolio

investors. Looking ahead, the author argues that the region's stock markets will need to consider some fairly radical initiatives, such as merging into a single regional equity market (an equity markets version of the AIA), or individually striking alliances with some of the world's major stock markets, if they are not to run the risk of becoming dormant.

Chapter 11, penned by Kee Hwee Wee and Hafiz Mirza, reviews investment cooperation within Southeast Asia, largely from the perspective of the ASEAN Secretariat. The authors identify key developments in the region's efforts to promote FDI activity since the 1970s, assess the extent to which regional investment cooperation has supported Southeast Asia's competitiveness, and discuss future prospects for regional cooperation in the area of foreign investment. The authors are broadly optimistic that regional cooperation will continue, and that the AIA arrangement can be used as a platform for new initiatives to maintain Southeast Asia's competitiveness. Wee and Mirza stress that whilst all the ASEAN member countries need to move together in this regard, some degree of flexibility will need to be given to countries at different stages of development.

Chapter 12, by Hal Hill, concludes this volume. Hill eloquently draws out some of the issues addressed in the previous chapters, against both the wider backdrop of Southeast Asian economic development (and diversity) and recent literature on FDI. With regard to the competitive threat posed by China, the author argues that forward-looking and pro-active Southeast Asian countries are likely to benefit significantly from China's seemingly inexorable growth, whilst the slow and more hesitant countries may prove to be the principal losers. Those Southeast Asian countries looking for new policy options could seek to emulate and adapt key elements of Singapore's successful approach towards FDI. Hill also discusses an issue prevalent in Southeast Asia's FDI regimes, but not discussed in much detail by the earlier chapters – the use of incentives. He argues convincingly that the fairly widespread deployment of various fiscal incentive programmes in the region to attract FDI inflows is symptomatic of on-going deficiencies in the business environments in several Southeast Asian countries. Fiscal incentives also tend to be a risky, and often costly, means of attracting foreign investors, with uncertain returns. They are a 'second best' approach to attracting FDI inflows, and can easily be discounted by potential foreign investors as being unsustainable and easily withdrawn. Far better, therefore, for host countries to adopt a 'first best' approach by seeking to address directly those features of the host country's macro-economic and business environment that keep foreign investors away. Consequently, Southeast Asia's policy-makers need to find ways of providing commercially profitable and politically stable host country environments that will attract foreign investors, and also benefit local investors.

Perhaps one of the main conclusions emanating from the analyses provided by the chapters that follow is that the recent downturn in Southeast Asia's FDI activity cannot be entirely attributed to cyclical trends and the global dip in foreign investment flows; nor the legacy of a prolonged hangover from the Asian financial crisis of 1997–98. Whilst these may explain the current situation in part, something more structural also seems to be going on. The international business

environment has been undergoing radical change in recent years, and so have the factors that drive and determine FDI activity (World Bank, 2003b). As a consequence, the policy prescriptions and strategies that Southeast Asia used to such good effect in the 1980s and 1990s to attract and host FDI activity need to be regularly revisited, revised where necessary, and expanded on. It could be argued that policy-makers in Southeast Asia have been somewhat slow to recognize and react to the sorts of changes in global business and FDI activity that the following chapters have identified, as the Asian financial crisis and the global downturn in FDI flows have served to distract and partly obscure their presence. This fog is lifting, however, as the competitive threat posed by China is focusing minds and galvanizing new economic policy and business initiatives within Southeast Asia, including ways to offset China's remarkable magnetism for FDI flows. In this context, several chapters focus on the need to develop regional initiatives in Southeast Asia, extrapolating the ground-breaking work of AFTA and the AIA frameworks in new and complementary directions. ASEAN would appear to be the most obvious vehicle for such collaborative efforts.

If the increasing competitive threat posed by China has acted as a 'wake up call' for Southeast Asia, and is able to spark new policy initiatives in the region, then all well and good. However, it should be kept in mind that Southeast Asian countries are not solely competing with the continental-sized economy sitting immediately to north of them. They are also competing with each other, and together as a region, for advantageous places in an increasingly competitive international business 'food chain', which extends far beyond Asia. It will be interesting to see whether individual Southeast Asian countries, or the region as a whole, are able to rise to the new challenges of attracting and hosting foreign investment activity in the years ahead. If so, the region may witness the revival in vigorous FDI activity that policy-makers desire. If not, the region's successful track record in attracting and hosting FDI during the 1980s and 1990s may become something for the history books, as the recent hiatus in foreign investment activity becomes a more prolonged affair.

Notes

1 Statistical sources on FDI flows cited in this chapter are taken from the International Monetary Fund's 'International Finance Statistics Database', unless otherwise stated.

2 In 1991, 35 countries introduced 82 changes in their FDI regimes, compared with 71 countries making 208 changes in 2001. In 1991, 97.6 per cent of all changes made were pro-FDI, compared to 93.3 per cent in 2001 (down from a high of 98 per cent in 2000). East Asia introduced the highest number of pro-FDI changes.

3 In the electrical machinery industry, the share of VIIT in East Asia's total trade grew from 31 per cent in 1996 to 43 per cent in 2000. The share of Japan's total trade with the electrical machinery industry in the five main Southeast Asian economies, grew between 1988 and 2000, as follows: Indonesia 2 per cent to 39 per cent; Malaysia 40 per cent to 34 per cent; the Philippines 16 per cent to 55 per cent; Singapore 17 per cent to 43 per cent; and Thailand 16.5 per cent to 41 per cent. See Fukao *et al*., 2002: 10.

4 The collapse in global FDI flows in 2000–01 was largely attributable to the rapid deceleration in cross-border M&A activity. However, developing countries' share of this

mode of FDI has generally been very small, fluctuating between a low of 3.5 per cent in 1987 and a high of 12.6 per cent in 1993.

5 The earlier significant wave of international location of production occurred in the 1970s, after the quadrupling of the oil price in 1973–74.

6 FDI flows to Southeast Asia peaked in 1997, at US$30.7 billion.

7 The sharp contraction registered by the industrialised countries was almost exactly of the same magnitude, at 52 per cent. At the time of writing (March 2003), a global revival in cross-border M&A deal flow had yet to occur.

8 See ‘Trade in Asia’, *The Economist*, 2 November 2002, p. 55.

2 The challenges of the new economy for multinational firms

Lessons for Southeast Asia[1]

Peter J. Buckley

2.1 Introduction

This chapter examines the impact of the 'new economy' on decision-making in the multinational enterprises (MNEs). Here, the new economy is taken to mean the technological revolution brought about by the widespread use of the internet and electronic commerce (e-commerce), together with the political developments in the first years of a new millennium. These developments have brought a new volatility to international business and to the operations of MNEs. The responses of firms to these pressures, and to 'globalisation', which multinationals help to further, have resulted in important changes of strategy in the world's MNEs, with widespread consequences for the world economy.

The chapter is structured in the following way. Section 2.2 examines the operations of MNEs in a single market. This is an artificial situation, but it helps to clarify the importance of key decisions, and the impact on those decisions of changes brought by e-commerce. Section 2.3 then goes on to examine operations in more than one market, and Section 2.4 tackles the crucial issues of interaction between markets. Section 2.5 looks in detail at the meaning of globalisation for MNEs and shows the interaction between globalisation and e-commerce. Section 2.6 concentrates on the internal effects of technological and socio-political change within MNEs. Reactions to increased volatility are shown to have a profound impact on internal organisation. Section 2.7 is a summary, and Section 2.8 draws out implications for Southeast Asia and its investment attraction agencies.

2.2 Operations of multinational firms in a single market

2.2.1 Location and ownership strategies

The typical US MNE of the 'golden age' was a vertically, as well as horizontally, integrated firm. In consequence, each division of the firm was locked into linkages with other divisions of the same firm. As Asian competition intensified, there was growing recognition of the costs of integration of this kind. Figure 2.1 shows the complex network of a MNE involved in a single market. There are two critical decisions covering each of the activities displayed

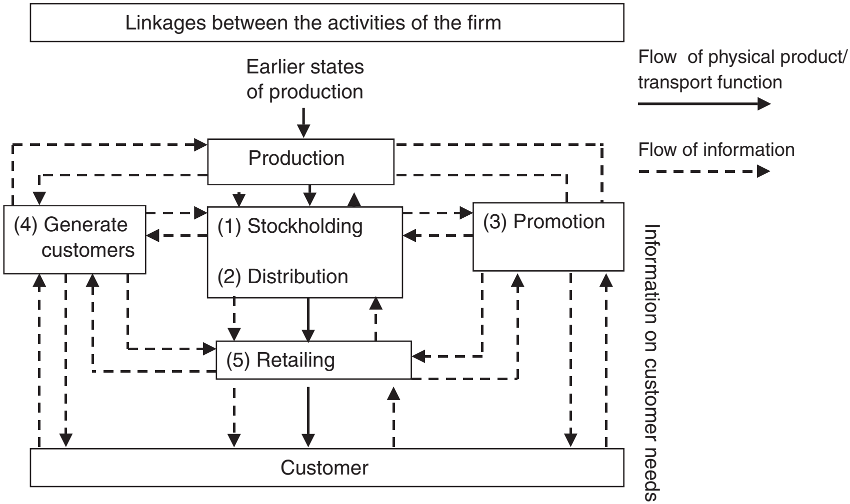

Figure 2.1 Linkages between the activities of the firm (Reproduced from Buckley *et al.* (1990)).

(production, stockholding, promotion, etc.). These are (1) where should the activity be located, and (2) how should it be controlled? The control decision is whether to own and operate the function in-house or to subcontract, outsource or contract for the function outside the company. Joint ventures are a half-way house between ownership and contract. These two decisions determine the strategy of the company but need careful co-ordination. For instance, a promotional (advertising) strategy must be carefully co-ordinated with the product or service supply chain.

Commitment to a particular source of supply or demand of any product, intermediate good or service is relatively low-cost in a high-growth scenario, since it is unlikely that any investment will need to be reversed. It is much more costly in a low-growth scenario, where production may need to be switched to a cheaper source of supply, or sales diverted away from a depressed market. The desire for flexibility therefore discourages vertical integration – whether it is backward integration into production, or forward integration into distribution. It is better to subcontract production and to franchise sales instead. The subcontracting of production is similar in principle to a 'putting out' arrangement, but differs in the sense that the subcontractor is now a firm rather than just a single worker.

2.2.2 Disintermediation and re-intermediation

Dis-integration was also encouraged by a low-trust atmosphere that developed in many firms. Fear of internal monopoly became rife, including worries about the

'hold-up' problem, even when the single source of supply was an internal one. Production managers faced with falling demand wished that they did not have to sell all their output through a single sales manager. Sales managers resented the fact that had to obtain all their supplies from the same small set of plants. Each manager doubted the competence of the others, and ascribed the loss of corporate competitiveness to selfishness and inefficiency elsewhere in the firm. Divisions aspired to be spun off so that they could deal with other business units instead. On the other hand, managers were wary of the risks that would be involved if they severed their links with other divisions altogether. The result is that a much more complex strategy set faces-decision makers in MNEs.

2.2.3 B2B e-commerce

B2B transactions account for 80 per cent of all e-commerce. E-shopping accounts for only approximately 1 per cent of all retail sales in the US (or one-tenth of catalogue sales). However, it should be pointed out that usage of the net is greater than the number of transactions, because customers can use it to compare prices and to search for information. The new value chain is shown in Figure 2.2, which illustrates both the impact of disintermediation on the vertically integrated firm and the opportunities for re-intermediation.

Disintermediation by e-commerce reduces warehousing costs but increases the costs of maintaining a reliable web site. It reduces stock holding cost and fixed capital but as logistics and distribution requirements become more complex and costly, there are gains in economies of scale and scope by using e-commerce and the ease of data exploitation is a major benefit, allowing companies to reach

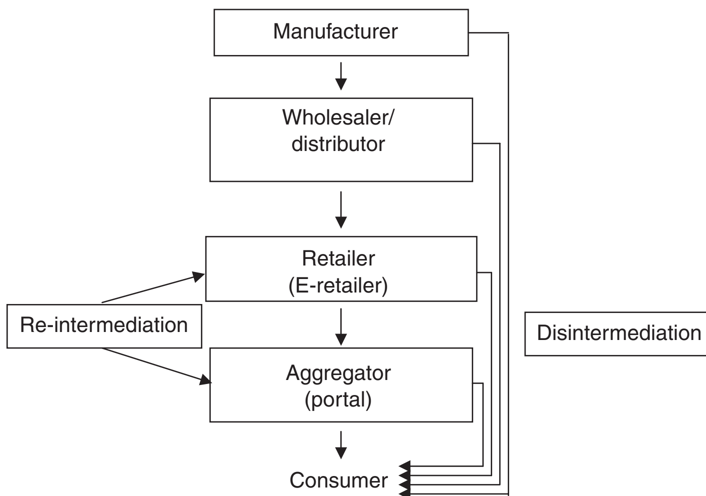

Figure 2.2 The new value chain.

Source: *The Economist*, e-commerce survey, 26 February 2002.

customers and sources of supply more easily and to foster competition for supply contracts. These advantages can be summarised as 'reach' and 'richness'. Reach describes the size of the audience which can be accessed and the ease of connection. This measures the number of customers a business can service or how many products it can offer. Richness describes the customisation of service, the depth and detail of information, which can be given or collected. The degree of affiliation measures the attachment of customers to individual suppliers and reciprocally the company's responsiveness to customer needs. The argument is that global/local trade-offs (see Section 2.4) can be managed better on the web using e-commerce, so that integration and responsiveness are replaced by reach and richness.

2.2.4 Re-intermediation using e-commerce

Figure 2.2 shows that as well as disintermediation e-commerce allows re-intermediation. A number of wholesalers/distributors can be aggregated by an e-retailer and on this reading a portal is equivalent to a shopping mall. Aggregators thus acquire considerable buying power. An example is the impact of e-commerce on travel agents. Many travel agents have been disintermediated but the response to this is a 'clicks and mortar' strategy integrating e-commerce with traditional business. Successful travel agents now manage a combined strategy. This is instructive for businesses facing such challenges. The advent of e-commerce has also introduced new players such as 'navigators' who represent customers and fulfil their choices, and 'infomediaries' who take care of privacy issues and provide payment security.

The nature of the product and therefore of the industry remains important in e-commerce transactions. We can contrast 'high touch' versus 'low touch' goods and services (e.g. clothes and shoes versus books, computers and CD-ROMs). For the second group delivery over the internet is a prime example of the impact of e-commerce in changing the competitive dynamics of an industry. E-commerce lowers barriers to entry to industries where electronic delivery is possible and provides opportunities for growth by re-intermediation. However, firms still have to find the best location for all the activities in the value chain and to protect their market niche. Achieving optimum scale of each activity in the chain and consistency of product delivery and quality remain major competitive necessities.

2.2.5 Strategy, e-commerce and networks

These changes are challenges for 'old economy' companies – integrating online functions with existing brand and back office infrastructure. B2B, building online links with suppliers and customers, implies a redesign of business processes network. Smaller companies may find it easier to operate internationally. It is therefore easier to reach customers but there are still information problems, logistics difficulties and the necessity to maintain management control. Products still have to be distributed and thus the firm has to take account not just of transport

costs but also of regulatory differences between countries, cultural distance and other barriers.

A natural way to cope with these pressures is to allow each division to deal with external business units, as well as internal ones. In terms of internalization theory, internal markets become 'open' rather than 'closed'. This provides divisional managers with an opportunity to bypass weak or incompetent sections of the company. It also provides a competitive discipline on internal transfer prices, preventing their manipulation for internal political ends, and bringing them more into line with external prices. There are other advantages too. Opening up internal markets severs the link between the capacities operated at adjacent stages of production. The resulting opportunity to supply other firms facilitates the exploitation of scale economies because it permits the capacity of any individual plant to exceed internal demand. Conversely, it encourages the firm to buy in supplies from other firms that have installed capacity in excess of their own needs.

The alignment of internal prices with external prices increases the objectivity of profit measurement at the divisional level. This allows divisional managers to be rewarded by profit-related pay, based on divisional profit rather than firm-wide profit. Management may even buy out part of the company. Alternatively, the firm may restructure by buying in a part of an independent firm. The net effect is the same in both cases. The firm becomes the hub of a network of interlocking joint ventures (Buckley and Casson, 1988, 1996). Each joint venture partner is responsible for the day-to-day management of the venture. The headquarters of the firm co-ordinates the links between the ventures. Internal trade is diverted away from the weaker ventures and towards the stronger ones, thereby providing price and profit signals to which the weaker partners need to respond. Unlike a pure external market situation, the partners are able to draw upon expertise at headquarters, which can in turn tap into expertise in other parts of the group.

A network does not have to be built around a single firm, of course. A network may consist of a group of independent firms instead. Sometimes these firms are neighbours, as in the regional industrial clusters described by Best (1990), Porter (1990) and Rugman *et al*. (1995). Industrial districts, such as 'Toyota city', have been hailed as an Asian innovation in flexible management, although the practice has been common in Europe for centuries (Marshall, 1919). As tariffs and transport costs have fallen, networks have become more international and 'virtual'. This is demonstrated by the dramatic growth in intermediate product trade under long-term contracts. For example, an international trading company may operate a network of independent suppliers in different countries, substituting different sources of supply in response to both short-term exchange rate movements and long-term shifts in comparative advantage.

Flexibility is also needed in research and development (R&D). A firm cannot afford to become overcommitted to the refinement of any one technology, in case innovation elsewhere should render the entire technology obsolete. As technology has diffused in the post-war period, the range of countries with the competence to innovate has significantly increased. The pace of innovation has consequently

risen, and the threat of rapid obsolescence is therefore higher as a result. The natural response for firms is to diversify their research portfolios. But the costs of maintaining a range of research and development projects are prohibitive, given the enormous fixed costs involved. The costs of basic R&D have escalated because of the increased range of specialist skills involved, while the costs of applied R&D have risen because of the need to develop global products which meet increasing stringent consumer protection laws. Joint ventures are an appropriate solution once again. By establishing a network of joint ventures covering alternative technological trajectories, the firm can spread its costs whilst retaining a measure of proprietary control over new technologies.

The advantage of joint ventures is further reinforced by technological convergence, for example, the integration of computers, telecommunications and photography. This favours the creation of networks of joint ventures based on complementary technologies, rather than on the substitute technologies described previously (Cantwell, 1995). Joint ventures are important because they afford a number of real options (Trigeorgis, 1996) which can be taken up or dropped, depending upon how the project turns out. The early phase of a joint venture provides important information which could not be obtained through investigation before the venture began. It affords an opportunity later on to buy more fully into a successful venture – an opportunity which is not available to those who have not taken any stake. It therefore provides greater flexibility than does either outright ownership or an alternative involving no equity stake.

2.3 Operations of multinational firms in more than one market

The new dynamic agenda focuses on: uncertainty and market volatility; flexibility and the value of options; co-operation through joint ventures and business networks; entrepreneurship, managerial competence and corporate culture; and organisational change, including the mandating of subsidiaries and the ‘empowerment’ of employees. Flexibility may be defined as the ability to re-allocate resources quickly and smoothly in response to change. The greater is the amplitude and frequency of change in the environment, the greater is the need for flexibility. As far as MNEs are concerned, the impact of change is captured by the volatility induced in the profit stream. The volatility of profit that would occur if the firm made no response to change summarises the impact on the firm of volatility in its environment.

The international diffusion of modern production technology has increased the number of industrial powers, and hence increased the number of countries in which political and social disturbances can impact significantly on global supplies of manufactured products. The liberalisation of trade and capital markets means that the ‘ripple’ effects of shock travel farther and wider than before (Casson, 1995; chapter 4). Ripples are transmitted more quickly too: news travels almost instantaneously, thanks to modern telecommunications. Thus speculative bubbles in stock markets spread quickly around the world. Following the breakdown of the Bretton Woods exchange rate system, fluctuations have created a new dimension of financial volatility too.

As a result, any given national market is now affected by a much wider range of disturbances than ever before. Every national subsidiary of a MNE experiences a multiplicity of shocks from around the world. It is no longer the case that a national subsidiary has to respond to shocks originating in its national market alone. The shocks come from new sources of import competition and new competitive threats in export markets too. While most shocks reveal themselves to firms as competitive threats, new opportunities for co-operation may sometimes be presented as well. The awareness of this sustained increase in volatility has led to a search for more flexible forms of organisation.

Increased volatility is not the only reason for greater interest in flexibility. Contemporary culture is very much opposed to building organisations around a single source of monopoly power. The nation state, for example, is under threat from advocates of regional government. The traditional role of the state, to supply defence, can in principle be affected through multilateral defence treaties in which politically independent regions club together for this specific purpose. The demise of the Soviet bloc, and the subsequent political realignment between its member states, may be seen as an example of this kind of cultural change at work. This distrust of monopoly power may be linked to an increase in other forms of distrust, as suggested next.

The aversion to internal monopoly is apparent amongst MNEs as well. This movement began in the early 1980s when the powerful central research laboratories of high-technology MNEs were either closed down, shifted to the divisions, or forced to operate as suppliers to 'internal customers' in competition with outside bodies, such as universities (Casson *et al.*, 1991). Headquarters' bureaucracies came under attack shortly afterwards, as 'de-layering' got underway. The favoured form of firm has become a federal structure of operating divisions drawing on a common source of internal expertise, but where each division belonging to the federation is free to outsource expertise if it so desires. As with any trend, there has been a tendency for certain advocates to take it to extremes. Just as the 'golden age' was rife with suggestions that oligopolies of hierarchical MNEs would come to dominate world markets, so the 1990s have spawned visions of the 'network firm' and the 'virtual firm.' A factor common to these visions is a 'fuzzy' boundary of the firm, where the firm fades into the market, through joint ventures, with declining proportional equity stakes. These arguments for fuzzy boundaries are, unfortunately, often based on equally fuzzy reasoning. Fuzzy boundaries can be configured in many different ways. The new research agenda outlined here places arguments for fuzzy boundaries on a rigorous basis, and predicts the specific form that fuzziness will take in each particular case.

2.3.1 Dynamic market entry (and exit)

Consider the problem of modelling market entry from a dynamic, rather than a static, point of view (Chi and McGuire, 1996). The most important new point to take into account is that the foreign market can decline as well as grow. Divestment or withdrawal must be considered as serious strategies. Clearly, these

strategies do not apply until the market has been entered, but once it has been entered they may need to be used. Static models assume that the market will be constant, while very simple dynamic models, such as Buckley and Casson (1981), only suppose that the market will grow. In a volatile environment a market may grow to begin with, attracting investment, but then go to decline, requiring divestment instead. Such explicit recognition of adverse scenarios is a characteristic of the new research agenda.

Switching between strategies is costly, and the costs depend on both the strategy the firm is switching from, and the strategy the firm is switching to. In some cases, switching costs decompose neatly into a cost of exit from the old strategy and a cost of setting up the new strategy. Detailed modelling of such costs is a key element of the new research agenda.

To preserve flexibility, it is important for the firm to choose at the outset strategies whose exit costs are low. This tends to favour exporting over host-country production, and licensing over internalization. In other words, it reveals foreign direct investment (FDI) as a high-risk strategy. Switching decisions can be mistaken, however, because the information upon which they are based is poor. Expected switching costs are reduced by avoiding unnecessary switches. Different strategies afford different opportunities for capturing information from the host environment and feeding it back to inform subsequent switching decisions. The new agenda involves explicit modelling of how the strategy chosen at one stage affects the information available at following stages.

Foreign direct investment offers better opportunities for information capture than either licensing or exporting, since ownership of assets confers ownership of information too. This means, for example, that if volatility caused the market to unexpectedly grow, then the foreign investor should recognise this quickly. Since it is often cheaper to expand existing capacity than to build from scratch, the foreign investor also faces lower cost of capacity expansion than does an exporter who decides to switch to foreign production at this stage. While exporting continues to confer more flexibility in response to market decline, therefore, FDI confers more flexibility in respect to market growth. Is it possible to find a strategy with a better combination of characteristics than either exporting, licensing or FDI? An international joint venture (IJV) may provide the answer (Kogut, 1991). Investing in a 50:50 partnership with a host-country producer lays off some of the risks associated with wholly owned FDI. At the same time, information capture remains reasonably good. There is an option to expand capacity if there is unexpected market growth, and a further option to increase commitment by buying the partner out. There is also an easy option to withdraw by selling out to the partner. The partner provides a ready market for divested assets that an ordinary direct investor lacks. There is a downside, of course – an obvious problem is that the partners may themselves become a source of volatility. This is why trust is such an important element in an IJV. In this way the emphasis on risk management within the new research agenda leads to the emergence of new ‘compromise strategies’, which would be dominated by more conventional strategies, were it not for the ‘option value’ they possess within a volatile environment.

International joint venture options can only be exercised once, of course, unless the investor switches back to an IJV arrangement at a later date, when they can be exercised all over again. This explains IJV instability as a rational response to the role that IJVs fulfil. An IJV in which the options are never exercised is probably inferior to a wholly owned investment, while an IJV in which the options are exercised at the first available opportunity does not last for very long. When IJVs are chosen because of their option value, it is normally inefficient both to switch out right away, or to never switch at all. The optimal timing of a switch is one at which uncertainty about future market growth is dispelled for a reasonable period of time. This implies that the duration of an IJV is, on average, fairly short and relatively variable. This new approach provides a simple means of deriving such hypotheses about the period of time for which a given strategy will be pursued.

2.4 Interaction between markets

2.4.1 Global/local operations

There has always been a tension between the pressures to globalise and the need to stay local and to serve individual customers, in the strategic decisions of MNEs. The advantages of global operations are cost based, maximising economies of scale and reducing duplication, thus achieving efficiency. The advantages of localisation are revenue based, allowing differentiation to reach all customer niches and achieving responsiveness. The tension can be summed up in the phrase ‘the cost advantages of standardisation versus the revenue advantages of adaptation’. (Global and local oppositions are shown in Figure 2.3.) Much of the strategy of the MNE can be explained by the attempts of management to reconcile these pressures. Over time, firms have been advised to switch their organisation so as to balance these pressures – one example is the ‘transnational’ type of organisation advocated by Bartlett and Ghoshal (1989). However, pressures

GLOBAL	LOCAL
Cost	Revenue
Efficiency	Responsiveness
Centralisation	Decentralisation
Standardisation	Adaptation
“GLOCAL”?	

Figure 2.3 Global and local oppositions.

in different industries push firms towards a strategic imperative (scale in electronics, local demand differences in consumer goods) and different functions require different balances of global/local orientation (finance, production, sales functions). The 'hub and spoke' model is a key method of attempting to reconcile these conflicts.

The globalisation of markets has been a major factor in the growth of volatility, as explained before. A feature of many global markets is the use of regional production and distribution hubs, where several neighbouring countries are serviced from the same location. The regional hub, like the IJV, can be understood as a strategy that offers superior flexibility. Just as an IJV offers a compromise ownership strategy, a regional hub offers a compromise location strategy. Because the hub is nearer to each market than the home location, it reduces transport costs, and offers better information capture too. Yet, because it is close to several markets, it avoids exclusive commitment to any one. If one market declines, production can be switched to other markets instead; provided the shocks affecting the national markets are independent (or less than perfectly correlated, at any rate), the hub provides gains from diversification. These are real gains that only the firm can achieve, as opposed to the financial gains from unrelated product diversification, which have proved disappointing in the past, because they are best exploited through the diversification of individual share portfolios instead.

2.4.2 Location and ownership strategies revisited: 'hub and spoke strategies'

The two strategies of IJV and hub can be combined (see Figure 2.4). Since one – the IJV – is an ownership strategy and the other a location strategy, they can, if desired, be combined directly in an IJV production hub. Closer examination of the issue suggests that this is not normally the best approach, however. The model suggests that a combination of a wholly owned production hub supplying IJV distribution facilities in each national market is a better solution. A hub facility is too critical to global strategy to allow a partner to become involved, because the damage they could do is far too great. Even with a wholly owned hub facility, the combination still affords considerable flexibility to divest or withdraw from any single market. The advantage of the combination is that when divesting, the distribution facility can be sold to the partner, while the production capacity can be diverted to markets elsewhere. These options for divestment are combined with useful options for expansion too. This example illustrates the crucial role that the concepts of flexibility and volatility play in analysing foreign market entry in the modern global economy. Without these concepts it is impossible to fully understand the rationale for IJVs and production hubs. It is also impossible to understand why these strategies have emerged at this particular historical juncture and not before.

While some of the insights of this model can certainly be expressed in terms of a framework, a framework is too crude to analyse the interplay of the different factors in a completely rigorous way. The concepts of adjustment costs and exit

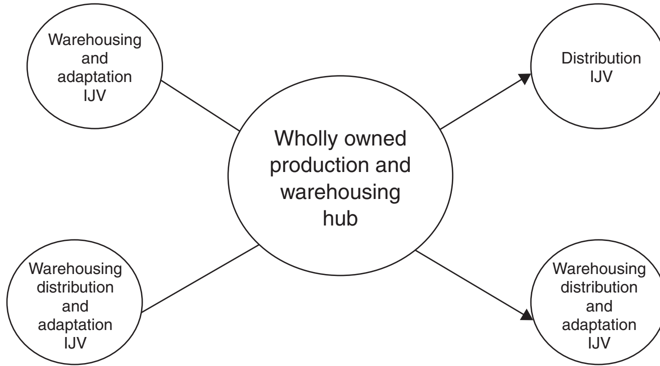

Figure 2.4 'Hub and Spoke' strategies: an example.

costs can already be found in the strategy literature, for example, but even this simple example is sufficient to show that the interplay of present entry and future exit cannot be properly understood without the aid of a fully specified model. This does not mean that the strategy literature is flawed. The new dynamic agenda is perfectly compatible with much of the existing strategy literature, but it goes beyond it by developing and refining the insights in a way that the strategy framework is unable to do.

2.5 Globalisation

2.5.1 The differential speed of globalisation

The impact of electronic communications and the increased skill of managers in deploying these resources is to allow de-duplication in the firm's international activities. Several authors on the development of MNEs' organisational structures (Doz and Prahalad, 1984; Bartlett and Ghoshal, 1987; Ohmae, 1990) have commented that a period of replication of functions abroad (clone models, multi-domestic structures) are followed by more fully integrated structures (transnational structures, global organisation). These more truly globally integrated forms are achieved by de-duplicating functions, often by coalescing them back to head office, or by having single locations for activities such as finance or divisional R&D. The advance of electronic communication has made this process more manageable.

There are a number of problems with globalisation using e-commerce: delivery; taxation (electronic customs clearance and vertical warehousing); language and currency differences (digital currencies?); patenting of business processes; and privacy/data protection. There are also issues of trust, which arise particularly when face-to-face transactions are not the norm.

2.5.2 Mass customisation

Mass customisation is another important means of reconciling scale and differentiation (efficiency and responsiveness), for example, in textiles – bespoke garments en masse from offshore sites with rapid delivery. Another example is 'lean retailing' – distribution and design centres linked to production centres by electronic means. Electronic ordering and automated distribution centres and inventory management systems linked to customers enable rapid response to customer needs. This combines information technology, speed and flexibility with low labour costs. So the custom versus bulk manufacture divide becomes fine. ('Cyber consumers expect to be able to customise everything'.)

De-duplication of function becomes possible where electronic links allow single locations to service the whole firm's needs. Rather than a call centre for each division or country, a single one can serve all. There is also a tendency for re-integration of the supply chain from independents back to the major manufactures, as e-commerce matures.

2.6 Internal effects on the multinational firm

2.6.1 Flexibility and internal organisation

In a very volatile environment the level of uncertainty is likely to be high. Uncertainty can be reduced, however, by collecting information. Flexibility was defined earlier in terms of the ability to respond to change. The costs of response tend to be smaller when the period of adjustment is long. One way of 'buying time' to adjust is to forecast change. While no one can foresee the future perfectly, information on the present and the recent past may well improve forecasts by diagnosing underlying long-term trends. Collecting, storing and analysing information therefore enhances flexibility because by improving forecasts, it reduces the costs of change. Another way of buying time is to recognise change as early as possible. In this respect, continuous monitoring of the business environment is better than intermittent monitoring, because the potential lag before a change is recognised is eliminated. Continuous monitoring is more expensive than intermittent monitoring, though, because more management time is tied up.

Investments in better forecasts and speedier recognition highlight the trade-off between information and adjustment cost. This trade-off is particularly crucial when volatility is high. High volatility implies that more information should be collected to improve flexibility, which in turn implies that more managers need to be employed. This is reverse of the usual recommendation to downsize management in order to reduce overhead costs. To improve flexibility whilst downsizing management, the trade-off between information and adjustment cost must be improved. There are two main ways of doing this. The first is to reduce the cost of information processing through new information technology (IT). The second is to reduce adjustment costs by building flexibility into plant and

equipment, both through its design and its location. A combination of IT investment and flexible plant can reconcile greater flexibility with lower management overheads in the manner to which many MNEs aspire.

The information required for strategic decision-making is likely to be distributed throughout the organisation. It is no longer reasonable to assume that all the key information can be handled by a single chief executive, or even by the entire headquarters management team. It is difficult to know in advance where the really crucial information is likely to be found. Every manager therefore needs to have the competence to process information effectively. Managers need to be able to recognise the significance of strategic information that they acquire by chance, and to have the power of access to senior executives in order to pass it on. In other words, ordinary managers need to become internal entrepreneurs.

Few entrepreneurs have sufficient information to make a good decision without consulting other people, however. In a traditional hierarchical firm, the right to consult is the prerogative of top management. If ordinary managers are to have the power to initiate consultation, and act upon the results, then channels of communication within the firm need to be increased. Horizontal communication, as well as vertical communication, must be easy, so that lower level managers can readily consult with their peers. A natural response is to 'flatten' the organisation and encourage managers to 'network' with each other. This improves the trade-off between local responsiveness and strategic cohesion (Bartlett and Ghoshal, 1987; Hedlund, 1993). Unfortunately, though, there has been some confusion over whether flatter organisations remain hierarchies at all. However, as Casson (1994) shows, the efficient managerial processing of information normally requires a hierarchical structure of some kind. The key point is that the more diverse are the sources of volatility, the greater are the advantages of widespread consultation. The less predictable is the principal source of volatility on any given occasion, the greater is the incentive to allow consultation to be initiated anywhere in the organisation. In practice this means that an increased demand for flexibility is best accommodated by flattening the organisation, whilst maintaining basic elements of hierarchy.

If flexibility were costless, then all organisations could build in unlimited flexibility at the outset. In practice, the greater is flexibility, the higher transactions costs become. For example, the flexibility to switch between different sources of supply and demand (described earlier) means that relations with customers and suppliers become more transitory than before. Cheating becomes more likely, because the prospect of further transactions between the same two parties is more remote. Direct appeals to the other party's loyalty lose their credibility too.

The same effect occurs when internal entrepreneurship is promoted. Internal entrepreneurs are given more discretion to act upon information that they have collected for themselves, and this increases their opportunity to cheat. Giving managers a direct stake in the business activities they help to build is one solution. The firm incubates new business units in which particular managers, or groups of managers, have equity stakes. An alternative approach is to appeal to

the integrity of managers instead. They are treated well, and in return are expected to be open and honest about what they know.

It is one of the ironies of the 1990s that at a time when personal integrity needed to be high in order to support more flexible organisations, it had been allowed to fall very low. The decline of traditional religion, the intellectual cynicism created by two world wars, and the rise of mass consumerism have all been blamed for this state of affairs. Communitarians argue correctly that moral values like integrity are most efficiently engineered at the societal level, through family, church and school. But when these institutions fail, they must be engineered to support specific economic relations instead (Fukuyama, 1996). Firms must engineer these values amongst their employees at their own expense instead (Kotter, 1996). Greater flexibility therefore implies greater costs in promoting a corporate culture that reinforces moral values.

2.6.2 Outsourcing and logistics

Many input functions are now viably outsourced – even human resources departments and procurement.[2] Digital delivery of product is analogous on the output side. The danger is the loss of core competences (outsourcing IT 'loses part of company's brain'). This development contributes to volatility and increases the mobility of activities internationally, as a great deal of outsourcing functions are competed for on a global basis. The policy of promoting linkages (forward as well as backward) followed by many agencies of national and local government needs to account for these changing decision-making parameters.

As is always the case, disintegration of established supply chains is followed by re-integration and consolidation. The trend to outsource (dis-internalise) manufacturing by major multinationals led initially to subcontracting to independents – many of them located in Southeast Asia (and Mexico). Contract manufacturing,[3] has been growing by 20 per cent per year in the late 1990s and the early part of this century. However, contract manufacturers are rapidly consolidating, through mergers, and are expected to reach an oligopolistic equilibrium, with around six firms dominating the global market. These firms are becoming supply chain managers, sometimes even organising distribution and repair. These links between customers and suppliers are, of course, facilitated by the use of the internet.

Contract manufacturers, ensured of future contracts are thus able to achieve economies of scale and to become more capital intensive, replacing unskilled labour by high-tech capital equipment. This trend is accelerated by the competitive imperative becoming speed to market, not cost. A linked supply of available factories in different national locations means that contract manufacturers can switch production lines between these units. Flexibility is achieved by using these 'shell' factories between principals – entire production lines can be flown in from another location. Vertical disintegration is thus accompanied by specialisation. The principal concentrates on R&D, design and marketing, the contract manufacturer provides a service to the global supplier. Companies with a strong manufacturing

culture, and a commitment to a fixed location, may be out-competed by more agile 'virtual' firms owning no manufacturing facilities at all.

2.7 Summary

Multinational firms face a number of key challenges in the new millennium. Among these are:

- the management of e-commerce, and its integration with conventional business firms;
- reacting to increased volatility in the world economy by strategies based on flexibility of response;
- reassessing ownership and location factors in
  - relocation
  - IJVs and alliances
  - disintermediation
  - de-duplication;
- revisiting market entry strategies, namely,
  - sequential market entry
  - dynamic market entry;
- the creation, renewal and maintenance of viable corporate cultures, to combine competence, honesty and entrepreneurship;
- coping with uncertainty, notably the increased political uncertainty following the events of 11th September, 2001.

2.8 Implications for Southeast Asia

There are a number of suggestions for Southeast Asia and its investment agencies, which emerge from the above analysis.

2.8.1 Dynamic market entry

Investment attraction (and retention) requires attention to be paid to dynamic market entry. Investment agencies need to take a long-term view of the foreign market servicing strategies and sourcing strategies of MNEs. This includes both locally owned firms and foreign investors. Foreign firms having only sales subsidiaries or subcontracting agreements, or indeed utilising sales agencies, may (be induced to) expand into wholly owned production or service centres.

2.8.2 Hubs

Investment agencies should understand the 'hub and spoke' strategy, and monitor its development, particularly in an integrating area like the European Union.

The appeal of hubs with higher order activities (such as R&D or finance) is particularly attractive for locations like Singapore, but spokes may well develop into hubs or sub-hubs. This may involve supporting or fostering IJVs between local and foreign firms. Investment may not always be 'greenfield ventures' on a new site, but mixed forms with joint ventures and takeovers as key entry strategies. A more sophisticated attitude to takeovers is implied by this approach.

2.8.3 Expectations of Southeast Asian economies

There is much more competition for 'footloose' FDI projects. The entry of China as a major location for labour intensive projects has created substantial difficulties for those countries trying to compete as a location for export-orientated projects. Many countries are engaged in attempting to upgrade their offer to potential inward investors. This may include direct cost competition or attempts to attract higher-order activities and skilled labour/knowledge intensive projects.

The entry of China as a global economic superpower and super-location for inward FDI will be consolidated by its membership of the World Trade Organisation and its policy of increasing openness. The competitive response of Southeast Asian countries is less sure. China's range of exporting industries covers the spectrum from cheap labour-intensive products like toys to sophisticated ones like computer chips. Where is Southeast Asia to find a niche? The response must be a flexible one. China may have areas of absolute advantage, but trade is based on comparative advantage. Further, as China's trade balance becomes increasingly positive, its exchange rate will rise. The growth of China's domestic purchasing power will also provide opportunities for export sales to this new consumer base.

The era of massive new greenfield projects designed for export may be passing. Much more likely are incremental changes in MNE configuration – the results of de-duplication, outsourcing, offshore production and re-investment. The volatility of strategy increasingly makes FDI a two-way bet, unless strong investment retention policies are in place. The rationalisation of facilities by MNEs is ongoing and relentless.

2.8.4 Networks and clusters

Establishing viable clusters – of subcontractors and suppliers – around an important principal plant has been fashionable. My analysis, and the impact of e-commerce, suggests that these clusters are becoming increasingly dispersed and virtual. It may be possible to build clusters *de novo*, but this is not the norm. A more detailed understanding of company networks is necessary. More sophisticated policies on 'promoting linkages' need to evolve.

The 'Asian crisis' and its aftermath has not only slowed inward FDI from outside Southeast Asia, it has also disrupted intra-regional flows of FDI. Both of these factors: the decreasing share of world FDI attracted by Southeast Asia, and disrupted intra-Southeast Asian networks, have serious long-term effects. The switch

of footloose FDI to China may have permanent repercussions, but the necessity to re-consolidate regional networks is vital in a region of small interdependent states.

2.8.5 E-commerce

The operations of small, fully internationalised companies are now much more viable. Many companies are alleged to be 'born global' and this means paying attention to start-ups and potential small global players in the domestic economy. There is a clear importance to the building and maintenance of state-of-the-art electronic infrastructure. Physical infrastructure quality still remains important in attracting and retaining investment. The attitude of investment attraction agencies must be like a venture capital company which expects only a few (perhaps 1 in 20?) projects to fully succeed.

2.8.6 Volatility

The key message of this chapter is that volatility in the global economy is increasing. IJVs, for instance, are likely in general to be short-lived but variable in longevity. There will not be massive 'successes' in the attraction of new greenfield investments or massive 'failures' in closure, but the search for flexibility will mean that incremental shifts will be many and cumulatively profound. In this context, there is no substitute for being close to the companies' thinking.

Impact of New Developments in Southeast Asia	
Location	New locations
	Race to the bottom?
Ownership	FDI in Southeast Asia
	Networks of Southeast Asian firms
	Entrepreneurship
Internalisation	Vertical disintegration?
	De-duplication?
	Size of firms

Notes

1 The basic framework of this chapter is derived from Buckley and Casson (1998).
2 See 'Out of the back room', *The Economist*, 1 December 2001, pp. 75–76.
3 See 'Factories for hire', *The Economist*, 12 February 2000, p. 81.

3 The political economy of foreign direct investment in Southeast Asia

Economic security perspectives

Christopher M. Dent

3.1 Introduction

Foreign direct investment (FDI) has played an integral part in Southeast Asia's contemporary economic development experience. The industrialisation of many of the region's states has depended to a significant degree on the investment of foreign multinational enterprises (MNEs) in their economies. This especially applied to the original core five members of the Association of Southeast Asian Nations (ASEAN) – Indonesia, Malaysia, Philippines, Singapore and Thailand – that have pursued an increasingly outward-oriented economic development strategy based on export- and FDI-led growth. These twin processes have been prime drivers behind Southeast Asia's impressive techno-industrial transformation over recent decades, which, according to Chia (1999), allowed the region's constituent economies to 'overcome the constraints of small domestic markets and narrow resource bases; exploit comparative advantage and scale economies; access foreign capital, technology and marketing and managerial expertise' (p. 249). Chia further observed that Southeast Asia's success in attracting FDI could be generally attributed to a combination of political, economic and social factors, including the supportive developmental policies of the region's governments, favourable macroeconomic conditions and factor endowments (especially labour and natural resources), and rapidly expanding domestic markets.

This was at least the general situation up until the region's 1997/98 financial crisis. In the crisis aftermath, levels of inward FDI into Southeast Asia have fallen dramatically, especially in countries such as Indonesia and the Philippines, where the post-crisis reconstruction of the economy has proven problematic, and foreign investor confidence is accordingly low. Moreover, those in the region that subscribe to the view that the volatility of foreign capital was more crisis-culpable than domestic economic factors have strengthened economic nationalist and 'anti-globalisation' resistance in some Southeast Asian countries towards all forms of foreign investment, thus lumping FDI in with short-term speculative capital movements. Yet to the more discerning, the crisis revealed the relative advantages of FDI (especially of the 'greenfield' variety) over foreign loans and other manifestations of foreign capital, as the former incorporates the added value of not just foreign capital infusion into the domestic economy but also that of management, production, technology and marketing capabilities.

Furthermore, crisis events did not question that the ASEAN core member states should fundamentally divert away from their outward-oriented trade and FDI development strategy, but rather modify certain aspects of it. While this may not be the view of the region's economic nationalists and still weak – yet growing – 'anti-globalisation' civil movements, there has been a general consensus that the ASEAN economies' interaction with foreign capital required re-evaluation and subsequent adjustments in FDI and international financial policy. Most Southeast Asia's states cannot escape the fact that they are structurally integrated into wider regional (i.e. East Asian) and global production chains, not least because of the significant penetration of inward FDI, and hence foreign MNEs interests, in many key sectors. Therefore, they would find it difficult to disengage from an outward-oriented strategy unless in cases where considerable politico-economic deconstruction transpires, as perhaps may be expected in Indonesia over forthcoming years.

There remains much diversity and also continuity in the political economy discourse on FDI in Southeast Asia. For example, Singapore continues to be a strong advocate of FDI, in accordance with its general embrace of globalisation. Like Singapore, the Malaysian leadership continues to proactively attract higher-technology inward FDI. However, it is demonstrably suspicious of the ideological baggage often associated with globalisation, and Prime Minister Mahathir has at times viewed certain aspects of globalisation as a surrogate form of Westernisation. In Indonesia, economic nationalists advocate the notion that a dependency on FDI compromises the integrity of national economic management. Meanwhile across the region, foreign MNEs and host governments have been the subject of growing criticism from human rights activists over the exploitation of labour under 'sweatshop' working conditions, and also from environmentalists over the ecological damage incurred by certain FDI projects and lax environmental regulations set by the state that made them permissible.

Both the technical aspects of FDI policy as well as FDI diplomacy are set within the broader foreign economic policy (FEP) framework (Dent, 2002). Certain phases of development are discernible in Southeast Asian states' approaches to FDI during the post-colonial period. A more favourable disposition towards FDI was evident in the transition from the import-substitution industrialisation (ISI) – where cultivating national self-dependence was in many Southeast Asian cases a key underlying theme of economic policy *per se* – to export-oriented industrialisation (EOI), in which export-oriented FDI marked a critical shift in Asia's trade–FDI policy nexus and development (Athukorala, 1998). In this context, inward FDI in Southeast Asia formed an integral part in developing various export production capabilities in progressively higher grades of techno-industrial activity from broadly the 1970s onwards. Over time, more labour-intensive sectoral investment (e.g. in agro-processing, textiles, etc.) gave way to more capital-intensive FDI projects (e.g. computer and electronics manufacture).

A range of technical policy measures was available to Southeast Asian states to induce and manage inward FDI. Promotive incentives included tax concessions, investment subsidies, accelerated depreciation allowances, infrastructural provision and facilities, especially those found in designated export processing zones and industrial estates. In contrast, FDI restrictions, regulations and performance criteria

included limits on foreign equity ownership, outright bans on investing in 'sensitive' or 'strategic' sectors, restrictions on foreign employment, minimum local content, export and technology transfer requirements, and restrictions on the repatriation of profits. Over time, Southeast Asian states have placed an increasing emphasis on promotive measures, while restrictive measures have been cut back in the wider sweep of neo-liberal reform and engagement with globalisation. Amongst the region's states, Singapore has developed the most effective and sophisticated FDI policy that has combined openness with selective sectoral promotion. Indeed, FDI has been central to the city-state's development strategy since independence, based consistently on targeting higher-tech sectors for FDI-based development. Here, Singapore's Economic Development Board (EDB) has played the pilot agency role of the developmental state, working in an 'adaptive partnership' with transnational capital, in response to challenges posed by globalisation (Dent, 2003a). Most other Southeast Asian states had specific agencies charged with managing FDI policy, such as Thailand's Board of Investment (BOI), that was established in 1959 with the explicit aim of promoting inward FDI in addition to domestic private investment.

The general shift to a more promotive FDI approach in the core ASEAN-5 countries coincided with the surge of Japanese outward FDI during the late 1980s and early 1990s, as a consequence of the Yen revaluation policy after the 1985 Plaza Accord. Meanwhile in Indochina, prospective ASEAN member states such as Vietnam and Cambodia were 'instrumentalising' the fundamentals of FDI policy, with foreign investment laws passed in the Indochina sub-region from the late 1980s onwards. Vietnam has adopted many lessons from China's 'open door' policy towards inward FDI, and has proved particularly successful at attracting foreign investment. More recently, Southeast Asia's 1997/98 financial crisis brought significant changes to FDI policy, not least because a new promotive approach was required to attract foreign investor interest in the region as a whole. This involved a further wave of policy liberalisation and deregulation (e.g. on equity ownership, local content rules, etc.) that was combined with new incentive measures. In sum, the crisis had shown that engaging globalisation is a dynamic economic and political learning process, and subsequent 'smarter' adjustments in FDI policy supposedly reflected this.

This chapter makes a political economy analysis of FDI and Southeast Asia, discussing in more detail the issues and developments raised in this introductory section. More specifically, it utilises a conceptual framework of economic security to analytically structure this study. As this author has argued elsewhere, the pursuit of economic security interests principally orientate FEP objectives (Dent, 2002). It was noted earlier that FDI policy and diplomacy form a constituent FEP element, and the application of this economic security approach offers a new methodology for examining the political economy of FDI in the region.

3.2 Economic security: a new conceptual framework of analysis

Discourses on economic security form part of the 'new' security agenda in the international political economy and international relations literatures, that is its

broadening beyond the traditional focus on just politico-military issues and concerns. The growing salience of economic security issues is associated with the respective shifts from geo-politics to geo-economics, from military superpowers to economic superpowers, and hence from politico-ideological competition to economic competition. As Stremlau (1994) contends, 'we are entering an era when foreign policy and national security will increasingly revolve around our commercial interests, and when economic diplomacy will be essential to resolving the great issues of our age' (p. 18). In a similar vein, Reynolds (1993) argued that, 'the definition of national security has changed from the amount of military firepower a country commands to include questions of economic and technological advantage' (p. 31). This chapter offers the following definition of economic security in a FEP context: *safeguarding the structural integrity and prosperity-generating capabilities and interests of a politico-economic entity in the context of various externalised risks and threats that confront it*. Here, 'politico-economic entity' broadly equates with a FEP power (e.g. a nation-state) with respect to its own territorial economy and extra-territorial (e.g. trans-border or transnational) economic interests. Hence, FEP protagonists[1] may work to safeguard the transnational commercial interests of their home-based or hosted foreign MNEs, and thus have direct relevance to FDI-related issues.

The 'structural integrity' aspect of this working definition of economic security essentially relates to maintaining the internal construction of the economy during its interactions in the global economy, and its ability to meet the basic demands of economic agents located therein. Where meaningfully applied, this can be linked to proximate notions of the economy's survival in the international system and thus the prevention of its structural collapse – a rare event in absolute terms, as economies invariably recover in a physical sense, albeit sometimes in a new politico-geographically defined form. The 'prosperity-generating capabilities' aspect of the definition broadens the conventional boundaries of the economic security concept beyond its usual attention to minimising direct and immediate economic vulnerabilities. Safeguarding prosperity-generating capabilities works towards this objective anyway, through reducing the future scope for economic security risks, vulnerabilities and threats, constituting a sort of 'insurance policy' or 'preventative medicinal' approach. The development of these capabilities can also be linked to welfare maximisation – both localised and global – and the externalisation of FEP interests. Also relevant is Lubbe's (1997) distinction between short-term and long-term economic security objectives, with the former concerned with confronting specific challenges (e.g. unilateral commercial policy threats) and the latter with preserving economic potential, and the capacity to counteract structural destabilisation.

In comparing these last two aspects of the economic security definition, safeguarding the 'structural integrity' of the FEP power is more defensive in connotative action, whereas safeguarding 'prosperity-generating capabilities and interests' relates more to promotive or enhancing actions. As such, 'safeguarding' in this latter context involves proactive measures for advancing the FEP power's economic security interests, for example through foreign economic policies that

cultivate certain prosperity-generating functions within the economy, such as is found within FDI policy measures pertaining to technology transfer and export production requirements. Strengthening economic diplomacy ties with other FEP powers may also foster FDI, trade or finance-related linkages that serve similar economic security objectives.

In further applying this definition to FEP analysis, a typology set of economic security interests can be developed that broadly orientates FEP objectives, and thus that of FDI policy. The eight economic security typologies that are outlined here form the main analytical structure of this chapter:

- *Supply security*: relating to securing key supply chains involving foreign sources. This is especially important for import-dependent or foreign technology-dependent economies that respectively lack natural resources or indigenous techno-industrial self-sufficiency. It can also apply to securing the supply of international credit and finance, as articulated here, and human resources in short indigenous supply. Supply diversification forms part of a vulnerability management strategy of economic security.
- *Market access security*: concerns securing the best access possible to key foreign markets. This is particularly crucial for export-orientated economies with small domestic markets, although this has become a prime economic diplomacy objective of all FEP powers.
- *Finance-credit security*: ensuring the financial solvency of the FEP power in the international system, as well as its maintenance of access to, or influence or control over sources of international credit. In recent times, this has become an acute economic security concern of developing countries in the context of 'Third World' debt and other countries that have lately required IMF assistance, e.g. Indonesia.
- *Techno-industrial capability security*: preserving and developing the ability of the economy to generate prosperity, productivity and other welfare-creating factors, and maintaining the economy's position as close as possible to the technological frontier. This may derive from indigenous or foreign sources, and relate to issues of access and acquisition of foreign technology.
- *Socio-economic paradigm security*: the 'defence' of a society's preferred socio-economic paradigm and its welfare goals where defined.[2] This often entails the resistance of foreign pressure to adapt to new international norms that are associated with a counter-paradigm. We later relate this to debates in Southeast Asia concerning FDI and the infusion of neo-liberal values in the region's post-crisis restructuring process.
- *Trans-border community security*: regionalised concerns that may either precipitate trans-border economic crises or relate to localised interdependence issues, for example, Southeast Asia's sub-regional economic integration projects. These often centre on trans-border spillovers, or externalities that require market failure correction policies, and hence the management of a shared trans-border economic space. This space itself may of course be partly created by growing FDI linkages between Southeast Asian countries.

Trans-border community security issues can also focus on issues from other security sectors, such as pollution, drug trafficking and economic migration. Furthermore, regional architectures for economic security (e.g. ASEAN) provide a fall back position if the liberal world economic order is jeopardised.

- *Systemic security*: upholding the integrity of the international economic system, entailing co-operative and concessionary acts to uphold multilateral regimes of systemic governance, facilitate inter-state bargaining and maintain overall systemic stability. This, though, has limited relevance to our debate on FDI and Southeast Asia, and we shall therefore omit an applied analysis of this economic security typology to it.
- *Alliance security*: maintaining and developing international economic partnerships with state and non-state actors in pursuance of the interests mentioned here. This may take various forms, ranging from donor–client alliance relationships to looser co-operative or co-ordinative arrangements between relatively equal partners.

There are natural overlaps between these eight different typologies. The link between supply security and finance-credit security has already been noted, as has the underpinning functions performed by alliance security. Techno-industrial capability security may also be served by supply security where, for example, an infusion of foreign technology through inward FDI or other means enhances the latter. Frictions often arise too between different economic security objectives, for example, when inward FDI assists the finance-credit and techno-industrial needs of the economy but simultaneously poses a threat to socio-economic paradigm security interests. We now apply this analytical framework of economic security to study various FDI-related issues in Southeast Asia.

3.3 Economic security, FDI and Southeast Asia

3.3.1 Supply security

For many Southeast Asian countries, inward FDI has been a prioritised acquisitional means to secure the supply of key developmental assets, be they material, technological, managerial or entrepreneurial in nature. Thus, FDI has performed a critical sourcing function in this respect, and is moreover indicative of the periphery-type dependency Southeast Asia retains upon the 'core' advanced industrial economies (AIEs). The role of FDI in perpetrating this developing region's subservient dependence upon the AIE core remains a contentious political economy debate. Nevertheless, it is increasingly constituent to international supply chain links involving Southeast Asia, both to the region's states and firms and to foreign investing firms in the region.

Foreign MNEs based in Southeast Asia will usually source a significant level of inputs from outside the host country. This can serve supply security objectives in one sense by establishing access to value-adding technology, components and

resources from overseas, including from AIE-based sources. However, the question is to what extent is the firm serving its own corporate objectives rather than the economic security interests of the host country? As noted earlier, Southeast Asian governments generally have local content rules that require foreign firms to source indigenously to specified minimum degrees. Thus, supply security may not appear that relevant from the host country's perspective, unless the supplied entities concerned can be effectively diffused in some way, such as technology, managerial expertise, financial resources, etc. Here, supply security works in tandem with techno-industrial capability security: the host Southeast Asian country is likely to permit the supply of value-adding imports via the foreign investing firm, whilst it lacks the indigenous techno-industrial capability to locally supply the MNE. However, the diffusion of these foreign supplied assets eventually builds up this indigenous capability. According to Fong (1990), the process of acquiring technology capability from abroad may occur in three stages: (i) the transfer of existing technology to specific goods and services; (ii) the assimilation and diffusion of these technologies in the host country; and (iii) the development of indigenous capability to innovate from this technology base. Thus, FDI initially brings the first stage technology transfer, and invariably resides at least over the second stage. Urata (2001) also makes the point that technology spillovers from inward FDI can take many forms, for example, through skilled workers, local supplier firms, and so on.

If the Southeast Asian country is the outward investor, then FDI can also play an important supply security role. For example, we discuss later how the Singapore government's motives for promoting the mainly FDI-facilitating, transnational development of the Indonesia–Malaysia–Singapore Growth Triangle (IMSGT) project were at least partly based on integrating the city-state with a natural economic hinterland, from which it could more effectively draw upon strategic supply sources, such as freshwater and day-migrant labour. Similar supply security interests are at work within the Greater Mekong Sub-region (GMS) Programme, where more micro-level FDI projects between Thailand, Vietnam, Cambodia, Laos and Myanmar are focused on managing vital hydro-related and other natural resource supply linkages. From another perspective, Tokyo views the extensive FDI links of Japanese companies in Southeast Asian states as strategically important, especially with those countries such as Indonesia that supply critical resources (e.g. oil and raw materials) to Japan's economy.

3.3.2 Market access security

This economic security typology naturally focuses on FDI linkages with trade and trade policy. While FDI forms part of a market access strategy for foreign MNEs in Southeast Asia, it too can be viewed in market access security terms by FEP protagonists. As previously discussed, the promotion of export-oriented FDI marked a significant historic shift in the FDI–trade policy nexus for many Southeast Asian states. In Malaysia, Singapore and Vietnam in particular, inward FDI has been purposely and extensively deployed to construct the export

production base of their economies. From a general perspective, this process has strengthened their export production capabilities and thus improved their economies' de facto access to key export markets. It also marks the departure from the more self-dependent ISI approach of the early industrialisation period, where there was more of a general distrust of inward FDI *per se*. Thus, FDI's links with market access security interests in Southeast Asia has become increasingly relevant.

In addition, foreign hosted MNEs are in many circumstances better able to resist protectionist pressures in their home countries in such a way as to favour imports from their affiliates, say located in Southeast Asia. This relates to the more effective counter-lobbying power of foreign MNEs over their home governments, in comparison to Southeast Asia's indigenous export producers and governments. For instance, American firms such as Boeing, AOL Time Warner, Oracle and Exxon-Mobil have proved effective advocates of the US's free trade agreement (FTA) initiatives with Singapore and Thailand, where these firms have FDI-embedded commercial interests.

We must also position Southeast Asian FDI policy and market access security in a wider regional framework. This especially concerns ASEAN's Free Trade Area (AFTA) initiative, where FDI and trade are closely linked in the process of both forging regional integration and exploiting the benefits from it. An integral element of this project is the ASEAN Investment Area (AIA), which is designed to create free investment flows (i.e. intra-regional liberalisation) within the region by 2010 and free foreign investment flows (i.e. liberalised extra-regional FDI policy) by 2020 (Narine, 1999). The underlying purpose of the AIA initiative is to attract FDI into the AFTA market by enabling foreign investors to better develop a regional division of labour within it, based on a more effective configuration of MNEs' regional production chains, in accordance to the locational competitive advantages of Southeast Asian countries. In this sense, the intra-firm trade linkages cultivated by AFTA and AIA are intended to bind the market access security interests of ASEAN member states into deeper interdependent alignment, thus connecting with alliance security interests. However, intra-regional trade in Southeast Asia remains relatively low, and has recently fallen in significance, as a consequence of the 1997/98 financial crisis. The FDI-related market access security interests of Southeast Asian states thus remain primarily focused on the US, Japanese and European markets. In addition, certain post-crisis problems with realising the AFTA initiative have arisen. Most notably, the Thai government and its hosted foreign MNE auto producers have been frustrated by Malaysia's phased three-year delay in its AFTA commitments on auto trade liberalisation.

3.3.3 Finance-credit security

Inward FDI can perform many finance-credit security functions, especially for developing countries whose general finance-credit position may be weak. As a capital inflow, it augments domestic savings and brings in foreign exchange, which the economy can utilise to procure foreign items necessary to improve its

techno-industrial capacities (e.g. high-tech capital goods), hence connecting it to another key economic security interest. The linkage between FDI and finance-credit security for Southeast Asian states has become increasingly important since the 1997/98 financial crisis. The crisis exposed the poor methods deployed by the region's governments in liberalising their financial markets during the 1990s, when they opened up domestic financial systems and capital accounts to the global economy without implementing robust supervisory and monitoring mechanisms and prudential regulations. Acquisitional FDI was thus permitted to flow into speculative asset markets such as real estate and corporate stock, creating 'bubble economy' conditions. Thailand was perhaps the prime example of such an approach. In contrast, Taiwan's financial authorities had retained rules whereby foreign investors were obliged to channel funds into productive asset investments. In the crisis aftermath, Southeast Asian governments have, to varying degrees of sophistication, introduced new checks and balances into their international investment policies, especially on acquisitional FDI.

The crisis also demonstrated the advantages of FDI over foreign loans. As Chia (1999) has argued, inward investor profitability and the associated outward remittances of profits and dividends are generally aligned with the performance of the macroeconomy, including the balance of payments, as poor export performance is reflected in low profits and outward remittances. However, foreign loans come with a fixed debt servicing charge, regardless of the economic cycle. For Southeast Asia's less developed countries, FDI may also provide additional financial inflows, over and above that of foreign aid. The FDI–trade policy nexus is relevant here too, as Southeast Asian governments may weigh up the net balance of trade effects from inward FDI and its implications for finance-credit security, with local content measures being particularly germane. Furthermore, the close linkage between international finance and FDI policy must be taken into account. For instance, Malaysia's imposition of capital controls in September 1998 had a deleterious effect on inward FDI levels for a period, as it constrained the financial flexibility of the country's hosted foreign MNEs, as well as sending an adverse signal to prospective new foreign direct investors. In Vietnam, joint ventures between foreign and domestic firms must earn sufficient foreign exchange to meet all their foreign currency needs. While this minimises finance-credit security risk, it also places a constraint on potentially beneficial projects involving infrastructure or import substitution activities that typically earn low foreign exchange earnings in the short-term. Thus, the relationship between FDI policy, associated policies and finance-credit security objectives in Southeast Asia remains complex.

3.3.4 Techno-industrial capability security

The prominent linkage between FDI and Southeast Asia's industrialisation makes this a particularly significant economic security theme. Inward FDI has played a major role in advancing the techno-industrial capabilities of the region's economies, yet their ability to make this an effective process depends on various

factors, as other chapters in this volume discuss. From a political economy perspective, it can very much depend upon the capacity and functions of the state to effectively partner foreign MNEs in their FDI projects. Two key debates are discussed in relation to this. The first concerns what Stopford and Strange (1991) referred to as the 'new' diplomacy, this being how states compete with others to create wealth within their own territory, rather than extending power and control over other states' territory. Competing for value-adding inward FDI – especially of the higher-tech variety – is a critical part of that process, involving various levels and forms of bargaining between states and MNEs. Moreover, competition between different Southeast Asian countries to capture the techno-industrial capability benefits of inward FDI, and thus enhance their economic security position, has intensified in recent years. As Ling and Yong (1997) observed, countries like Malaysia find it increasingly difficult to compete with emerging economies like Vietnam and China in certain FDI policy incentive areas, and should instead concentrate on developing locational advantages, such as higher quality human capital and infrastructure. Malaysia has more or less adopted this approach, in many ways following Singapore's earlier policy shift in this direction.

The second debate relates to developmental statism. In fundamental terms, a developmental state is one that pursues ongoing transformative economic projects in a 'late industrialisation' context (Woo-Cumings, 1999). It seeks to close the developmental gap between itself and the advanced industrial states, and works in various forms of partnership with both business and society to realise this ultimate objective. Many Southeast Asian states have demonstrated elements of developmental statism in their approach to national economic management, with Malaysia and Singapore arguably its most ardent and effective practitioners in the region. In Singapore, the EDB remains the key pilot agency of the developmental state and at the centre of FDI policy formulation and implementation. In terms of policy approach, it now places more emphasis on creating a more effective FDI environment (e.g. infrastructural development, tax exemptions) rather than direct financial inducements, such as job creation grants. For the first few years of the EDB operations, it welcomed almost any inward FDI project. However, it is now far more selective about proposed foreign investments in the city-state, affording current priority to those projects that will enhance Singapore's knowledge-based economy (KBE) development capacities. Consequently, FDI policy dovetails into the overarching techno-industrial upgrading strategy of the Singapore developmental state. Indeed to some, Singapore's FDI policy is synonymous with its industrialisation policy, in that the core of its techno-industrial development has derived primarily from the contributions of hosted foreign MNEs. Hence the state, through its various FDI policy initiatives and strategies, has guided transnational capital's development of the Singapore economy (Chen, 1983; Chia, 1986; Huang, 1989; Lim and Pang, 1991; Soon and Stoever, 1996; Lee, 1997). This too applies to Singapore's outward FDI policy, where the IMSGT project and overseas industrial park policy played a key part in the economy's techno-industrial restructuring in the 1990s, through the state-partnered relocation of lower-tech Singapore-based business activities to more

cost-competitive locations in the Southeast and East Asian region, which in turn freed up space for new higher-tech FDI into the city-state. Most recently, the Singapore government has developed a range of FDI policy and 'new' diplomacy initiatives to develop an international hub for biotechnology production, research and development within the city-state. The Malaysian Government's Multimedia Super Corridor (MSC) – a specially designated geo-cyberspatial site located just outside Kuala Lumpur, created to both attract high-tech FDI and provide a hub for e-commerce development – can be understood in similar developmental statist terms.

Foreign direct investment is therefore particularly seen by Southeast Asia's developmental state practitioners as integral to a Schumpeterian 'creative destruction' process, whereby infusions of newer technology FDI over time displaces the old. As this upgrading develops, so the prosperity-generating capacities of the economy grow. In many Southeast Asian countries, FDI was initially channelled into import-substitution industrial activities, augmenting domestic capital formation and techno-industrial capabilities in these sectors. This then shifted into export-oriented industrial activities as part of the broader structural transformation of their economies, as well as reflecting aforementioned changes in the FDI–trade nexus. In Thailand, the role performed by hosted foreign automobile manufacturers is highly relevant here, helping to push forward the technological frontier of the Thai economy (Ramstetter, 1997). In Malaysia's Vision 2020 programme, inward FDI has been afforded a priority role in meeting various techno-industrial capability objectives. Previously, Malaysia's Ministry of Trade and Industry's subcontract-exchange scheme had, since 1986, sought to integrate local suppliers into the production networks of foreign hosted MNEs through a computerised clearing house of buyer's requirements and vendor's capabilities. This proved especially successful in the auto sector.

3.3.5 Socio-economic paradigm security

While Southeast Asian states have increasingly courted inward FDI as part of meeting various economic security objectives, many are still highly sensitive to the social and cultural impacts associated with foreign investment. This has many facets. At one level, the connection between FDI and the maintenance of the socio-economic paradigm security interests of the region's states can be set within the context of the so-called 'anti-globalisation' movement, and the growth of civil society activism in FEP-related issues in general. Representations from this broad-based movement contend that the penetration of global capitalism in the region, and its associative neo-liberal values, has exacerbated problems of social inequality and environmental degradation in developing countries. There is also an association here with the previously discussed dependency predicament. Many Southeast Asian countries remain wary of becoming too dependent upon inward FDI, especially where it compromises the state's ability to direct national economic development down particular routes. For example, it may lead to uneven development within a country and hence cause problems relating to

internal centre–periphery divergence, resource over-exploitation and the undermining of community livelihoods (Dixon, 1991).

Another aspect of this debate concerns economic nationalism, which can be defined as the proclivity of the state, firms and individuals for economic actions, decisions or alliance formation that seek to advance the nation's domestic or international position, at the potential expense of foreign national or international interests (Dent, 2002). Thus, economic nationalism represents a form of resistance against foreign counter-influences that inward FDI is often seen to embody. It is also viewed as elemental to building national economic resilience and self-sufficiency, and therefore as addressing dependency predicaments. Most Southeast Asian countries maintain FDI restrictions in those areas or sectors of the economy where the retention of national sovereignty or state control is deemed critical. Common examples include the media, real estate and strategic resources and industries, e.g. energy. While Southeast Asian countries are by no means alone in this approach, economic nationalism continues to significantly influence FDI policy formation in the region. Indonesia has a particularly strong tradition in this respect, and there was a resurgent economic nationalist backlash during the 1997/98 financial crisis in response to foreign investors purchasing 'firesale' priced domestic assets. Economic nationalism also underlies certain post-crisis policy developments in Thailand, where Thai Prime Minister Thaksin Shinawatra has recently sought to prioritise the development of indigenous techno-industrial, export production and entrepreneurial capabilities, and in doing so wean the country's perceived over-dependence on hosted foreign MNEs. With this in mind, Thailand adopted a new telecommunications law in 2001 that limited foreign shareholding in telecoms firms to 26 per cent, down from the previous 49 per cent foreign equity limit.[3] As Thaksin himself commented, 'We are convinced that Thailand needs to strengthen its economic capabilities in a manner that would provide the real sector…with a considerable degree of immunity to the risks associated with globalisation and increased integration into the global economic system'.[4] Even more recently, however, the Thaksin government has promoted the idea of Thailand's 'dual track' approach to economic policy and development, whereby FDI and indigenous enterprise are deemed as equally important. This, it was hoped, would send a more positive signal to foreign investors. Meanwhile in Malaysia, investment policies have been guided by long-standing national objectives of empowering *bumiputra* (i.e. indigenous) business interests in the economy, as part of redistributing the balance of wealth between the country's ethnic groups. Consequently, restrictions exist on inward FDI to avoid the crowding-out of certain forms of local entrepreneurship.

Malaysia is also an interesting case study of Southeast Asian states' sometime dualistic approach to FDI and globalisation more generally. On the one hand, the Malaysian government has gradually opened up the country to transnational capital, as part of neo-liberal economic restructuring and deepening industrialisation processes (Chin, 2000). For example, foreign investors enjoy no restrictions on capital or information movements within the MSC zone and the industrial sector. Malaysia has become significantly dependent upon inward FDI and its economy

has materially benefited from infusions of foreign capital, and yet its political leadership under Prime Minister Mahathir has been highly critical of certain aspects of globalisation and transnational capital interests. In this respect, the wider 'globalisation project' is seen as simply an extension of 'Westernisation', and more specifically as imposing 'western' values and ideologies (e.g. free markets, rugged individualism) upon developing Asia. Thus, American and European FDI may at times be viewed as the Trojan horse by which such neo-colonialism is realised.

We should not, though, simply conclude that inward FDI always poses some degree of threat to the socio-economic paradigm security interests of Southeast Asian states. This is not least because the associated infiltration of foreign capital, and all the socio-cultural baggage that accompanies it, can often reconstitute those interests themselves, especially if it has become deeply embedded within the domestic political economy. Both Malaysia and Singapore demonstrate this best in the region, and notably in the latter, where the global 'culturisation' of Singaporean society and highly internationalised nature of the economy reflect a state that has actively embraced foreign influences, synthesising or simply accommodating best practices from overseas, in order to enhance the city-state's prosperity-generating capabilities. In short, many view Singapore as a product of globalisation. Extracting FDI and foreign capital from the city-state would fundamentally compromise an important part of the socio-economic paradigmatic foundations on which its contemporary economic development is based.

3.3.6 Trans-border community security

Foreign direct investment can play an important role in trans-border community building between localised economic agents nominally divided by international boundaries. In Southeast Asia, much of this has centred on the various subregional economic integration projects or 'growth triangles' that emerged from the late 1980s. In general terms, these are based on the development of trans-border economic networks or the complementary exploitation of sub-regionally located capital, labour and material resources. From an international political economy perspective, they perform the function of managing the deepening economic interdependence between contiguous border zones of different Southeast Asian countries, and thus represent exercises in sub-regional economic diplomacy. Whilst both central and local governments have been instrumental in formalising these projects, they are ultimately founded on established patterns of sub-regionalised trade and FDI links, whereby transnational production and distribution systems have already bound different elements of Southeast Asian national economies together into this interdependent relationship.

From this stems the need for ASEAN states to address common economic security challenges or predicaments. It was previously noted how the Singapore government's push behind the IMSGT project was partially motivated by the need to secure better access to strategic supply sources. By promoting FDI and other trans-border commercial linkages with the Johor province of Malaysia and the Riau province of Indonesia under this project, Singapore bound the economic

interests (and to some extent the economic destinies) of these two sub-national territories with its own. Denying the city-state the strategic resources it requires to drive forward dynamic trans-border economic development ultimately compromises Johor and Riau's own prosperity-generating capabilities and interests, and hence economic security. Such cultivated interdependence thus undoubtedly made the Malaysian and Indonesian authorities more open to Singapore's desire for better access to Johor's freshwater supplies and Riau's natural gas resources. Both Johor and Riau's engagement in the IMSGT project also provided new opportunities to realise certain techno-industrial capability security objectives, via FDI-facilitating technology transfers from Singapore-based firms relocating elements of their production chain over the border. Singapore's first foreign industrial parks were established at Batam and Bintan Islands in the Riau province during the early 1990s as part of this development.

There is a deeper politico-diplomatic aspect to the IMSGT project. Given the historic tensions between these three Southeast Asian states, and the particularly vulnerable position of Singapore, the project enabled the city-state to emphasise the economic dimension of 'border management' with its two large neighbours. Consequently, it has also to some extent provided a firmer diplomatic foundation for dealing with trans-border spillovers or externalities involving these countries, which has often been linked to 'new' security sector issues, such as pollution – the forest fire haze problems of the late 1990s in the regional locale being a case in point. However, endeavours to construct an IMSGT-based trans-border economic community can only achieve so much. Firstly, it is more a bipedal than a triangular arrangement, owing to the still underdeveloped economic linkages between Johor and Riau, and hence undermining the notion of widespread trans-border interaction within the IMSGT zone. Secondly, many Singapore-based investors have not been lured by the economic advantages and incentives that accompany relocation in Johor and Riau. Other low costs locations, such as China, are proving increasingly more attractive in comparison. Thirdly, Singapore's IMSGT partners can only assist its techno-industrial restructuring process to a certain degree. Further infrastructural and human resource development investments are required from both Malaysian and Indonesian sources before future phases of FDI-driven restructuring can be engaged. There is a current feeling that the IMSGT is losing its dynamics and momentum, for the above and 1997/98 crisis-related reasons, which have led Singapore to generally extend its economic security interests beyond Southeast Asia.

We have already noted the supply security interests at work within the GMS, another Southeast Asian 'growth triangle' project underpinned by intra-regional FDI linkages. The prime focus here is the international management of trans-border economic resources shared by the riparian states of Thailand, Vietnam, Cambodia, Laos, Myanmar and China's Yunnan province. The GMS was initiated in 1992 with financial assistance from the Asian Development Bank, with the principal goals of facilitating sustainable economic growth and improving the standard of living in the Mekong region, by means of factor input specialisation and enhanced trade and FDI between participating member states. As with the

IMSGT project, issues of economic interdependence and strategic resource diplomacy are highly pertinent to the GMS, and FDI plays a key part here in addressing common economic security challenges in this sub-regional locale. Many investment projects here are designed to co-manage the Mekong's hydro-resources that are vital to maintaining shared food security and energy security interests. Others are aimed at developing new prosperity-generating capabilities, such as eco-tourist industry development, which also indirectly assist tackling other trans-border community security threats like drug trafficking.

3.3.7 Alliance security

Our preceding analysis discussed the role of FDI in promoting sub-regional economic diplomacy in Southeast Asia, and therein certain alliance security aspects. Foreign direct investment also serves to maintain and develop international economic partnerships in accordance to economic security interests at other levels. While it is the FDI strategies of Japanese MNEs that have principally forged deepening linkages between the Southeast Asian and Japanese economies, governments from both sides have drawn strategic diplomacy advantage from them. For example, in his diplomatic tour of the region in January 2002, Japanese Prime Minister Koizumi 'played the FDI card' when appealing to Southeast Asian states to accept his proposed Initiative for a Japan–ASEAN Comprehensive Economic Partnership,[5] understood by many as an endeavour to strategically circumvent the China–ASEAN free trade agreement initiative that had been signed a couple of months earlier in November 2001.[6] Hence, Japan's FDI links with the ASEAN group continue to serve the perceived vital purpose of advancing the country's diplomatic influence in Southeast Asia, as well as its hegemonic position in the wider East Asian region more generally. For their part, Southeast Asian states closely compete with China for inward FDI from Japan and the region's advanced newly industrialised economies of South Korea, Taiwan and Hong Kong.

It is also worth noting that the recent proliferation of bilateral FTA initiatives in the Asia-Pacific region invariably carry a range of FDI facilitation measures, in addition to those on trade liberalisation (Dent, 2003b). A good example of such a 'broad band' FTA is the Japan–Singapore Economic Partnership Agreement (JSEPA), which was signed in January 2002. Thailand has also approached Japan to initiate a similar agreement that would combine FDI, trade and miscellaneous economic co-operation measures. The aforementioned ASEAN–China FTA project will also examine the means to promote FDI relations between both sides. Two further points should be made here. Firstly, and to restate an earlier point, FDI and trade policy and diplomacy are becoming increasingly linked in the FEP calculus of Southeast Asian states. Secondly, the FDI dimension of these FTA projects makes an important contribution to the alliance security interests of those states that have initiated them. This is an especially evident motivation behind Singapore's bilateral FTA diplomacy, in which its agreement with Japan and its current FTA negotiations with the US are viewed as critical to more deeply

embedding the commercial interests of these two economic superpowers in not just the city-state but in the Southeast Asian region. However, Malaysia's leadership has been notably critical of Singapore's intent, seeing its active bilateral FTA diplomacy[7] as a means to simply consolidate its position as the region's trade and investment hub, and moreover undermine alliance security ties within ASEAN, by diverting attention away from the group's AFTA and AIA projects.[8] While Singapore has vehemently defended its position, this aspect of FDI relations is indicative of the contesting alliance security interests evident amongst Southeast Asian states. The AIA scheme may realise a closer convergence of such interests through its promotion of intra-regional FDI relations, although ASEAN's past initiatives in this area were less than successful.[9]

3.4 Conclusion

Foreign direct investment has been a critical component in the economic development of many Southeast Asian countries. This chapter has presented a political economy analysis on this issue, using a new conceptual framework of economic security. From this analytical perspective, FDI has posed a series of economic security challenges to the region's states, carrying both opportunities and threats to different aspects of their economic development experience. As these states have moved to a more outward-looking development strategy, so the perceived opportunities offered by FDI have come to outweigh the perceived threats. Over time, ASEAN member states competed with each other to capture the value-adding benefits that inward FDI projects would bring to their domestic economies. For the core five members of ASEAN (Indonesia, Malaysia, Philippines, Singapore and Thailand) in particular, the twin processes of export- and FDI-led growth subsequently became prime drivers behind Southeast Asia's impressive techno-industrial transformation over contemporary times.

However, Southeast Asia's 1997/98 financial crisis, and its consequent deleterious impact on foreign investment in the region, served to underline the growing interdependent FDI relationship between ASEAN member states. The deeper trade, investment and financial inter-linkages created by the expanding transnational systems of production and distribution of MNEs in the region meant that member states were significantly affected by crisis-related problems occurring in others, such as the downsizing or withdrawal of inward FDI projects. This forms part of a wider regional agenda to more commonly manage economic security predicaments. Developing or improving FDI relations between Southeast Asian countries is an important element of that agenda, as was discussed here in relation to sub-regional economic integration projects like the IMGST and the GMS Programme.

In the crisis-aftermath, there has also been growing concern in the region over the economic security threats that inward FDI can pose. This is being particularly expressed by economic nationalists and the still small but fast growing 'anti-globalisation' civil society movement, who broadly equate global capitalism as a compromising agent in relation to indigenous development paradigms. While the

socio-economic and environmental impact of inward FDI can indeed be damaging, it has been argued in this chapter that both state and society in Southeast Asia must adopt a more discerning approach toward FDI. In this respect, governments from the region should improve various aspects of (developmental) state capacity, in order to more effectively partner FDI projects, in accordance with robust stakeholder principles, whereby representations from the wider FDI-affected community are duly involved. From this approach, the economic security implications of FDI may be better addressed.

Notes

1 These relate to actors that are responsible for the directing (political or quasi-political leadership) or managing (bureaucratic leadership) of FEP.
2 For Alting von Geusau and Pelkmans (1982), national economic security is at stake when external parameters change in such a manner as to cause a breakdown of the preferred socio-economic order, and that economic security is dependent upon the ability of governments to maintain and develop the preferred socio-economic system as its welfare goals.
3 See *Financial Times*, 19 July 2002.
4 See *Rethinking Recovery*, speech made by Prime Minister Thaksin Shinawatra at the Institute of Southeast Asian Studies, Singapore, 23 August 2001.
5 See *Japan and ASEAN in East Asia: A Sincere and Open Partnership*, speech made by Prime Minister Junichiro Koizumi, Singapore, 14 January 2002.
6 The full ASEAN–China FTA was signed a year later, in November 2002.
7 By March 2003, Singapore had: ‘operationalised’ bilateral FTAs with New Zealand and Japan; signed FTAs with Australia and the US; undertaken formalised negotiations for similar agreements with Canada and Mexico; agreed with Chile and New Zealand to create a trilateral FTA by 2004; and discussed proposals for other FTAs with South Korea, Taiwan and Hong Kong.
8 See *Straits Times*, 10 May 2002. However, by late 2002, Malaysia had initiated its own bilateral FTA policy, with the announcement of proposals for establishing FTAs with both Japan and the US.
9 These comprised the ASEAN Industrial Complementation (AIC), ASEAN Industrial Joint Ventures (AIJV), and ASEAN Industrial Projects (AIP) schemes, that were designed as exercises in FDI policy co-ordination to reduce the costs of competition between member states in attracting inward FDI, as well as fostering intra-regional FDI co-operation and linkages (Pangestu, 1990).

4 An examination of the impact of AFTA on Southeast Asian foreign direct investment

Amale Scally and Jayasinghe Wickramanayake

4.1 Introduction

The aim of this chapter is to examine the relationship between foreign direct investment (FDI) and regional integration in Southeast Asia. This examination is made in the context of the Association of Southeast Asian Nations (ASEAN), which has been moving rapidly towards a higher degree of integration since the inception of the ASEAN Free Trade Area (AFTA) in January 1993. More specifically, the focus is on the ASEAN-5 member countries – namely Indonesia, Malaysia, the Philippines, Singapore and Thailand – as adequate data is not readily available for the other ASEAN members.

AFTA was formulated in January 1992, at the Fourth ASEAN Summit in Singapore. It was declared that a free trade area would be established in fifteen years (by 2008), beginning in January 1993. This deadline has since been advanced to 2003. AFTA's implementation involves the phased reduction of tariffs on manufactured imports from ASEAN members through the Common Effective Preferential Tariff (CEPT) scheme. The implications of such an arrangement for trade and investment flows within ASEAN countries and between ASEAN and non-members are important. This is especially relevant if the proposition that FDI contributes to the economic growth of host countries is true (Athukorala and Menon, 1996). The implications for non-member countries are equally important, especially for neighbouring countries such as Australia and New Zealand. The focus of this chapter is, however, on the impact of AFTA on inbound FDI flows to ASEAN and its member countries. No examination is made of the impact of AFTA on intra-FDI flows (i.e. flows of FDI among ASEAN countries) nor on sectoral FDI flows (i.e. FDI flowing to different sectors of the economy).

In previous studies, it has been hypothesised that regional integration leads to increased FDI flows to the integrating region and to its member countries. This hypothesis was formulated in the context of European integration, the focus being on the trade creation and trade diversion effects of this regional arrangement. The concept of a 'Fortress Europe' was prominent in these studies, the argument being that *outsiders* (i.e. exporters to European countries) would benefit from investing within the European Community in order to become *insiders*. This would avoid outsiders being discriminated against from a trading perspective (Almor and Hirsch, 1995). Similarly, and despite ASEAN's open regionalism (Ariff, 1994),

the formation of a free trade area by ASEAN may be discriminatory towards outsiders and thus put them at a relative disadvantage *vis-à-vis* insiders. ASEAN countries may increase their share of each other's markets as a result of their trade preferences, and this could be detrimental to exporters from non-member countries servicing the ASEAN region and its member countries. Japan, the United States, Australia and China would be mostly affected if this proposition held true. This is not a current cause for concern, as the evidence points to the greater de facto integration of ASEAN with the rest of the world than with its own region (Amelung, 1992). The concerns, however, are real and should not be dismissed.

The central hypothesis, that net FDI flows to the integrating region increase after integration, has been tested by various researchers by looking for structural shifts in FDI flows before and after integration (Scaperlanda, 1967; Wallis, 1968; D'Arge, 1969; Schmitz, 1970). The results of this approach being inconclusive overall, researchers then proposed that FDI is determined by three main factors, which are all positively affected by regional integration (Scaperlanda and Mauer, 1969; Lunn, 1980, 1983; Scaperlanda and Balough, 1983; Balasubramanyam and Greenaway, 1993; Aristotelous and Fountas, 1996). These studies hypothesise that *market size, market growth* and *tariff discrimination* towards "outsiders" increase post-integration, and as these variables have been found to be important determinants of FDI (Leftwich, 1973; Culem, 1988), regional integration should thus lead to increased FDI inflows to the integrated region and its member countries. The major flaw of this approach, in our opinion, lies in its lack of direct assessment of the impact of regional integration on FDI flows to the integrating region and to its member countries. In other words, these studies have assumed that market size, market growth and tariff barriers increase due to regional integration, but they do not explicitly test whether they have.

More recent studies (Almor and Hirsch, 1995; Bellak, 1996; Oxelheim and Gartner, 1996) have adopted a more conceptual approach, examining the statistics on FDI available for the countries concerned, and comparing pre- and post-regional integration trends of FDI. These studies are not empirically rigorous, however, in that factors other than regional integration could explain the structural shift post-integration. Indeed, FDI flows are determined by various factors, and it would be very rare for FDI shifts to be explained by one factor alone, unless this was tested for rigorously.

Athukorala and Menon (1996) accurately point out that much has been written about ASEAN and AFTA, but that there has been a lack of attention given to the implications of AFTA for FDI in the region. They further state that this is a serious omission when one considers the role FDI has played in the region as one of the most important sources of economic growth. There is even greater urgency in investigating this issue due to the more recent plans of ASEAN to create an ASEAN Investment Area (AIA) which may be discriminatory towards non-members (Menon, 1998). The Asian crisis that plagued the region recently also adds to this sense of urgency, as the implications for growth and FDI still seem uncertain. To our knowledge, there has been no empirical investigation of the impact of the formation of AFTA on FDI flows to the ASEAN region and its constituent member

states. The only study examining this issue from a theoretical point of view is that of Athukorala and Menon (1996). This chapter aims to remedy the current lacuna.

The chapter is structured as follows: we have used various methods to test for the impact of AFTA on FDI in ASEAN, and a summary of the results is given in Section 4.2. Concluding comments along with suggestions for further research are given in Section 4.3.

4.2 Impact of AFTA on inbound FDI flows to ASEAN

Our discussion on the likely impact of AFTA on inbound FDI flows to the ASEAN region and its member countries is based on the results of empirical work, which was carried out to test the impact of the formation of AFTA on FDI flows to ASEAN and its member countries, for the period 1968–97. This period was chosen because data was available for our purposes. Various statistical methods were used to test this. A comparison of pre- and post-AFTA flows of FDI into the region as a whole, and into the ASEAN-5 members was first made. Testing for structural shifts in FDI flows was also undertaken. The focus was, however, on ascertaining the significance of market size, market growth and tariff discrimination as determinants of FDI flows to the region and to the ASEAN-5 countries. The impact of AFTA was also tested explicitly, using various techniques. As these tests were conducted for the period 1968–97, they thus exclude the impact of the Asian crisis.

4.2.1 Preliminary analysis

A starting point in our examination was to compare the changes in the absolute amounts of FDI before and after integration, as well as to test for differences in the means of these series. The latter tests involved a comparison of the mean of the FDI series prior to 1992 with the mean of the FDI series after 1992. Two sample periods, 1968–97 and 1986–97, were selected. The latter period was chosen as it was a smaller period with an equal number of years before and after the creation of AFTA, that is 1986–91 and 1992–97. This may be a more accurate approach for testing whether a shift occurred in FDI flows due to AFTA. The longer period, 1968–97, may contain other shifts which could distort our results. The results from our tests for differences are discussed briefly here. The statistical tables (Tables 4.A1–4.A6) relating to this section are provided in the Appendix of this chapter.

In nominal terms, FDI flows to ASEAN have increased more than six-fold in the post-1992 period, from an annual average of US$557 million in the period 1968–91 to an average of US$3,612 million in the period 1992–97 (Figure 4.1). The increase is still evident when a shorter time period is selected prior to integration, as the average FDI flows for the 1986–91 period was US$1,362 million. This increase was experienced by all the ASEAN-5 members. Tests for differences in the means reveal that FDI flows prior to the creation of AFTA (1992) are significantly different from those prevailing after AFTA. This suggests

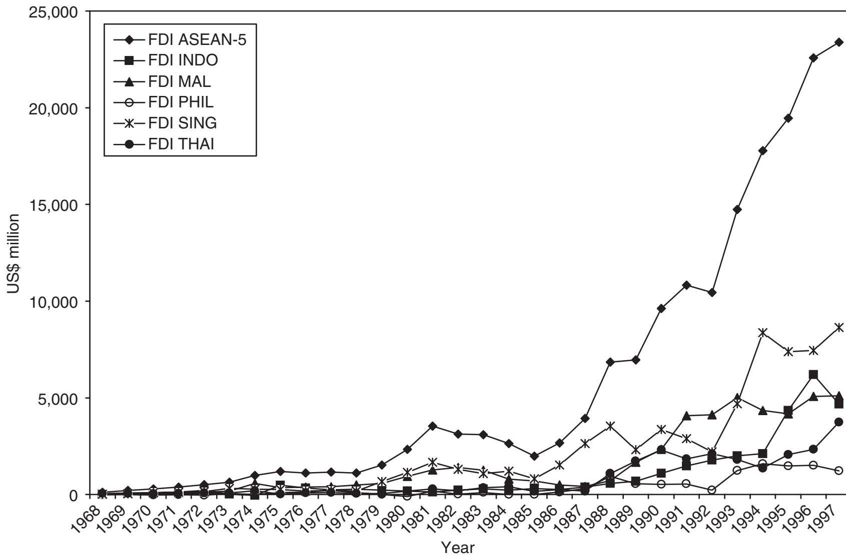

Figure 4.1 Nominal FDI flows to ASEAN-5 member countries, 1968–98.

that the announcement of the creation of AFTA may have had a substantial impact on FDI flows to the region and to the ASEAN-5 countries, and that this impact has been as positive as might have been expected.

A better perspective is gained by using real values of FDI (Figure 4.2) rather than nominal values. Real values were obtained by deflating the nominal values above by the GDP deflator of the respective countries. Results obtained using real values are consistent with those obtained with nominal values. In other words, increases in FDI flows were experienced by the region and the ASEAN-5 countries after AFTA was implemented. Tests for differences in the means of the FDI series suggest once again that the differences are significant. It must be noted however that in the case of the Philippines and Thailand, these differences are not significant over the shorter sample period (1986–97). This would suggest that the shift in the FDI flows of these two countries would have occurred prior to AFTA, and that the impact from AFTA had yet to be felt.

When FDI as a proportion of GDP is used, the increase is evident across the board, but the differences in the means of the series are not as overwhelmingly significant. Indeed, the differences are found to be significant for the longer time period (1968–97), but not over the smaller time period, except for Indonesia. This would again suggest that the explanation for these differences might not be found in the specific creation of AFTA, but in that of ASEAN in general. Similar results are generated when FDI as a proportion of gross domestic capital formation (GDCF) is used. In this latter case, the differences in the means over the longer time period are even less significant overall.

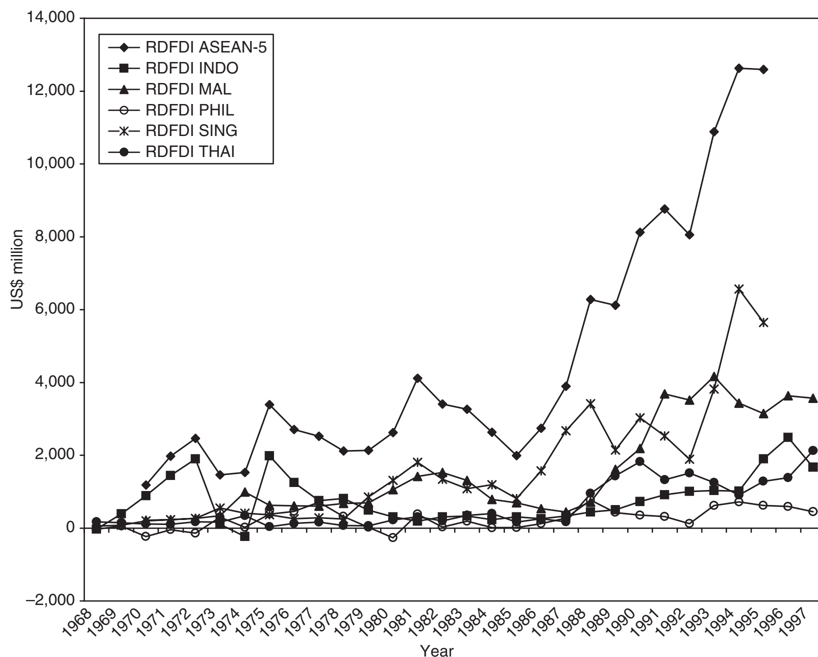

Figure 4.2 Real FDI flows to ASEAN-5 member countries, 1968–98.

FDI per capita (Figure 4.3) has also increased for the region and the ASEAN-5 countries, and the means are significantly different over the longer and shorter time periods. When real FDI per capita is examined, however, the significant differences no longer apply in the case of the Philippines and Thailand (Figure 4.4). It should be noted that none of the ASEAN countries achieved China's growth rate in FDI inflows (except for Vietnam, which started from very low levels of FDI inflows). Indeed, absolute amounts of FDI flows to China have increased from an annual average of US$3,105 million in 1986–91 to US$32,401 million in 1992–97, representing a nominal growth of over 943 per cent.

The results of this preliminary approach thus provide mixed results, depending on how FDI is measured. These results suggest however that AFTA has had a positive impact on inbound FDI flows to the ASEAN-5 countries examined here.

A cross-country comparison was also conducted, by examining whether the share of FDI flowing to ASEAN and to the ASEAN-5 member countries, relative to other regions/countries, had increased following the signing of the CEPT in 1992. We differentiated between non-integrated regions (i.e. regions that are characterised by de facto integration) and integrated regions (i.e. those that are characterised by de jure integration). De facto integration represents increasing economic interdependence among countries. That is, de facto integration is

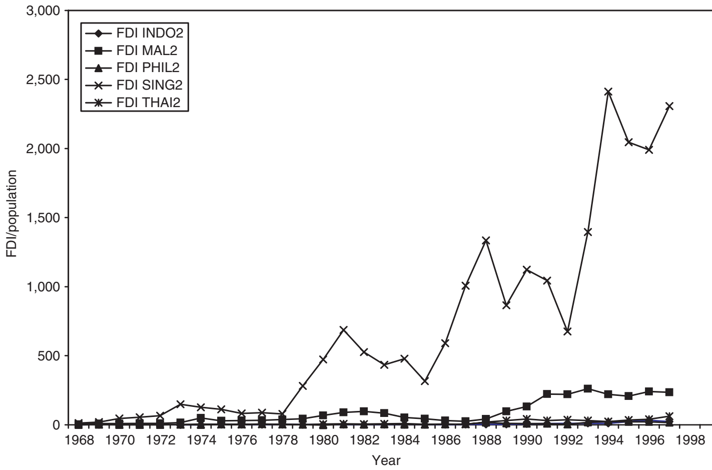

Figure 4.3 FDI flows per capita for ASEAN-5 countries, 1968–98.

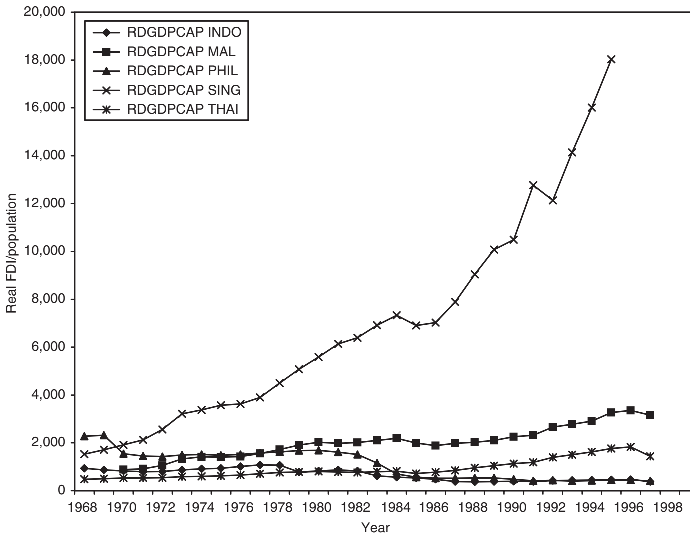

Figure 4.4 Real FDI flows per capita for ASEAN-5 countries, 1968–98.

dependent on market forces, while de jure is determined by political and institutional factors. De facto integration can be thought of as 'market-led' while de jure can be thought of as 'policy-led' (Narula, 1996). The sample period was 1986–97. Data was not available from 1968 to use the longer time period.[1]

It was found that when comparing FDI flows in ASEAN as a proportion of world FDI flows, the increase was not as spectacular as when absolute amounts

were compared. In fact, FDI flows into ASEAN amounted to 6.2 per cent of world FDI in the period 1986–91 and increased slightly to 6.6 per cent in the period 1992–97. As a proportion of FDI flows into the US, FDI flows into ASEAN had experienced a slight increase from 2.65 to 3.35 per cent. FDI inflows into ASEAN relative to FDI inflows into the NAFTA region represented 21.8 per cent in the 1985–91 period, and 26.5 per cent after 1992, showing small signs of 'favouritism' towards ASEAN in this instance. Compared to China, however, a remarkable decrease was evident, as FDI flows into ASEAN, relative to FDI flows into China, decreased from 269.4 per cent to 57 per cent, over the same periods. This was reinforced by the finding that inflows of FDI in ASEAN relative to inflows of FDI in the "three Chinas" (Hong Kong, Taiwan and the People's Republic of China) had decreased from 167.3 per cent to 31.51 per cent. Thus, the attractiveness of the Chinese region to FDI since 1992 is clearly evident.

Latin America as a region also proved increasingly attractive, with FDI in ASEAN decreasing relative to FDI in Latin America over the 1986–97 period. In fact, the decrease had been from 179 per cent in 1986–91 to 126 per cent in 1992–97. The numbers indicate, however, that ASEAN is still favoured to Latin America by foreign direct investors. If Mercosur is considered (Mercosur is the regional trade agreement between Argentina, Brazil, Uruguay and Paraguay), inflows of FDI into ASEAN represented 318.4 per cent of those to Mercosur in the pre-1992 period, while post-1992 this ratio decreased to 250.7 per cent. Again, the balance still tilts in ASEAN's favour, although this may change, when one considers recent developments in Argentina for instance. ASEAN inward FDI represented 14.4 per cent of EU inward FDI in the 1986–91 period, increasing slightly to 19.3 per cent post-1992; despite the creation of the European Union in 1992. It is believed that the reaction by foreign investors to regional integration in Europe had already occurred by 1992. It is thus no surprise to find that the creation of the European Union in 1992 did not overly tip the balance of FDI towards Europe post-1992.

4.2.2 Testing for structural shifts in FDI

As mentioned earlier, testing for structural shifts in FDI flows after 1992 was also conducted. The sample period was 1968–97. As a preliminary indication, the tests suggested that shifts occurred in FDI flowing to the region and the ASEAN-5 countries. These shifts, however, appear to have occurred well before AFTA was created. For this reason, the regressions were run for a shorter sample period, namely 1986–97, and this time they revealed no structural shift post-AFTA. The exception was the Philippines, where a structural shift seems to have occurred after 1993. This was the case when nominal values of FDI were used; it was no longer the case when real values were considered. In fact, when the regressions were run with real values, structural shifts appeared for Malaysia (after 1991) and Singapore (after 1993). It is interesting to note that these are the two members that probably stand to benefit most from AFTA. The reader is referred to the statistical tables (see Tables 4.A7 and 4.A8) provided in Appendix of this chapter.

4.2.3 Testing for the impact of AFTA on FDI

Theoretical considerations

Athukorala and Menon (1996) examined the possible impact of regional integration on the investment location decisions of multinational firms, and argued that the impact will vary depending on the differences in the motives underlying the investment decisions of these multinationals. They distinguished between market-seeking investments and efficiency-seeking investments. Market-seeking investments are investments aiming to supply host and other markets in the region, while efficiency-seeking investments are driven by the desire to gain competitive advantages over those provided by the home economy. For the purpose of analysing the effect of regional integration on FDI flows, market-seeking investments were further divided into two categories: those of the tariff-jumping kind, that is investments triggered purely by tariff preferences, and those motivated by the market enlargement effect of regional integration.

Theoretically, the formation of a free trade area can impact on investment decisions of the tariff-jumping kind, through creating a perceived threat of protection for extra-regional trade. This has also been labelled the *tariff discrimination hypothesis* (Scaperlanda and Mauer, 1969; Lunn, 1980; Scaperlanda and Balough, 1983, *inter alia*). As was mentioned earlier, previous studies on the relationship between regional integration and FDI flows to the European Economic Community (EEC) were made on the grounds that the fear of a Fortress Europe would motivate outsiders to become insiders. Later, Balasubramanyam and Greenaway (1993) found that one of the most important motives behind the increase in East Asian FDI flows to the EEC since the late eighties was the concern that the single European market would be protectionist and affect trade with non-member countries. Similarly, Oxelheim and Gärtner (1996) argued that alternative explanations to increased FDI flows to the European Union may be seen as being inferior to the fear of Fortress Europe as the triggering factor. The argument of these studies was that the establishment of a common external tariff by the EEC would lead to greater flows of FDI to the region. This has been hypothesised and tested by many scholars with mixed results (Balassa, 1961; Hinshaw, 1964; *inter alia*).

As Scaperlanda and Mauer (1969) note, however, it is difficult to assess empirically the impact of tariff discrimination on FDI flows, due to the unavailability of data or differences in the reporting of tariff data. Direct estimates of Non-Tariff Barriers (NTBs) are not available either (Aristotelous and Fountas, 1996). For this reason, Scaperlanda and Mauer used a proxy, assuming that increased effective discrimination will decrease imports from suppliers outside the region, while simultaneously increasing intra-regional imports. As trade and FDI flows are considered substitutes, at least for trade in secondary products, this means that FDI flows from suppliers outside the region should increase. Although this and similar proxies have their limitations, this approach was adopted here, due to a lack of data on tariffs suitable for our purposes. (The reader is referred to Table 4.A9 in the Appendix for a list of variables that were used in our modelling.)

The prospect of a Fortress AFTA is remote, however. Indeed, ASEAN is integrating by establishing a free trade area, where typically each country retains its own tariffs against the rest of the world. This differs from the practice adopted when a customs union is established, in which a common external tariff is adopted (Robson, 1980). It is essentially with this latter practice that the concept of a fortress has been prominent. We would thus expect tariff discrimination to be less relevant in the case of AFTA. Almor and Hirsch (1995) contend that even without the prospect of protectionism and tariff discrimination, outsiders may be put at a relative disadvantage compared to insiders, for cost reasons rather than for tariff reasons. Non-members will thus benefit from becoming insiders, through FDI. This argument is particularly relevant to ASEAN, which is characterised by open regionalism. Almor and Hirsch's argument would be more appropriate in this instance: outsiders to a regional integration arrangement are put at a disadvantage, for cost considerations rather than for tariff reasons.

The *market size hypothesis* states that the removal of tariff barriers on intra-regional trade leads to an increase in the size of the domestic market, with domestic here encompassing all member countries of the integrated region. This hypothesis has been otherwise labelled as the market enlargement hypothesis (Athukorala and Menon, 1996) and it is argued that this increase in market size would allow firms to take advantage of economies of scale, especially if the member countries have similar income levels and similar demand structures. According to Scaperlanda and Mauer (1969), the market size hypothesis is based on the assumption that an inadequate market size has retarded the specialisation of productive factors. The argument then is that foreign investment will occur as soon as the market is large enough to allow gains from economies of scale (Balassa, 1967; Bandera and White, 1968; Krause, 1968). Empirical studies have used the Gross National Product (GNP) of the host country or host region as a proxy for market size. Alternatively, Gross Domestic Product (GDP) or GDP per capita have also been used (Balasubramanyam and Greenaway, 1993).

A third hypothesis has been tested by researchers, and that is the *market growth hypothesis*. It is based on the relation between the level of aggregate demand and the stock of capital (total investment) needed to satisfy this demand (Scaperlanda and Mauer, 1969). Theoretically, the relationship is between the percentage rate of growth of GNP or GDP and foreign investment (in nominal terms). An alternative proxy for market growth that has been widely used is the absolute change in GNP or GDP. The rationale for including market growth in a model of FDI is that it is thought to capture fluctuations in output of the countries of a particular region (UNCTAD, 1993a). It is hypothesised that market growth and FDI are positively related, as a region or country experiencing a stable or accelerating growth of output is likely to be more attractive to investing companies than one experiencing wide fluctuations in growth of output (UNCTAD, 1993a).

The studies previously reviewed, the majority of which were carried out in the late sixties and early seventies, found mixed results. Indeed, their results appear to be dependent on model specifications. None of the three explanatory variables (market size, market growth and tariff discrimination) advanced by theory as

important determinants of FDI flows seemed to be consistently supported by empirical evidence. That said, the support for market size was greatest. The support for the inclusion of a growth variable has been inconsistent to date. For this reason, a United Nation's study published in 1992 concluded that foreign direct investment flows seem to be very strongly related to the level of GNP and its underlying growth, but that no clear link to short-term changes in rates of GNP growth can be found (UNCTC, 1992). The empirical evidence pointing to a structural shift in FDI flows to the EEC post-integration was also inconclusive.

It should also be noted that none of these studies specifically tested for the impact of regional integration. They were all based on the assumption that market size, market growth and tariff discrimination were determinants of FDI induced by regional integration. We contend that the impact of regional integration on FDI flows should be tested directly, as market size, market growth and tariff discrimination have been found to explain FDI even in the absence of regional integration. For this reason, we include a proxy for regional integration in our modelling.

Model and results

An Unrestricted Error Correction Model (UECM) was used to assess the impact of the signing of the CEPT on inbound FDI flows to ASEAN and its ASEAN-5 member countries. The reader is referred to Mehra (1991), Hendry and Ericsson (1991) and Banerjee *et al.* (1998) for explanations of Error Correction modelling. In practice, re-specifying our initial model into an UECM involved estimating regressions including both the levels of the variables (representing their long-run relationship) and the first differences of the variables (representing the short-run dynamics). This is the approach proposed by Banerjee *et al.* (1986, 1998).

Our model tested for the significance of AFTA explicitly, as well as for the significance of market growth, market size and tariff discrimination. These variables were selected initially to be consistent with previous studies. Additional variables were then included in this model. Various proxies for market size, market growth and tariff discrimination were used, as shown in Table 4.A9 in the Appendix. The model was estimated for the ASEAN-5 countries, using nominal values, real values and log-real values. Regional integration was proxied through the use of dummy variables, namely AFTA92 or AFTA93, the former to proxy for the *announcement impact* of AFTA, while the latter was used as a proxy for the *creation impact* of AFTA on FDI flows.

Selected results are provided in the Appendix (Tables 4.A10–4.A18). Support for market size as a determinant of FDI was found consistently for the Philippines, Singapore and Thailand, with the expected positive sign. Below average support was found, however, for Malaysia, and very low support for Indonesia. Support for market growth was consistent for Malaysia, the Philippines and Thailand, while surprisingly the support for Singapore was below average, and that for Indonesia was negligible. The sign was positive as expected. Tariff discrimination was consistently significant and negative in the Indonesian models, contrary to theory, which states that tariff discrimination should lead to increased FDI flows as

outsiders use FDI to become insiders. In this case, tariff discrimination seems to be acting as a deterrent, suggesting that investors value the openness of countries. Tariff discrimination was found to be insignificant for the other countries, however, as expected. Mixed results were obtained on the significance of regional integration as a determinant of FDI; it was mostly found to be an insignificant factor, however. When some support was found for its significance, it seemed to be a positive determinant for Indonesia and Singapore, and negative for Malaysia, the latter being a puzzling result.

It was found that in most cases the regressions only explained approximately half of the changes in FDI. The models had a higher explanatory power for Singapore, however, and to a lesser extent Thailand. For this reason, it was deemed that additional variables should be included in the model. These variables were selected by reviewing the existing theoretical and empirical literature. The inclusion of additional variables was also supported by a survey of multinationals with ASEAN operations which was conducted as part of this research (Scally, 1999). Although the aim of the overall research project was to examine the impact of AFTA on FDI inflows to ASEAN at a macroeconomic level (time-series analyses), it was deemed that microeconomic considerations were too important to be excluded from such an analysis. Furthermore, results from a survey at the firm level helped in determining which variables should be included as determinants of FDI in a macroeconomic model of FDI. Despite their limitations (Forsyth, 1972; Dunning, 1973; UNCTC, 1992), surveys provide valuable information which cannot be uncovered in macroeconomic studies.

As Dunning's eclectic paradigm (Dunning, 1977, 1998) is seen as providing the most satisfactory framework to study FDI to date, it helped in determining which variables should be added to our models. Dunning (1977) proposes that the multinational enterprise (MNE) is an economic organisation which possesses certain advantages (ownership advantages) *vis-à-vis* its competitors and chooses to use these assets itself; that is to internalise them in a foreign location, rather than to licence the rights of production to foreign firms. This gives rise to the existence of two additional advantages, namely internalisation and locational advantages. For this reason, the eclectic paradigm is also referred to as the OLI paradigm. According to Dunning (1998: 45), the OLI triad of variables (ownership, location and internalisation) determining foreign investment and MNE activity 'may be likened to a three-legged stool; each leg is supportive of each other, and the stool is only functional if the three legs are evenly balanced'. If Dunning's proposition is accepted, then we need to include ownership variables in FDI modelling, as so far our model has only included locational variables in the form of host country market size and market growth, as well as an internalisation variable in the form of the tariff discrimination proxy. This is done by including home country market size variables, as has been done in previous studies (Huang, 1997; Andersen and Hainaut, 1998; *inter alia*), for lack of a better macroeconomic proxy. The ASEAN-5 countries examined here are dependent mostly on Japan and the US for FDI inflows. For this reason, we included the GDP of the US and that of Japan in our previous models.

The reader is referred to Tables 4.A17 and 4.A18 in the Appendix for the results relating to these additonal tests. Size was again found to be a significant and positive determinant of FDI in Singapore, but a negative one for Malaysia and Thailand. Growth was also found to be significantly negative for Malaysia and Thailand, while it was significant and positive for the Philippines. As for tariff discrimination, it was found to be significant for all countries except Indonesia. The signs in the estimating models were conflicting, however; tariff discrimination negatively affected FDI in Malaysia and Singapore, while it positively affected FDI in the Philippines and Thailand. Regional integration was found to be significant and negative for Malaysia and the Philippines, while it was positive for Thailand. Further, it was found that the market size of the US affected FDI positively in Indonesia, Malaysia and Thailand, while the market size of Japan affected FDI negatively in Indonesia, and positively in Malaysia. In sum, we obtained substantially different results when including proxies for ownership variables.

For comparison, panel data analysis was also used to test for the significance of these variables (see Tables 4.A19 and 4.A20 in the Appendix). One of the advantages of using panel data is that the number of observations is increased. In our case, an additional advantage is that this type of analysis amounts to examining the determinants of FDI in ASEAN as a region. Results revealed host market growth, tariff discrimination and Japanese market size to significantly and positively affect FDI. Regional integration was found to be insignificant in this case. Results from the panel data analysis seem to make more sense than those related previously, as signs are consistent with theory.

Summary of findings

In summary, we have found that the support for AFTA as a significant factor in attracting FDI flows to the integrating region and its member countries was poor and inconsistent. This confirmed our early predictions that ASEAN’s integration is vastly different from that of the European Community, and for this reason has not triggered the outsiders’ response that the European Community (European Union now) did. Rather, the opportunities to attract FDI still lie within the general framework of the determinants of FDI. Regional integration would act as a catalyst only through its positive impacts on market size and market growth. Results of the various tests conducted indicated that regardless of the methodology and regardless of the various proxies used for market size and market growth, there was support for the market size and market growth hypotheses. As expected, tariff discrimination found very minimal support. All these results are consistent with the findings of previous empirical studies, as reviewed by the UNCTC (1992) or Dunning (1993). These results also concur with findings from a survey of foreign multinationals in ASEAN (Scally, 1999). The survey revealed that overall market-seeking motives were most important, and among these the *needs for a local presence in an expanding regional market* were prominent. Motives associated with regional integration were also important. Indeed, *host markets’ growth potential* as well as *market size* were considered important. As for the host

country being a member of ASEAN, results were inconclusive, with respondents being divided on its importance.

When OLI determinants of FDI in ASEAN were examined in the survey, it was revealed that intangible ownership advantages (i.e. created advantages) such as support from the parent company, marketing and managerial skills, a long established presence and a regional presence were predominant. This may explain the incongruities in our model using home countries' GDP as a proxy for ownership variables. The most important internalisation incentive was that of becoming an insider in an integrated region, which lent support to the hypothesis that regional integration is an important determinant in the decision to invest. As for the locational advantages of ASEAN, only a couple were revealed to be important: geographical proximity to important markets and economic stability. Among potential locational disadvantages, the lack of transparency, a small local market, economic instability and the level of competition were all perceived to be important. Once again, there was some evidence of the importance of regional integration in determining FDI. This support for regional integration as being an important factor for FDI did not suggest, however, that the creation of AFTA would lead to greater FDI in the member countries of ASEAN. It would seem that references to the importance of regional integration were made in the context of ASEAN in general.

4.3 Concluding comments

The survey results suggest that it might be too early to assess the impact of AFTA, and that further research be made on this topic when AFTA is fully operational, after 2003. A survey of current exporters to the region should also be conducted, in order to assess the likelihood of these exporters becoming insiders through FDI in ASEAN, due to its greater integration through AFTA. The date of the establishment of AFTA was advanced from 2008 to 2003, due to the initial success in implementing the CEPT. It is unlikely, however, that 2003 will see a surge in FDI activity in ASEAN, especially inward FDI, since AFTA seems to have not had the impact the EU has had on inward FDI flows. There is no mention of a 'Fortress ASEAN', for instance, nor is 2003 sounding alarm bells to outsiders in Asia, as 1992 did to those afraid of being excluded from Europe. The Asian crisis may also have worked against AFTA, at least in the short term.

On the basis of this chapter's findings, it would seem that AFTA will only be successful in attracting FDI if it proves to be a catalyst for increased market size and greater market growth. Member countries should therefore make a greater effort in terms of coordinating their approaches towards economic, financial and political management, to try and ensure that these factors do not undermine what AFTA aims to achieve. It is important that these member countries understand that interdependence means a partnership in sickness and in health; this was demonstrated during the Asian financial crisis.

Recall that the market size hypothesis is based on the assumption that an inadequate market size has retarded the specialisation of productive factors. Once barriers to intra-regional trade have been reduced, market size should increase,

allowing firms to take advantage of economies of scale, especially if the member countries have similar income levels and similar demand structures. Foreign investment should occur as soon as the market is large enough to allow gains from economies of scale. Our results suggest that this is happening in the Philippines, Singapore and Thailand. Surprisingly, the results for Malaysia are not convincing, but we suspect that the Malaysian model may be mis-specified and it is currently being revised. The results for Indonesia, however, suggest that this member country would benefit from greater integration and further reductions in trade barriers, in order to allow investing firms to enjoy economies of scale in that country as well. It should not be forgotten that although these five countries belong to the same Free Trade Area, they are still dissimilar in many ways.

Our results in support of the market growth hypothesis are consistent with theory, although the results for Singapore are puzzling. Indeed, recall that it is hypothesised that market growth and FDI are positively related, as a region or country experiencing a stable or accelerating growth of output is likely to be more attractive to investing companies than one experiencing wide fluctuations in growth of output (UNCTAD, 1993a). Our results confirm this for Malaysia, the Philippines and Thailand and once again reveal that Indonesia has some catching up to do if it is to benefit from integration with its partners. The relationship between FDI and market growth was not found to be as strong in Singapore though. As mentioned earlier in this chapter, the support for the inclusion of a growth variable has been inconsistent to date, with FDI flows apparently being very strongly related to the level of GNP and its underlying growth, but with no clear link to short-term changes in rates of GNP growth being found. This may explain the results for Singapore.

Tariff discrimination has been found to be negligible in attracting FDI to the five ASEAN countries examined here. This was as expected. Additional testing has actually revealed that FDI is strongly related to the openness of these ASEAN countries. This is a factor which AFTA can further improve by reducing remaining barriers to trade and investment, both inside the region and outside it.

This chapter has also highlighted the lack of broad awareness about AFTA outside the Australasian region. This is an issue ASEAN should address if it wants to achieve one of its aims in creating AFTA – to attract increased FDI flows. It is important for AFTA to publicise its aims and achievements to date, and to highlight the benefits of its Free Trade Area. This should initially be directed to established multinationals in ASEAN, as greater awareness of AFTA may lead these investors to restructure their operations to take better advantage of opportunities provided by regional integration. This would in effect increase FDI of the efficiency-seeking type. ASEAN countries would benefit greatly from this restructuring. Publicity should then be extended outside ASEAN, in order to attract potential new investors.

In order to attract further FDI inflows, ASEAN should also review its proposed AIA plans, so as not to discriminate against foreign investors, as this would counteract AFTA's chances of attracting greater FDI flows. ASEAN leaders agreed to found an AIA at the Bangkok Summit Declaration in 1995 in order to promote ASEAN as a single investment region (Menon, 1998). This could potentially be a greater drawcard to foreign investors than AFTA has been. This will only be possible, however, if AFTA does not pursue its initial plan of granting preferential

treatment to ASEAN investors in member countries. Two options were considered: one requiring a firm to have a minimum cumulative ASEAN ownership share of 30 per cent; the other requiring a firm to have minimum 51 per cent ASEAN ownership (Menon, 1998). There was a proposal to provide this preferential treatment from 2003 in order to increase intra-ASEAN investment following the regional financial crisis. From 2020, it is intended for the preferential access to ASEAN members to be eliminated, after which the AIA would operate on a non-discriminatory basis. It is feared that the plan as it stands may discourage foreign investment, which the region needs to continue its recovery from the crisis. Indeed, as the crisis demonstrated, foreign investment is much less volatile than portfolio investment; this is especially crucial in times of uncertainty, where flight of foreign capital can aggravate the economic situation.

Our tests have tentatively indicated that Singapore and Malaysia stand to gain the most from AFTA. This is what has happened in Europe until recently, with leading countries benefiting the most from integration. This is again an issue which needs to be addressed, as AFTA's success depends on the benefits of AFTA flowing to all member countries, rather than to the leading ASEAN countries. Note that the focus of this study has been on market-seeking investments. There is a huge potential for the relocation of existing FDI activities, as well as for new FDI to be distributed across ASEAN, on the basis of the comparative advantage of each member country. Indeed, up until now, there has been some duplication of FDI activity, as investors have not viewed ASEAN as an integrated entity. This would allow each member to exploit its niche markets, and may result in a more equitable distribution of FDI.

Since AFTA on its own may not be successful in attracting additional FDI inflows, there may be some benefits in developing linkages with other regions. For instance, the linkage between the CER (Closer Economic Relations), involving Australia and New Zealand, and AFTA could be developed further, since Australia has fared relatively well economically, despite recent regional and global crises. This may offset some of the negative impacts incurred by Australian and New Zealand exporters due to the discriminatory trade barriers created by AFTA. This may also increase the awareness of AFTA outside the region, and it may benefit both the CER and AFTA in attracting greater FDI inflows. In practice, however, such a linkage will probably take time due to the differences among these two regions. A linkage between the CER and North American Free Trade Agreement (NAFTA) seems more probable at this stage.

Another possibility for AFTA is to consider a linkage with China. This project was proposed a few years ago, and has its merits.[2] If AFTA and China form a Free Trade Area, it would be the world's biggest. AFTA may benefit from such a linkage in many ways: market size and market growth would be increased thus attracting greater FDI; competition with China for foreign investment would not have negative impacts in the sense that even if FDI flows to China first, AFTA would ultimately share in the benefits of this increased FDI; and awareness about AFTA would increase as investors' interest in China has been growing in the past decade.

In addition, and as noted by many researchers (Arndt, 1996; Menon, 1998), ASEAN should extend its scope, and not limit its focus on reducing tariffs. It should be looking at moving to higher levels of integration faster, in order to

provide the image of a truly integrated region to outsiders. Of course, this image should be supported by the reality of integration at various levels, if trade and investment are to flow easily within the region. This does not have to mean a unified ASEAN, following the European example. Rather, it should involve working in cooperation to decrease barriers to trade and investment, especially hidden ones. Great care must be taken in avoiding or reducing internal tensions. Sub-regional arrangements among members of AFTA may be seen as a platform towards greater integration, but may be counter-effective in the sense that duplication may occur. They may also provide the image of a fragmented AFTA, rather than a unified one.

Finally, it would seem that although one of AFTA's aims is to increase FDI flows to the region, this has not happened as yet. Foreign direct investment to ASEAN can be explained by other determinants such as the market size and growth of the member countries, their openness, the economic climate in investing countries *inter alia*. Regional integration as a significant determinant of FDI does not find support as yet. It is thus strongly recommended that member countries continue working on improving their economic, political and social climate if further FDI is to be attracted.

Appendix

Tables 4.A1–4.A6: Tests for differences in the means of FDI series pre- and post-AFTA92

Table 4.A1

Country	*FDI-real value (US$ million)*				
	Mean pre-AFTA		*Mean post-AFTA*	*T-test*	
	(1968–91)	*(1986–91)*	*(1992–97)*	*(1968–97)*	*(1986–97)*
Indonesia	608.36	528.33	1,518.62	3.50[b]	3.68[a]
Malaysia	964.14	1,527.06	3,576.38	7.82[a]	3.85[a]
Philippines	185.02	376.68	521.06	2.84[a]	1.16
Singapore	1,112.72	2,559.41	4,478.34	5.28[a]	2.18[c]
Thailand	387.38	993.32	1,411.4	4.78[a]	1.31
ASEAN	3,257.62	5,984.81	11,505.8	6.71[a]	3.45[a]

Table 4.A2

Country	*FDI-nominal value (US$ million)*				
	Mean pre-AFTA		*Mean post-AFTA*	*T-test*	
	(1968–97)	*(1986–97)*	*(1968–91)*	*(1986–91)*	*(1992–97)*
Indonesia	325.96	746	3,517.17	8.43[a]	3.62[a]
Malaysia	809.33	1,617.33	4,638	10.00[a]	4.95[a]
Philippines	156.75	501.17	1,212.33	7.44[a]	3.03[b]
Singapore	1,083.42	2,710.83	6,453.17	8.04[a]	3.51[a]
Thailand	408.71	1,233.33	2,238.67	5.94[a]	2.06[c]
ASEAN	556.83	1,361.73	3,611.87	9.91[a]	4.73[a]

Table 4.A3

Country	FDI1 = (FDI/GDP)×100				
	Mean pre-AFTA		Mean post-AFTA	T-test	
	(1968–91)	(1986–91)	(1992–97)	(1968–97)	(1986–97)
Indonesia	0.61	0.75	1.8	4.76[a]	3.52[a]
Malaysia	3.4	3.9	5.9	3.44[a]	1.63
Philippines	0.44	1.22	1.75	4.26[a]	1.22
Singapore	6.69	10.09	8.38	1.15	1.15
Thailand	0.91	1.7	1.5	2.02[c]	0.31
ASEAN	12.05	17.66	19.33	4.26[a]	1.22

Table 4.A4

Country	FDICAP = (FDI/POP) million USD per capita				
	Mean pre-AFTA		Mean post-AFTA	T-test	
	(1968–91)	(1986–91)	(1992–97)	(1968–97)	(1986–97)
Indonesia	2.01	4.14	18.09	8.49[a]	3.68[a]
Malaysia	52.55	91.34	230.70	8.59[a]	4.34[a]
Philippines	2.77	8.37	17.33	6.57[a]	2.59[b]
Singapore	416.31	994.15	1,804.39	6.63[a]	2.82[b]
Thailand	7.68	21.93	37.8	5.72[a]	1.94[c]
ASEAN	481.33	1119.93	2,108.31	7.19[a]	3.32[a]

Table 4.A5

Country	FDI3 = (FDI/GDCF) × 100				
	Mean pre-AFTA		Mean post-AFTA	T-test	
	(1968–91)	(1986–91)	(1992–97)	(1968–97)	(1986–97)
Indonesia	2.8	2.2	5.7	2.29[b]	3.69[a]
Malaysia	12	13	15	1.19	0.65
Philippines	2.18	6.61	7.5	3.41[a]	0.45
Singapore	18	28	24	1.51	0.87
Thailand	3.3	5.5	3.9	0.67	1.05
ASEAN	7.65	11.06	11.22	3.52[a]	0.36

Table 4.A6

Country	RFDICAP = (RFDI/POP) US$ million per capita				
	Mean pre-AFTA		Mean post-AFTA	T-test	
	(1968–91)	(1986–91)	(1992–97)	(1968–97)	(1986-97)
Indonesia	4.32	2.95	7.84	1.84[c]	3.69[a]
Malaysia	64.6	86.41	178.57	6.29[a]	3.18[a]
Philippines	3.56	6.32	7.47	1.64	0.59
Singapore	432.73	940.61	1399.55	5.48[a]	2.14[c]
Thailand	7.61	17.71	23.87	4.45[a]	1.12
ASEAN	549.89	1053.99	1617.31	5.77[a]	2.63[b]

Notes
a Denotes significance at 10%.
b Denotes significance at 5%.
c Denotes significance at 1%.

Tables 4.A7 and 4.A8: Testing for structural shifts in FDI (selected results)

Table 4.A7 Testing for structural shifts in FDI, using nominal values, including lagged dependent variable

FDI_t	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*	*ASEAN*
GDP_{t-1}	0.004997(1.47)	0.015084(1.37)	0.008689(1.35)	0.070126(3.69)[a]	0.008015(2.65)[b]	0.0019 (1.47)
GR_t	0.034305(3.17)[a]	0.026036(0.85)	0.032391(1.52)	0.150236(2.89)[a]	−0.01337(−1.91)[c]	0.0153 (2.03)[b]
TD_t	−0.140732(−0.007)	−4.968551(−0.16)	11.38797(0.44)	8.779361(0.24)	−6.234301(−0.38)	14.036 (1.82)[c]
FDI_{t-1}	0.804081(5.71)[a]	0.778832(4.77)[a]	0.429236(1.97)[c]	0.124906(0.62)	0.737002(4.23)[a]	0.969 (23.44)[a]
c	−312.7165(−0.99)	58.21217(0.10)	−227.9638(−1.39)	−316.6136(−0.43)	16.04335(0.11)	−147.94 (−1.19)
R^2-adjusted	0.89	0.92	0.72	0.93	0.89	0.89
DW	1.6	1.62	2.11	1.84	1.63	1.90
JB	3.66	23.63[a]	7.67[b]	6.05[c]	3.94	
LM2	6.18[a]	9.39[a]	0.11	2.05	9.02[a]	
ARCH-LM(1)	18.76[a]	0.0056	3.96[c]	0.32	5.87[b]	
HET	29.18[a]	1.15	3.98[a]	2.15[c]	1.69	
RESET	14.48[a]	5.40[b]	0.67	0.043	0.35	
ADF	−5.49(1)[a]	−2.40(1)[b]	−3.29(1)[b]	−4.91(1)[a]	−2.48(1)[b]	
CHOW	2.40[c] (1980)	2.58[b] (1988)	2.33[c] (1986)	8.51[a] (1991)	2.89[b] (1982)	
	31.95[a] (1992)	3.62[b] (1992)	6.35[a] (1992)	8.25[a] (1992)	4.48[a] (1992)	

Notes

a Denotes significance at 10%.

b Denotes significance at 5%.

c Denotes significance at 1%.

Note that the inclusion of the dummy variable AFTA92 is an alternative to using the Chow test to assess whether structural shifts have occurred post-AFTA in the FDI series of member countries of AFTA.

Table 4.A8 Testing for structural shifts in FDI, using real values, including lagged dependent variable and AFTA92

$RFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*
$RGDP_{t-1}$	0.002514(0.47)	0.028612(1.85)[c]	−0.002818(−0.87)	0.067826(2.05)[c]	0.017646(2.38)[b]
RGR_t	0.001315(0.12)	0.036298(0.78)	0.010202(1.38)	0.371407(2.92)[a]	−0.004307(−0.43)
TD_t	−19.22205(−0.74)	−33.64266(−0.98)	8.997319(0.47)	10.43490(0.33)	−16.04462(−0.99)
AFTA92	633.1883(1.91)[c]	−1041.227(−1.63)	75.98628(0.49)	−1267.759(−1.74)[c]	−506.7533(−1.57)
$RFDI_{t-1}$	0.30287(1.57)	0.986985(4.33)[a]	0.269658(1.43)	0.059048(0.27)	0.639577(3.63)[a]
c	451.9244(0.83)	105.6385(0.19)	262.8273(0.91)	−532.4649(−0.74)	−277.6065(−1.57)
R^2-adjusted	0.27	0.87	0.29	0.87	0.81
DW	1.85	1.76	2.31	1.73	2.24
JB	4.92[c]	1.86	0.93	8.35[b]	1.17
LM2	4.42[b]	1.62	0.92	0.65	0.26
ARCH-LM(1)	2.73	0.016	0.14	0.15	4.38[b]
HET	1.79	1.13	0.95	4.58[a]	2.54[b]
RESET	0.24	0.35	0.50	0.008	1.47
ADF	−5.89(1)[a]	−2.65(1)[c]	−3.54(1)[b]	−3.33(1)[b]	−3.05(1)[b]
LM1	0.63				

Notes
a Denotes significance at 10%.
b Denotes significance at 5%.
c Denotes significance at 1%.
The lagged dependent variable was included here as results in Tables 4.A7 and 4.A8 were found to be spurious. This is the reason why Error Correction modelling was undertaken. Results of this modelling are given next in Tables 4.A10–4.A18.

Table 4.A9 List of variables; example for Indonesia

Variable	*Definition*	
FDIINDO	FDI flow to Indonesia, US$ million	Dependent variable; nominal values
RFDIINDO	Real FDI = (FDIINDO/GDP deflator) * 100	Dependent variable; real values
GDPINDO	GDP converted to mn of USD	Market size proxy; nominal values
RGDPINDO	Real GDP = (GDPINDO/GDP deflator) * 100	Market size proxy; real values
GDPCAPINDO	GDP per capita = GDPINDO/population	Market size proxy; nominal values
RGDPCAPINDO	Real GDP per capita = GDPCAPINDO/pop	Market size proxy; real values
GRINDO	$GDPINDO_t$-$GDPINDO_{t-1}$	Market growth proxy; nominal values
RGRINDO	$RGDPINDO_t$-$RGDPINDO_{t-1}$	Market growth proxy; real values
GRINDOP	($GDPINDO_t$-$GDPINDO_{t-1}$/$GDPINDO_t$) * 100	Market growth proxy; nominal values
RGRINDOP	($RGDPINDO_t$-$RGDPINDO_{t-1}$/$RGDPINDO_t$) * 100	Market growth proxy; real values
GRINDONC	($GDPNCINDO_t$-$GDPNCINDO_{t-1}$/ $GDPNCINDO_t$) * 100	Market growth proxy; nominal values
RGRINDONC	($RGDPNCINDO_t$-$RGDPNCINDO_{t-1}$/ $RGDPNCINDO_t$) * 100	Market growth proxy; real values
GRINDO1	Movav ($GDPINDO_t$, 5)	Market growth proxy; nominal values
RGRINDO1	Movav ($RGDPINDO_t$, 5)	Market growth proxy; real values
TDINDO	(Imports from ASEAN members/(total imports – imports from ASEAN members)) * 100	Tariff discrimination proxy

Tables 4.A10–4.A18: Testing for the impact of AFTA using error correction modelling

Table 4.A10 Real GDP per capita, real growth, TD, AFTA93 and interactive variables

$\Delta RFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*
$\Delta RFDI_{t-1}$	0.76015(4.06)[a]				
$\Delta RGDPCAP_{t-1}$					
$\Delta RGDPCAP_t$	−19.23161(−2.33)[b]				
ΔRGR_{t-1}					−0.061924(−2.21)[b]
ΔRGR_t	0.135304(2.35)[b]			0.392463(6.68)[a]	
ΔTD_{t-1}	50.20911(2.42)[b]				
ΔTD_t	−45.41(−2.03)[c]				
$RFDI_{t-1}$	−1.288441(−5.96)[a,d]	−0.051995(−0.47)	−0.829828(−4.39)[a,d]	−0.170338(−1.93)[c]	−0.507653(−3.14)[a,d]
$RGDPCAP_{t-1}$			−0.253728(−2.85)[a]		
RGR_{t-1}	0.151639(2.59)[b]	0.184446(3.48)[a]	0.011702(1.81)[c]		0.11516(3.22)[a]
TD_{t-1}	−44.73373(−1.61)				24.81924(2.35)[b]
AFTA93	−17751.19(−2.31)[b]	−768.8747(−1.95)[c]			−8694.33(−3.78)[a]
AFTA93*$RGDPCAP_{t-1}$	41.85908(2.39)[b]			−2.722966(−5.77)[a]	1.846331(2.92)[a]
AFTA93*RGR_{t-1}				0.921582(3.45)[a]	
AFTA93*TD_{t-1}				1276.486(5.41)[a]	393.2096(2.49)[b]
c	1200.062(2.71)[b]	−84.54573(−0.53)	517.5048(3.72)[a]	209.9458(1.55)	−227.3865(−1.94)[c]
R^2-adjusted	0.59	0.28	0.38	0.75	0.48
DW	2.22	1.81	2.14	1.99	2.04
JB	0.11	2.95	0.77	0.84	1.15
LM2	1.61	1.16	0.48	0.66	0.24
ARCH-LM(1)	0.59	0.0003	0.072	1.29	0.032
HET	1.071	1.71	1.24	2.53[c]	1.89
RESET	0.04	1.26	1.51	0.55	0.52
ADF	−4.53(1)[a]	−2.51(1)[b]	−3.35(1)[b]	−3.95(1)[a]	−3.52(1)[b]
LM1					

Notes
a Denotes significance at 10%.
b Denotes significance at 5%.
c Denotes significance at 1%.
d Denotes co-integration at 10% or less.

Table 4.A11 Real GDP, real growth in NC, TD, AFTA93 and interactive variables

$\Delta RFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*
$\Delta RFDI_{t-1}$	0.4934(2.56)[b]	0.6422(1.98)[c]			0.4316(2.52)[b]
$\Delta RGDP_{t-1}$		0.12415(1.94)[c]		−0.4025(−2.87)[a]	
$\Delta RGDP_t$		−0.187(−2.30)[b]		0.388(3.43)[a]	
$\Delta RGRNC_{t-1}$					
$\Delta RGRNC_t$		94.082(2.55)[b]			
ΔTD_{t-1}	53.194(2.32[b]				
ΔTD_t	−39.70(−1.73)[c]				−124.71(−4.19)[a]
$RFDI_{t-1}$	−1.092(−5.05)[a,d]	−0.3284(−1.49)	−0.62927(−3.77)[a,d]	−0.155(−0.94)	−0.857(−4.89)[a,d]
$RGDP_{t-1}$		0.0314(2.45)[b]	−0.005023(−2.17)[b]		0.03626(4.73)[a]
$RGRNC_{t-1}$		108.596(2.11)[c]			
TD_{t-1}	−62.43(−2.30)[b]				−36.21654(−2.59)[b]
AFTA93		−11363.44(−1.84)[c]		−24,345.35(−3.97)[a]	
$AFTA93*RGDP_{t-1}$	0.0081(2.33)[b]	−0.1235(−2.99)[a]		−0.77(−5.36)[a]	−0.012721(−3.79)[a]
$AFTA93*RGRNC_{t-1}$		2,054.924(2.28)[b]			
$AFTA93*TD_{t-1}$				2,386.06(5.15)[a]	
c	1,534.797(3.60)[a]	−1063.082(−2.42)[b]	430.15(2.91)[a]	213.8(1.49)	−582.80(−3.45)[a]
R^2-adjusted	0.46	0.46	0.31	0.74	0.57
DW	2.08	2.36	2.18	2.01	2.43
JB	2.69	2.78	2.11	0.82	0.056
LM2	2.41	1.43	0.65	0.90	1.51
ARCH-LM(1)	0.01	0.38	0.24	1.58	1.75
HET	1.39	1.63	0.84	3.74	3.99[a]
RESET	0.006	1.39	0.007	0.57	0.67
ADF					

Notes
a Denotes significance at 10%.
b Denotes significance at 5%.
c Denotes significance at 1%.
d Denotes co-integration at 10% or less.

Table 4.A12 Real GDP lagged, real growth in %, TD, AFTA93 and interactive variables

$\Delta RFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*
$\Delta RFDI_{t-1}$	0.487755(2.51)[b]				
$\Delta RGDPLAG_{t-1}$				−0.803833(−3.70)[a]	
$\Delta RGDPLAG_t$					
$\Delta RGRP_{t-1}$				−58.92392(−1.92)[c]	
$\Delta RGRP_t$		−19.42323(−1.89)[c]	49.29523(2.89)[a]	29.63811(1.77)[c]	
ΔTD_{t-1}	53.56(2.31)[b]				
ΔTD_t	−39.50865(−1.69)[c]	−82.5922(−1.99)[c]	72.00447(2.45)[b]		−97.05816(−3.32)[a]
$RFDI_{t-1}$	−1.06953(−4.96)[a,d]	−0.202976(−1.54)	−0.924884(−4.57)[a,d]	−0.487215(−3.15)[a,e]	−0.594901(−4.00)[a,d]
$RGDPLAG_{t-1}$		0.080002(3.39)[a]	−0.263468(−2.09)[b]	0.138622(4.29)[a]	0.023094(4.35)[a]
$RGRP_{t-1}$			61.41534(2.77)[b]	88.04994(2.63)[b]	27.66738(2.85)[a]
TD_{t-1}	−62.41706(−2.22)[b]	−137.0266(−3.04)[a]	32.74652(1.02)		
AFTA93	651.7047(2.22)[b]				
AFTA93*$RGDPLAG_{t-1}$		−0.054453(−3.99)[a]			
AFTA93*$RGRP_{t-1}$		116.9426(3.14)[a]		106.2843(3.72)[a]	
AFTA93*TD_{t-1}					−54.15546(−3.22)[a]
c	1523.8(3.53)[a]	1258.89(2.40)[b]	22.98662(0.95)	−1186.675(−2.72)[b]	−651.9373(−3.50)[a]
R^2-adjusted	0.45	0.36	0.52	0.72	0.51
DW	2.08	1.79	2.21	2.34	1.91
JB	2.65	7.59[b]	0.63	5.26[c]	1.58
LM2	2.62	1.66	0.70	0.51	0.40
ARCH-LM(1)	0.022	0.19	0.60	0.15	2.25
HET	1.11	1.02	1.39	1.23	1.85
RESET	4.55e−5	0.002	1.54	0.67	0.015
ADF	−4.85(1)[a]	−4.36(0)[a]	−4.02(1)[a]	−3.04(1)[b]	−3.44(1)[b]
LM1					

Notes
a Denotes significance at 10%.
b Denotes significance at 5%.
c Denotes significance at 1%.
d Denotes co-integration at 10% or less.
e Denotes co-integration at 25%.

Table 4.A13 Real GDP, real growth in %, TD, AFTA93 and interactive variables

$\Delta RFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*
$\Delta RFDI_{t-1}$	0.4762(2.57)[b]	0.330671(1.62)		0.559873(3.68)[a]	
$\Delta RGDP_{t-1}$				−0.797376(−4.44)[a]	−0.07931(−3.68)[a]
$\Delta RGDP_t$				0.830846(6.23)[a]	
$\Delta RGRP_{t-1}$					−27.16227(−2.31)[b]
$\Delta RGRP_t$				−61.05753(−2.98)[a]	51.34765(2.93)[a]
ΔTD_{t-1}	55.5392(2.48)[b]			−36.97143(−1.80)[c]	
ΔTD_t	−42.8649(−1.91)[c]				
$RFDI_{t-1}$	−1.00818(−4.88)[a,d]	−0.21424(−1.14)	−0.841881(−4.6)[a,d]	−0.899469(−4.73)[a,d]	−0.32887(−2.47)[b,d]
$RGDP_{t-1}$		0.036457(3.38)[a]	−0.00715(−2.98)[a]	0.089991(3.86)[a]	
$RGRP_{t-1}$		30.93263(2.63)[b]	9.762506(2.31)[b]		101.0033(4.06)[a]
TD_{t-1}	−58.1061(−2.19)[b]			18.53955(0.95)	
AFTA92					
AFTA92*$RGDP_{t-1}$	0.029334(2.44)[b]	−0.029895(−3.04)[a]		−0.216926(−6.85)[a]	
AFTA92*$RGRP_{t-1}$		83.68932(2.23)[b]		54.51653(5.78)[a]	
AFTA92*TD_{t-1}	−189.0264(−1.92)[c]				
c	1421.997(3.42)[a]	−849.92(−2.72)[b]	613.4554(3.83)[a]	−786.0227(−1.60)	−716.35(−3.54)[a]
R^2-adjusted	0.49	0.42	0.41	0.85	0.40
DW	2.19	1.93	2.13	2.61	2.08
JB	6.82[b]	1.76	0.42	0.49	0.43
LM2	2.18	0.47	0.53	1.51	0.17
ARCH-LM(1)	0.00025	0.29	0.01	1.74	0.88
HET	1.67	2.43[c]	1.43	1.77	1.39
RESET	0.13	14.7[a]	1.58	0.037	0.42
ADF	−4.81(1)[a]	−2.85(1)[a]	−3.35(1)[b]	−3.71(1)[a]	−3.37(1)[a]
LM1					

Notes

a Denotes significance at 10%.

b Denotes significance at 5%.

c Denotes significance at 1%.

d Denotes co-integration at 10% or less.

Table 4.A14 Real GDP per capita, real growth, TD, AFTA92 and interactive variables

$\Delta RFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*
$\Delta RFDI_{t-1}$	0.536551(2.56)[b]	0.428531(1.99)[c]		0.829833(4.41)[a]	
$\Delta RGDPCAP_{t-1}$					
$\Delta RGDPCAP_t$	−17.30249(−1.80)[c]	−7.906252(−2.58)[b]		−0.740308(−3.63)[a]	14.19882(8.00)[a]
ΔRGR_{t-1}					
ΔRGR_t	0.122956(1.89)[c]	0.562167(2.65)[b]		0.714419(6.68)[a]	−0.250125(−8.38)[a]
ΔTD_{t-1}					
ΔTD_t					−95.80874(−5.28)[a]
$RFDI_{t-1}$	−0.955009(−4.18)[a,d]	−0.383161(−1.59)	−0.829828(−4.39)[a,d]	−1.09349(−5.29)[a,d]	−0.288453(−3.67)[a,d]
$RGDPCAP_{t-1}$			−0.253728(−2.85)[a]	0.270793(4.58)[a]	1.574714(7.10)[a]
RGR_{t-1}	0.132787(2.03)[c]	0.720515(3.48)[a]	0.011702(1.81)[c]	0.426012(3.35[a])	−0.2063(−6.17)[a]
TD_{t-1}					
AFTA92		−18119.77(−2.21)[b]		−10971.36(−4.03)[a]	−2843.182(−2.03)[c]
AFTA92*$RGDPCAP_{t-1}$	1.820821(2.85)[a]	1.650565(1.64)		−2.435635(−6.04)[a]	
AFTA92*RGR_{t-1}					
AFTA92*TD_{t-1}		533.1184(2.21)[b]		1690.363(6.10)[a]	113.7176(1.12)
c	392.554(1.68)	−148.0841(−0.78)	517.5048(3.72)[a]	−557.7925(−3.00)[a]	−906.3096(−6.05)[a]
R^2-adjusted	0.41	0.40	0.38	0.90	0.85
DW	1.93	2.19	2.14	1.98	1.62
JB	4.19	0.57	0.77	16.02[a]	1.84
LM2	2.05	0.37	0.48	0.35	0.19
ARCH-LM(1)	0.01	0.89	0.072	0.21	0.46
HET	2.44[b]	0.65	1.24	0.49	0.49
RESET	0.47	2.10	1.51	4.44[b]	0.094
ADF	−4.37(1)[a]	−3.97(1)[a]	−3.35(1)[b]	−3.01(1)[b]	−2.86(1)[c]
LM1					

Notes
a Denotes significance at 10%.
b Denotes significance at 5%.
c Denotes significance at 1%.
d Denotes co-integration at 10% or less.

Table 4.A15 Log real GDP, log real growth in NC, TD, AFTA92

$\Delta LRFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*	*ASEAN*
$\Delta LRFDI_{t-1}$		0.535(2.77)[b]				
$\Delta LRGDP_{t-1}$		2.73(2.67)[b]				
$\Delta LRGDP_t$		−2.00(−1.94)[c]				
$\Delta LRGRNC_{t-1}$						
$\Delta LRGRNC_t$		0.469(3.62)[a]		0.702(3.05)[a]	0.612(2.09)[c]	0.188(2.27)[b]
ΔLTD_{t-1}	1.199083(2.76)[b]					0.585(2.63)[a]
ΔLTD_t					−2.191(−3.13)[a]	0.654(2.60)[b]
$LRFDI_{t-1}$	−0.538568(2.80)[b,e]	−0.387(−3.21)[a,e]	−1.638(−4.39)[a,d]	−0.438(−2.52)[b]	−0.87(−5.24)[a,d]	−0.295(−6.08)[a,d]
$LRGDP_{t-1}$		0.393(1.79)[c]	−1.523(−1.78)[c]	0.548(2.13)[b]	1.121(2.45)[b]	
$LRGRNC_{t-1}$		0.471(2.96)[a]	2.362(2.46)[b]	0.708(2.92)[a]	0.949(2.56)[b]	0.394(3.70)[a]
LTD_{t-1}	−0.879554(−1.77)[c]		1.734(1.77)[c]		0.184(0.72)	0.572(4.88)[a]
AFTA92						
c	5.645099(2.56)[b]	−2.287(−1.50)	7.704(1.57)	−3.639(−2.44)[b]	−9.00(−2.33)[b]	−0.335 (−0.94)
R^2-adjusted	0.26	0.64	0.54	0.43	0.59	0.25
DW	1.57	2.19	1.72	2.16	1.88	1.92
JB	14.2[a]	1.27	1.22	0.81	0.41	
LM2	0.77	1.68	0.061	0.29	0.48	
ARCH-LM(1)	0.051	1.30	1.27	1.43	2.14	
HET	5.47[a]	0.21	1.07	2.14	1.62	
RESET	18.51[a]	2.47	0.097	2.18	1.32	
ADF	−3.36(1)[b]					

Notes

a Denotes significance at 10%.

b Denotes significance at 5%.

c Denotes significance at 1%.

d Denotes co-integration at 10% or less.

e Denotes co-integration at 25%.

Note that the L before the variable denotes the log of the variable.

Table 4.A16 Log real GDP, log real growth in NC, TD, AFTA92 and interactive variables

$\Delta LRFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*
$\Delta LRFDI_{t-1}$	0.43814(1.32)	0.653440(2.85)[b]	0.037375(0.19)		
$\Delta LRGDP_{t-1}$		2.426794(2.17)[b]			
$\Delta LRGDP_t$		−3.451412(−3.24)[a]			
$\Delta LRGRNC_{t-1}$					
$\Delta LRGRNC_t$		0.624778(4.77)[a]		0.702(3.05)[a]	0.611809(2.09)[c]
ΔLTD_{t-1}	0.788484(2.38)[b]				
ΔLTD_t					−2.190713(−3.13)[a]
$LRFDI_{t-1}$	−0.612307(−2.99)[a,e]	−0.261217(−2.16)[c]	−1.330543(−4.26)[a,d]	0.548(2.13)[b]	−0.8699(−5.24)[a,d]
$LRGDP_{t-1}$			−2.161489(−3.17)[a]	0.708(2.92)[a]	1.121295(2.45)[b]
$LRGRNC_{t-1}$		0.619246(4.02)[a]	2.220877(2.95)[b]		0.949374(2.56)[b]
LTD_{t-1}				−0.438(−2.52)[b]	0.184496(0.72)
AFTA92					
AFTA92*$LRGDP_{t-1}$	0.430366(1.93)[c]	−0.796432(−1.71)[c]			
AFTA92*$LRGRNC_{t-1}$		4.084850(1.72)[c]			
AFTA92*LTD_{t-1}	−1.844455(−1.65)				
c	3.685511(2.89)[a]	0.673845(0.82)	12.24779(3.69)[a]	−3.639(−2.44)[b]	−9.002471(−2.33)[b]
R^2-adjusted	0.35	0.62	0.60	0.43	0.59
DW	1.73	1.93	1.81	2.16	1.88
JB	5.34[c]	0.23	1.58	0.81	0.41
LM2	1.15	0.12	0.22	0.29	0.48
ARCH-LM(1)	1.99	0.05	1.02	1.43	2.14
HET	2.15[c]	0.38	1.12	2.14	1.62
RESET	31.51[a]	1.96	0.07	2.18	1.32
ADF	−4.14(1)[a]	−2.99(1)[c]			−3.66(1)[b]

Notes
a Denotes significance at 10%.
b Denotes significance at 5%.
c Denotes significance at 1%.
d Denotes co-integration at 10% or less.
e Denotes co-integration at 25%.
Note that the L before the variables denote the log of the variable.

Table 4.A17 Log real GDP, log real growth in NC, TD, AFTA93 and interactive variables

$\Delta LRFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*
$\Delta LRFDI_{t-1}$	0.449718(1.34)	0.59037(2.62)[b]			
$\Delta LRGDP_{t-1}$		2.695547(2.53)[b]			
$\Delta LRGDP_t$		−3.790858(−3.72)[a]	3.893334(1.76)[c]		
$\Delta LRGRNC_{t-1}$					
$\Delta LRGRNC_t$		0.630541(5.02)[a]		0.702(3.05)[a]	0.520276(1.82)[c]
ΔLTD_{t-1}	0.807424(2.42)[b]				
ΔLTD_t					−2.425818(−3.88)[a]
$LRFDI_{t-1}$	−0.594418(−2.88)[a,e]	−0.223391(−2.42)[b]	−0.83110(−3.84)[a,d]	0.548(2.13)[b]	−0.905359(−5.66)[a,d]
$LRGDP_{t-1}$			−1.190587(−1.82)[c]	0.708(2.92)[a]	1.720371(4.07)[a]
$LRGRNC_{t-1}$		0.636722(4.30)[a]			0.844687(2.49)[b]
LTD_{t-1}				−0.438(−2.52)[b]	
AFTA93					
$AFTA93*LRGDP_{t-1}$	0.428435(1.87)[c]	−1.042889(−2.13)[b]			
$AFTA93*LRGRNC_{t-1}$		5.265245(2.12)[c]			
$AFTA93*LTD_{t-1}$	−1.845407(−1.59)				−0.225485(−1.53)
c	3.593674(2.78)[b]	0.416384(0.66)	8.905296(3.25)[a]	−3.639(−2.44)[b]	−14.45444(−3.72)[a]
R^2-adjusted	0.34	0.65	0.42	0.43	0.62
DW	1.66	1.85	1.98	2.16	1.99
JB	6.35[b]	2.03	1.35	0.81	0.56
LM2	0.89	0.21	1.41	0.29	0.69
ARCH-LM(1)	1.32	0.16	0.08	1.43	5.70[c]
HET	2.16[c]	0.26	2.01	2.14	1.93
RESET	32.36[a]	1.83	1.34	2.18	2.07
ADF	−3.68(1)[b]	−4.40(0)[a]	−3.26(1)[b]		−3.98(1)[a]

Notes

a Denotes significance at 10%.

b Denotes significance at 5%.

c Denotes significance at 1%.

d Denotes co-integration at 10% or less.

e Denotes co-integration at 25%.

Note that the L before the variables denote the log of the variable.

Table 4.A18 Log real GDP, log real growth in NC, TD, AFTA92, including log real GDP of US and Japan

$\Delta LRFDI_t$	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*Thailand*
$\Delta LRFDI_{t-1}$	0.602962(2.02)[c]	0.228434(2.76)[b]	−0.903886(−5.52)[b]		
$\Delta LRGDP_{t-1}$		4.589725(8.05)[a]			8.864344(2.96)[b]
$\Delta LRGDP_t$	2.023484(2.16)[b]				12.54726(3.65)[b]
$\Delta LRGRNC_{t-1}$		0.112687(2.55)[b]			0.893722(3.07)[b]
$\Delta LRGRNC_t$	−0.600268(−2.37)[b]	−1.047934(−6.86)[a]		0.701717(3.05)[a]	−2.149434(−4.18)[a]
ΔLTD_{t-1}					2.669251(3.96)[a]
ΔLTD_t		−0.624645(−3.68)[a]	18.00784(7.74)[b]		1.765856(2.19)[c]
$\Delta LRGDPUS_{t-1}$		−0.398281(−6.86)[a]			−0.645712(−3.79)[a]
$\Delta LRGDPUS_t$			2.230839(5.40)[b]		
$\Delta LRGDPJAP_{t-1}$		−1.465004(−10.18)[a]			−6.026729(−6.07)[a]
$\Delta LRGDPJAP_t$	1.253022(7.68)[a]		19.82626(5.99)[b]		
$LRFDI_{t-1}$	−0.105253(−0.62)	0.258934(1.89)[c]	−1.856121(3.12)[c,d]	−0.438012(−2.52)[b]	0.83754(2.57)[b]
$LRGDP_{t-1}$	−0.002638(−0.005)	−1.501841(−6.49)[a]		0.547898(2.13)[b]	−6.440239(−3.49)[b]
$LRGRNC_{t-1}$	−0.57054(−1.71)	−1.496118(−7.39)[a]	4.746698(6.71)[b]	0.707839(2.92)[a]	−3.702722(−5.27)[a]
LTD_{t-1}		−1.719808(−5.93)[a]	6.434702(3.51)[c]		1.281618(2.13)[c]
$LRGDPUS_{t-1}$	0.372797(2.26)[b]	0.65765(4.81)[a]	1.547508(2.32)		1.144533(3.94)[a]
$LRGDPJAP_{t-1}$	−0.759828(−2.35)[b]	1.23026(7.58)[a]	1.727948(2.01)		0.974181(1.41)
AFTA92		−0.390192(−3.88)[a]	−2.949605(−3.62)[c]		0.974181(2.42)[c]
c	2.698643(0.33)	−1.243024(−1.77)	−73.1748(−6.81)[b]	−3.639351(−2.44)[b]	7.366393(1.41)
R^2-adjusted	0.79	0.97	0.87	0.43	0.85
DW	2.35	2.05	3.43	2.16	2.80
JB	0.51	0.18	0.70	0.81	0.11
LM2	0.67	0.50	13[a]	0.29	1.38
ARCH-LM(1)	0.49	0.21	0.16	1.43	0.085
HET	0.99	n/a	n/a	2.14	n/a
RESET	1.72	0.005	203.23[b]	2.18	0.0005
ADF	−3.95(1)[a]	−3.79(1)[b]	−7.21(0)[a]		−4.09(1)[a]

Notes
a Denotes significance at 10%.
b Denotes significance at 5%.
c Denotes significance at 1%.
d Denotes co-integration at 25%.
n/a Denotes insufficient observations.
Note that the L before the variables denote the log of the variable.

Table 4.A19 Panel data analysis using the pooled least squares method

Dependent variable: LRDFDI?
Method: Pooled Least Squares
Sample (adjusted): 1969, 1997
Included observations: 29 after adjusting endpoints
Number of cross-sections used: 5
Total panel (unbalanced) observations: 122

Variable	*Coefficient*	*Std error*	*t-statistic*	*Prob.*
C	−2.386849	1.408031	−1.695168[a]	0.0928
LRDGDP?	0.030438	0.027792	1.095187	0.2757
LRDGR?NC	0.213078	0.120118	1.773913[a]	0.0787
LTD?	0.513995	0.120381	4.269726[a]	0.0000
LRDGDPUS	−0.112852	0.133623	−0.844556	0.4001
LRDGDPJAP	0.329519	0.103016	3.198712[a]	0.0018
AFTA92	0.205656	0.200504	1.025694	0.3072
LRDFDI?(−1)	0.468664	0.070930	6.607429[a]	0.0000
R-squared	0.695406	Mean dependent var.		6.376023
Adjusted *R*-squared	0.676702	SD dependent var.		1.183208
SE of regression	0.672763	Sum squared resid.		51.59761
Log likelihood	−120.6172	F-statistic		37.18117
Durbin–Watson stat.	1.650821	Prob(F-statistic)		0.000000

Notes
a Denotes significance at 1%.
Note that the L before the variables denote the log of the variable.

Table 4.A20 Panel data analysis using the seemingly unrelated regression method

Dependent variable: LRDFDI?
Method: Seemingly Unrelated Regression
Sample: 1969, 1997
Included observations: 29
Number of cross-sections used: 5
Total panel (unbalanced) observations: 122

Variable	*Coefficient*	*Std error*	*t-statistic*	*Prob.*
C	−2.348703	0.820274	−2.863317[a]	0.0050
LRDGDP?	0.006596	0.038137	0.172966	0.8630
LRDGR?NC	0.169641	0.073220	2.316882[b]	0.0223
LTD?	0.343193	0.100898	3.401386[a]	0.0009
LRDGDPUS	−0.114530	0.075209	−1.522822	0.1306
LRDGDPJAP	0.310770	0.057637	5.391809[a]	0.0000
AFTA92	0.063120	0.120448	0.524044	0.6013
LRDFDI?(−1)	0.637605	0.060771	10.49184[a]	0.0000
Weighted statistics				
Unweighted statistics				
R-squared	0.677549	Mean dependent var.		6.376023
Adjusted *R*-squared	0.657750	SD dependent var.		1.183208
SE of regression	0.692202	Sum squared resid.		54.62242
Durbin–Watson stat.	1.857958			

Notes
a Denotes significance at 10%.
b Denotes significance at 5%.
Note that the L before the variables denote the log of the variable.

Acknowledgement

The authors wish to acknowledge the contribution of Dr Philip Adams in designing the questionnaire for this survey. His advice has been invaluable and much appreciated throughout this research.

Notes

1 The comparison of FDI flows into ASEAN with FDI flows to other countries and regions was undertaken using data published in UNCTAD's *World Investment Report 1998*.

2 See 'China and Southeast Asia eye world's largest free-trade area', *China Daily*, 11 February 2001.

5 The future of intra-regional foreign direct investment patterns in Southeast Asia

Frank L. Bartels

5.1 Introduction

Any account of intra-regional Southeast Asian inward foreign direct investment (IR FDI) flows must consider the archipelagic nature and geographical fragmentation of the region, the diverse range of political systems, the different economic structures, differing economic management styles, as well as the wide spectrum of cultural values and practices evident in Southeast Asia. At the June 2002 'ASEAN in the New Millennium' meeting in Thailand, the Director General of Thailand's Commerce Ministry's Department of Business Economics, Karun Kittisataporn concluded: 'There is no genuine strong cooperation within the Association of Southeast Asian Nations (ASEAN). Each country tends to be concerned about its own national interests'.[1] The dynamics of IR FDI need to be viewed through this lens, even if it is clouded by different responses in the region to the global economic slowdown.[2] Nevertheless, because Southeast Asia is geo-economically and geo-politically important to the economic well-being of both Atlantic and Pacific economies, future policy developments in IR FDI – as part of the engine of globalisation – deserve careful attention.

The rest of the chapter is organised as follows. Section 5.2, on industrial organisation in Southeast Asia, describes the constellation of global factors, regional motivations and policy levers that animate patterns of intra-regional FDI. Section 5.3, on the regional political-economy and its impact on patterns of intra-regional FDI, presents Southeast Asia's intra-regional flows of FDI, and delineates the dynamics of their different vectors in terms of predominant sources and hosts. This section lays out the statistical evidence of these flows and draws out the prevailing patterns, with a view of future behaviour of intra-regional FDI flows. Sections 5.4 and 5.5 close the chapter by drawing together the key features of intra-regional FDI and suggest an emergent morphology of FDI for the region.

5.2 Industrial organisation in Southeast Asia

Notwithstanding recent policy pre-occupations with economic uncertainty and political insecurity, as both Organisation for Economic Co-operation and

Development (OECD) and Emerging Markets (EMs) economies face part-cyclical and part-structural decelerations, FDI activity is widely accepted among policy makers as the manifestation of global economic integration (however asymmetrical). The underlying factors behind IR FDI appear to be four-fold: globalisation and world FDI flows in the past thirty years; the changing rates and directions of IR FDI; Multinational Enterprises (MNEs) performance in geo-economic space through headquarter–subsidiary relationships; and ownership structures of firms (also see later). The first and second reflect the microeconomic momentum of financial and structural globalisation.[3] The third reflects the microeconomics and industrial organisation of MNEs as spatial distributions of integrated international sourcing, technology, production, marketing and servicing networks (IINs) – which tend to be more advanced and complex for OECD-based MNEs than for Southeast Asian MNEs.[4] The fourth reflects regional corporate ownership patterns.

Despite the attention given to globalisation,[5] the world economy is more regionalised than globalised (Hirst and Thompson, 1999), and global FDI activity is dominated by the trans-Atlantic and trans-Pacific economies (UNCTAD, 1991, 2001, 2002a). Trans-Pacific FDI to emerging markets is in turn dominated by Asia (consequent to the 'strong Yen era' and the Japanese economic 'sphere of influence'), with China and Southeast Asia playing significant roles as hosts to FDI.[6] This said, the geo-economic circulation of capital flows – both FDI and Foreign Portfolio Investment (FPI) – within Southeast Asia has a discernible pattern, characterised by the distribution channels and logistics structure of the region's productive value-chains, linked through intermediate exports and imports to IINs.

The patterns of, and nuances within, aggregate IR FDI are suggested by four constellations of evidence (two of which are significant drivers of FDI, that is, MNEs' industrial organization and Asian corporate ownership) crucial to appreciating and understanding the likely future morphology and dynamics of the patterns. The first evidence concerns the overall asymmetry of globalisation and world FDI flows established over the past thirty years.[7] The second concerns the changing rates and directions of global inward FDI within the asymmetry. The third refers to how MNEs perform in geo-economic space through sophisticated organisation of their headquarter–subsidiary relationships (specific mandates for operationalising highly differentiated aspects of MNEs global and regional strategy). The fourth refers to the ownership structures of firms linked to IINs.

The first constellation of evidence provided by the asymmetrical pattern of global inward FDI flows, dominated by the industries of – and MNEs from – the 'Triad'[8] economies reaching across trans-Atlantic and trans-Pacific factor markets, with tentacular inter-company and intra-company relations (Mckibbin and Sachs, 1991; UNCTAD, 1993b, 2000) is unlikely to change radically. Indeed, a number of empirical studies together suggest that without serious attention to increasing the efficiency of policy and structural adjustment programmes, those developing countries (including the transitional economies of Southeast Asia) referred to as 'non-globalising'[9] risk becoming more or less permanently marginalised from the

international location of higher value-added manufacturing. Noting that MNEs have evolved to perform four interrelated activities that dominate the political-economy of global production – that is creating markets, investing, generating assets and changing human economic conditions (Eden and Lenway, 2001) – it is likely that the asymmetrical pattern will undergo further consolidation (UNCTAD, 2002b), and should further embed critical elements of Southeast Asia's linkages with IINs and 'offshore production'.[10] For the region, participation in this asymmetry is predicated by the relative differentiated degree of 'openness' (measured as the sum of exports and imports as a percentage of gross domestic product), notwithstanding the industrial structure of individual countries. Table 5.1, which ranks the 'openness' of Southeast Asian economies, provides a view over the last two decades.

This ranking of 'openness', viewed in the context of generally diminishing FDI flows to the region, indicates the current patterns of IR FDI and is powerfully suggestive of its future morphology, pointing to – *ceteris paribus* – increasing flows to Malaysia, Thailand and the Philippines, and diminishing flows to Singapore. Also, apart from Vietnam, that part of the IR FDI focused on the Indochina sub-region (comprising Cambodia, Laos, Myanmar and Vietnam) will continue to be weak.

The second set of evidence, the global rate at which IR FDI has been growing recently, has changed dramatically. From an average of 7 per cent per annum during the 1990s, FDI flows collapsed from US$1.3 trillion in 2000 to under US$700 billion in 2001, and a further decline of 27 per cent to US$534 billion in 2002 is expected.[11] Net capital flows to EMs, while not experiencing the sharp deceleration to OECD host countries, have been modest, at approximately US$100–150 billion per annum since 1995.[12] In comparison, FDI flows to

Table 5.1 Ranking of 'openness'[a] of Southeast Asian economies, 1982–99

Rank	*Host*	*1982*	*1990*	*1999*
1	Singapore	320.5	308.5	265.6
2	Malaysia	110.5	146.9	217.8
3	Thailand	47.5	75.8	102.9
4	Philippines	46.5	60.8	101.3
5	Indonesia	48.5	49.0	62.2
6	Vietnam	—	—	97.0
7	Cambodia	—	10.8	86.3
8	Laos	55.4	30.5	69.2[b]
9	Myanmar	19.9	5.6	1.5

Source: Country tables of Asian Development Bank's *Key Indicators, 2001*.

Notes

a Sum of exports and imports as a percentage of Gross Domestic Product.

b 1998 figure.

Developing Countries (DCs) slowed only fractionally from US$240 billion in 2000 to US$225 billion in 2001 and is expected to be about US$235 billion (including US$50 billion to China) in 2002. The overall pattern of FDI to DCs remains highly asymmetrical, with the majority flowing to a select few, often with traditional location-specific advantages (LSAs) that Southeast Asia has provided (Bartels and Freeman, 2000).

The motivations and rationales for FDI, reflecting the intra-regional and regional nature of business behaviour, continue to be described holistically by the distillation of theory and evidence known as the eclectic paradigm (Dunning, 1979, 1980, 1988; Galán and González-Benito, 2001; Buckley, 2002). In this distillation, the ownership, location and internalisation dimensions continue to be represented, respectively by organisational aggregated experience, host market, and organisational management of accumulated knowledge of foreign markets.Thus the key to patterns of Southeast Asia IR FDI is due to the performance of relatively few countries – namely the ASEAN-5[13] – with LSAs that were sufficiently differentiated in the late 1970s and early 1980s to match different levels and technological intensities of MNEs' efficiency-seeking international production. The challenge this group faces is that their LSAs – particularly oriented towards Original Equipment Manufacture (OEM) and electronic component assembly – and their exports are now structurally similar, and have an over-reliance on US high-tech import capacity. Table 5.2, depicting the structure of industrial output and exports in select East Asian countries, illustrates this structural convergence well.

Table 5.2 underscores two features. First, the one-dimensional sectoral nature of Asia's industrial landscape that, in 2000, had a combined output of electronic and information technology material valued at US$104 billion (equivalent to that

Table 5.2 Structure of industrial output and exports in selected East Asian countries

Host	*Percentage of high-tech in overall industrial output*	*Electronics as a percentage of total exports (2000)*
Malaysia	27	58
Philippines	n/a	60
Singapore	52	64
South Korea	13	39
Taiwan	35	46
Thailand	18	34

Sources: 'The Tech Wreck Hits Home', *Asiaweek*, 9 March 2001: 20–26; and 'It's Not Pneumonia, But Asia's Deep Chill Could Last', *Businessweek*, 30 July 2001: 22.

Note
n/a not available.

of the US in the same categories).[14] The implication here is that regional policies for increasing FDI would need to be structural, rather than cyclical.[15] Secondly, contrary to expectations, the capital markets of the region – necessary for mediating FDI and FPI flows – can be considered relatively weak (Freeman and Bartels, 2002).

It is important to recall that the historic drive for FDI into Southeast Asia, and subsequent intra-regional FDI flows, was largely based on MNEs searching for low-cost production sites (World Bank, 1993). However, more recent evidence suggests that direct labour costs and incentives are loosing importance for investors. Nevertheless, the region – as it moves slowly towards 'single market' status – remains attractive, despite the Asian economic crisis, in the perceptions of MNEs, although actual FDI flows continue to shrink.[16]

The third piece of evidence for understanding IR FDI is that the external and internal organisational dynamics of leading MNEs have changed radically since the 1980s, in response to falling barriers to cross-border investment and trade, and because of convergent advances in information and communication technology (also see Chapter 2 by Peter Buckley). Two characteristics of this change further underpin the understanding of Southeast Asian intra-regional FDI patterns. The primary aspect of the change is the move from atomistic competition to a broader range of collaborative formalities, termed joint international business associations (JIBAs) (Bartels, 2000; Young, 2000), that enable MNEs to compete against, and collaborate with, the same counterpart(s) in and across the borders of, Triad and EMs' economic spaces. The secondary change for MNEs is the spatial distribution of their intra-organisational functions, differentiated by specialisations and specific subsidiary mandates, and linked through IINs (Antonelli, 1999). These are articulated by mandates (e.g. in OEM subcontracting relationships) and the gradual spread of Southeast Asian international firms across the region. These collaborative formalities constitute an extension of the internalisation paradigm (Buckley, 1988) and, within regional integration, FDI can substitute for trade in intermediate inputs,[17] as part of the spatial distribution of international production (Heinrich and Konan, 2001).

MNEs have been accelerating their competitiveness by inter- and intra-organisational restructuring, away from creating stand-alone capacity and towards increasing capability in network control (Birkinshaw and Hood, 1998; Dunning, 2000a; Young, 2000). The imperatives of localisation permit Southeast Asian firms to participate in these networks through various subordinated relations such as International Joint Ventures (IJVs) and International Strategic Alliances (ISAs) (Bartels and Mirza, 1999; Bartels and Freeman, 2000; UNCTAD, 2001). The result of these changes is a dense network of concurrent collaboration, alliances and competition between international foreign firms in Southeast Asia on the one hand; and on the other hand, close relations with the concentrated and oligopolistic leading families that dominate the local corporates listed on the region's stock markets (Claessens *et al.*, 1998). The overall industrial structures of ASEAN-5 economies are remarkably similar, depending as they do, not only on exports to the high-tech sector of US industry,[18] but also on exports of basic chemicals, footwear, textiles and electro-mechanical (auto-related) sub-assembly.[19]

Hence, the significant productive assets of Southeast Asian corporates, in the majority, are either MNEs' subsidiaries and IJVs with local firms, or those controlled by a relatively few inter-related families, or government-linked companies in the case of Singapore (Claessens *et al.*, 1999; Stone, 2000). The performance-related policy 'driver' of FDI is an improvement in market contestability (a determinant of operating cash-flow) and the need to improve efficiency (a determinant of return on investment) (World Bank/MIGA, 2002). In this regard, the market contestability of Southeast Asia has improved, notwithstanding the remaining challenges of due diligence, custodial services and the problems of cross-border mergers and acquisitions (M&As) (also see Chapter 8, this volume by the same author).

The fourth constellation of evidence is the family-owned and conglomerate structure of Southeast Asian business. An examination of regional stock markets' capitalisation exposes the skewed profiles of ownership.[20] 'Guided' by government interventionist policy postures, these are changing. The change is being driven by the workings (though not as efficient or as quick as desired) of the market, and the shedding of non-core loss-making subsidiaries (part of M&A activity in Asia).

Furthermore, despite the geo-political and socio-economic heterogeneity of Southeast Asia, the structure of regional exports – often the reason for FDI – is biased towards high-tech and electronic components which have the same underlying technological 'driver' (silicon chip and related component technology), and a map of Southeast Asian industrial assets that act as repositories of investment shows overwhelming locational and structural similarities (Bartels and McGovern, 1998). The following typology shows the specially designated industrial areas (SDIAs) operating in the region:

SDIAs	*Number*	*Locations*
Industrial estates	253	Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Laos
Economic zones	61	Cambodia, Myanmar, Philippines
Special export processing zones	46	Indonesia, Philippines, Thailand
Free trade zones	3	Indonesia, Laos, Thailand
Technology parks	18	Indonesia, Malaysia, Philippines, Singapore, Thailand
Free industrial zones	84	Malaysia, Vietnam
Special industrial estates	26	Malaysia
Special economic zones	19	Philippines
Business and science parks	17	Philippines, Singapore, Thailand
Wafer fabrication parks	2	Singapore
Industrial promotion zones	1	Thailand

Source: ASEAN Secretariat 'ASEAN Investment Map', November 2000.

Additionally, industrial supply linkages, based on the 'flying geese' model (Akamatsu, 1962), find modern expression as 'growth triangles' operating in Southeast Asia.[21] This relative lack of industrial diversity – a necessary outcome of the sometimes coercive relations of intervention and co-ordination between Asian governments and business, as the socio-economic basis for industrialisation policy (Wade, 1990; Yu, 2000) – and hence the 'thinness' of ASEAN's capital asset structure poses problems for the region in a future increasingly determined by rule-based 'hard' agreements, exemplified by WTO regulations.

Given these constellations of evidence, two vectors to the overall pattern of IR FDI are visible. First, that for which Triad-based MNEs and their subsidiaries are responsible, and secondly that for which Southeast Asian MNEs are responsible. Generally, the former have entered, and consequently operated within, the region via JIBAs and cross-border M&A activity (Zhan and Ozawa, 2001). The latter have operated via a mix of entry modes for FDI (such as 'greenfield' in real estate, IJVs in manufacturing and ISAs in services), in conformity with the chronological trajectory of internationalisation and organisational spatial distribution.[22] Both groups are increasingly exploiting the industrial parks located throughout the region (Westhead, 1999). Where political uncertainties remain serious, lacklustre economic reform and truncated market opening policy implementation is undermining IR FDI flows and creating a 'three-speed' ASEAN.[23] It is instructive to note that as far back as 1986, and then again in 1995, both *The Economist* and BERI (Business Environment Risk Intelligence Inc.) rated the Philippines and Indonesia as presenting the greatest political risk in Southeast Asia to FDI (Howell and Xie, 1996).

At a political level, and in terms of formal regionalisation, the policy framework for IR FDI is provided by the 'Framework Agreement of the ASEAN Investment Area' (AIA), signed in October 1998, in Makati, the Philippines, and subsequently amended in April 1999 to incorporate all ten Southeast Asian countries.[24] The AIA agreement commits the granting of national treatment to ASEAN investors, except in manufacturing sectors indicated in the Temporary Exclusion List (TEL) and Sensitive List (SL), finalised at the AIA Council's second meeting in September 1999. TEL and SL have been developed for the agriculture, fishery, forestry and mining sectors. Commitment to national treatment is also accepted in services associated with these sectors. Progress towards complete national treatment status across ASEAN is embodied in a protocol – the Final Individual Action Plans 2000–04. For some commentators, this appears incompatible with ASEAN's long-held regard for non-interference in the domestic affairs of its members,[25] given the forces at work in ASEAN's various members and the prolonged time frame (2010–15) for achieving region-wide national treatment. Despite laudable efforts in liberalisation measures to enhance the investment climate and overcome regional managerial impediments, enacting statutes does not in itself change the overall FDI receptivity and climate, and obstacles to FDI prove resistant to either elimination or significant reduction (Bartels and Freeman, 2000).

Although opportunities for radical reform have not been exploited fully by governments hitherto willing to intervene, ASEAN has institutionalised a variety of

IR FDI arrangements.[26] The challenge remains region-wide interpretation, consistent at the operationalised level of firm FDI decisions. And regarding incentives, transparency that should hallmark serious intent for a 'level playing field' has not been prominently displayed. Also regionally, the political will to break the bonds of past successes of the 'East Asian development model' (which was not willing to separate efficiently and effectively the private interests of business from the public exigencies of the developmental state) remains emaciated.[27]

What then are the dynamics within the predominant pattern of IR FDI? The first aspect of the broad view is that FDI is marked by contagion (Hernández *et al*., 2001). Flows to, and subsequently within, the region are episodal and characterised by contagion, and with respect to Asia, importantly 'a more restrictive environment for the movement of capital across borders was not a deterrent to capital inflows' (Hernández *et al*., 2001: 14). Furthermore, at the micro-level, FDI flows were subject to contagion in the 1990s only from countries with 'a similar degree of trade openness (measured by exports/GDP)' (Hernández *et al*., 2001: 16).

Mobility of IR FDI is predicated on the international trade Heckscher–Ohlin–Samuelson paradigm of comparative endowments of productive factors, in conjunction with intra-industry trade and intra-industry MNEs subsidiary sales, as a function of the constraints on FDI, trade and policy regimes (Grubel and Lloyd, 1975), as well as the 'flying-geese' description of capital cascading across the region (Bloom and Noor, 1995). This underlying structure to the pattern of IR FDI, through 'trade links and neighbourhood effects' (Hernández *et al*., 2001: 14) is responsible for contagious flows. This suggests likely future changes to IR FDI. First, in the presence of diminishing returns the reappraisals of the region by investors, and hence downward pressure on FDI[28] is an episode unlikely to be reversed to significant extent in the short term. Secondly, given the fact that the majority of FDI flows to developing countries go to China and Southeast Asia, the reinvested earnings component of FDI to developing countries has steadily decreased from about 24 per cent in 1990 to 8 per cent in 1998 (UNCTAD, 2000: 19). Also, ASEAN sources of IR FDI have reduced their regional participation from just under US$5 billion in 1995 to just under US$1.5 billion in 1999 and, more importantly, the return on investment by US MNEs' FDI in ASEAN has fallen from about 24 per cent in 1995 to about 15 per cent in 1999 (ASEAN, 2000b). This is bound to diminish long-term IR FDI flows. Thirdly, even if coordinated, sudden relaxations of the policy environment across the region are unlikely to elicit significant FDI inflows or accelerate their regional circulation. Fourthly, the similarity in sectoral trade openness serves merely to reinforce diminishing returns.

Recent empirical research suggests that intra-industry trade and intra-industry MNEs' subsidiary FDI and production patterns of 'firm location, production, and trade are simultaneously and endogenously determined' (Markusen and Maskus, 2001: 17). Furthermore, intra-industry MNEs' subsidiary sales between pairs of countries are positively correlated with economic size and factor endowments. The implications are regional divergence, depicted by tables below, and an ASEAN

forced into a trichotomy – the ASEAN-5, Indochina-4 and Brunei – leading to increased extra-regional bilateralism and decreased IR FDI.[29]

Reference to IR FDI is not complete without considering the structural economic linkages between Asia, the US and Japan. While acknowledging Japan's weight in the region,[30] Asia's IR FDI flows are more vulnerable to US economic cycles than Japan's economic cycles (Abeysinghe and Forbes, 2001). The long-term view of IR FDI is proxied by the profile of export shares (1977–97), and trading patterns, which have high adjustment frictions because of asset specificities, and therefore can be altered only in the long term. Tables 5.3 and 5.4 indicate this profile.

The overall intra-ASEAN-5 export profile is approximately 20 per cent of Southeast Asia's total volume of commerce (ASEAN, 2000b), and intra-ASEAN trade is about 44 per cent of import trade with the Triad, China and South Korea. To indicate the extent to which ASEAN integration has yet to progress, intra-EU trade is some 70 per cent of total EU trade with the world.[31] Looking forward, the

Table 5.3 The changing profile of intra-Southeast Asian exports, 1977–97

ASEAN-5 country	*Percentage export share to an ASEAN-4 destination*[a]		
	1977	*1987*	*1997*
Indonesia	1	2	5
Malaysia	4	5	6
Philippines	2	4	6
Singapore	37	30	33
Thailand	10	7	8

Source: Abeysinghe and Forbes, 2001: 26.

Note
a ASEAN-4 = Indonesia, Malaysia, Philippines and Thailand.

Table 5.4 Southeast Asian trading partners, by export share, 1996

Exporter	*Percentage share of total exports into another ASEAN-5 member*				
	Singapore	*Malaysia*	*Thailand*	*Philippines*	*Indonesia*
Indonesia	9	2	2	1	—
Malaysia	21	—	4	1	2
Philippines	6	3	4	—	1
Singapore	—	18	6	2	2
Thailand	12	4	—	1	2

Source: Abeysinghe and Forbes, 2001: 32–33.

most significant issue for intra-ASEAN FDI will be the effective implementation of the common effective preference tariff (CEPT) – on which there are some doubts – that aims to create a reduction in tariff rates for manufactured intermediary inputs and final goods, to between zero and five percent.[32]

5.3 The regional political-economy and its impact on patterns of intra-regional FDI

According to one commentator, Southeast Asia presents 'an ugly picture',[33] and the region faces problems that will debilitate its ability to reform in a stable economic environment and predictable political atmosphere.[34] The fissionable characteristics of Southeast Asia are starkly portrayed by Indonesia and Philippines, whose collapsing institutions and secessionist movements are reflected in the fall of inward FDI flows, and the continuing feature of domestic investment that emphasises rent-seeking activities (Lipsey, 2001; IIF, 2002) (Table 5.5). One potential source of IR FDI, the privatisation programmes, has decelerated sharply, and is beset by nationalist sentiment. The economic slowdown in the trans-Pacific markets of Japan and US also bodes ill for Southeast Asia.[35]

Intra-Southeast Asian FDI displays a bias within the region, notably for the newest members of ASEAN. This arises because of the persistence of measures restricting trade, and the 'flying geese' paradigm, and distortions therein manifest in the narrow export-oriented industrialisation of Southeast Asia succinctly illustrated by Akamatsu (1962); Kojima (1978) and Hiley (1999: Fig. 4). Pre-1997, the dynamic of this regional bias was a 'virtuous circle' of intra-ASEAN economic flows and growth. After the turbulence of the Asian economic crisis, structural rigidities are preventing rapid adjustment and differentiation (Ryan, 2000). With respect to IR FDI, one significant outcome of the ASEAN Free Trade Area (AFTA) objectives of CEPT reductions is decreased pressure for tariff-jumping IR

Table 5.5 Stocks of inward FDI in Southeast Asian countries (except Brunei) in 2000

Host location	*Inward FDI (US$ billion)*	*Inward FDI stock per capita (US$)*
Singapore	80.000	20,000
Indonesia	60.000	290
Malaysia	54.000	2,300
Thailand	40.000	640
Vietnam	15.000	n/a
Philippines	14.000	180
Myanmar	2.500	n/a
Cambodia	0.605	n/a
Laos	0.551	n/a

Source: Economist Intelligence Unit, 11 July 2000, EIU website.

Note
n/a not available.

FDI. However, increased incentives for tradable goods should continue to expand intra-ASEAN exports. These have averaged 24 per cent throughout the 1990s, up from an average of 18 per cent in the 1980s (Heinrich and Konan, 2001).

Table 5.6 indicates the broad perspective of declining performance, and reflects the overall share of FDI flows to Southeast Asia that has continued to decrease over the long term. While Southeast Asia's share of FDI to developing Asia averaged over 30 per cent through the mid-1990s, by the end of the decade the region's share was down to 10 per cent,[36] represented by US$9 billion FDI to Southeast Asia in 1999, compared to US$18.9 billion in 1998, with Singapore taking the lion's share (Sauvant, 2001).

The Southeast Asian sources of these flows are dominated by outflows from Singapore, Malaysia and Thailand, respectively maintaining 72 per cent, 28 per cent, and 38 per cent of outward FDI in ASEAN. While the ASEAN-5 receive a disproportionately higher amount of FDI, relative to the size of their economies, according to the UNCTAD FDI Index (UNCTAD, 2001), the really dependent hosts to IR FDI are the Indochina-4 transitional economies who together receive a substantial proportion of their IR FDI from within Southeast Asia (UNCTAD, 1999).

Disaggregating IR FDI flows between non-Southeast Asian and Southeast Asian MNEs is problematic, as statistics tend to be IMF Balance of Payments oriented, and therefore identify country sources. However, given that Singapore is a key location for the regional headquarters of non-Southeast Asian MNEs; and that Singapore was the source of US$2,001 million of cross-border M&A purchases in Southeast Asia in the second half of 1997, compared to US$145 million in the first half (Bartels and Mirza, 1999), a high proportion of IR FDI must be attributable to non-Southeast Asian MNEs.

Evidence from the IINs of MNEs that constitute non-Southeast Asian IR FDI flows is provided by the automotive sector. The anticipation of both AFTA and AIA (but more so AFTA) has prompted European, Japanese, Korean and US auto manufacturers to invest in ASEAN, with Thailand and Malaysia benefiting disproportionately in terms of the level of manufacturing value added (MVA) (FOURIN, 1993). The result, in addition to overcapacity-induced fierce industry

Table 5.6 Intra-ASEAN cumulative net FDI flows (%)

Year	*Per cent of cumulative net FDI flows in ASEAN*
1995	23
1997	18
1998	2
1995–99	15

Source: Heinrich and Konan (2001).

competition, is a pattern of vertically integrated IR FDI, coupled with export/import distribution/logistics and final assembly for export sales (Katayama, 1999). Other examples of this pattern are suggested by the electronic component manufacturing sector (Hobday, 1996).

5.4 Intra-Southeast Asian FDI flows: statistical evidence and implications for the future

In the broadest terms, and over the long term, the patterns of IR FDI flows in Southeast Asia are depicted in Table 5.7, dominated respectively by Singapore as the major source, and Malaysia as the major host. Of the cumulative IR FDI approved in manufacturing between 1990 and 1998, amounting to US$35.5 billion (12 per cent of all IR FDI in manufacturing approved in ASEAN), US$17.8 billion (50 per cent) was sourced from Singapore and US$13.4 billion (38 per cent) was hosted by Malaysia (ASEAN, 1999). IR FDI, as a percentage of total FDI flows to Southeast Asia, had been increasing until the hiatus of the Asian economic crisis in 1997.

Notwithstanding the difficulty in separating firm-level sources and hosts for FDI between Southeast Asian and non-Southeast Asian MNEs, Figures 5.1 and 5.2 illustrate the morphology of IR FDI. This morphology indicates clearly that IR FDI has a vector pattern differentiated in spatial distribution, value and sector. Figure 5.1 shows that, from a host perspective, international firms from Singapore are the most widely spread in their regional FDI profile, and hold the predominant share of IR FDI in all Southeast Asian countries except Cambodia, Laos and Brunei (where massive Singaporean disinvestment has occurred). International firms in Malaysia have a spatial distribution profile more limited in contrast to Singaporean firms, and are dominant in Singapore, Cambodia and Brunei. International firms from Thailand have a somewhat similar spread to their

Table 5.7 Sources and hosts of net IR FDI flows for Southeast Asia, 1995 to first half of 1999 (US$ billion)

Country	*As source of IR FDI*	*As host to IR FDI*
Brunei	1.5	−21.1
Cambodia	0.3	22.7
Indonesia	3.0	8.2
Laos	0.12	1.5
Malaysia	34.0	30.4
Myanmar	−0.004	8.0
Philippines	1.1	3.8
Singapore	49.0	8.1
Thailand	11.0	20.6
Vietnam	0.09	17.8
Total value = US$9.8 billion		

Source: ASEAN FDI Database, 1999.

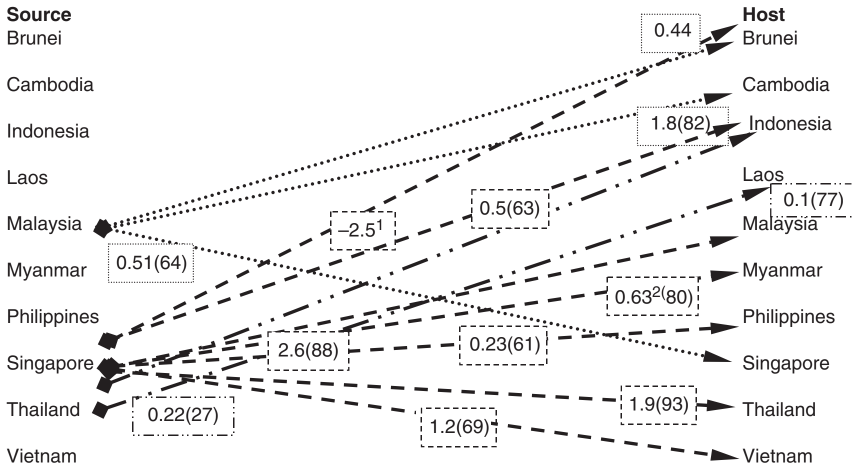

Figure 5.1 Host country perspective of IR FDI flows, from 1995 to first half of 1999. The figures are in US$ billion within box and the percentage of total inward ASEAN FDI held by source is given within parenthesis.

Source: ASEAN (1999).

Notes

1 Represents disinvestment/repatriation.

2 Services FDI, hospitality, construction, manufacturing.

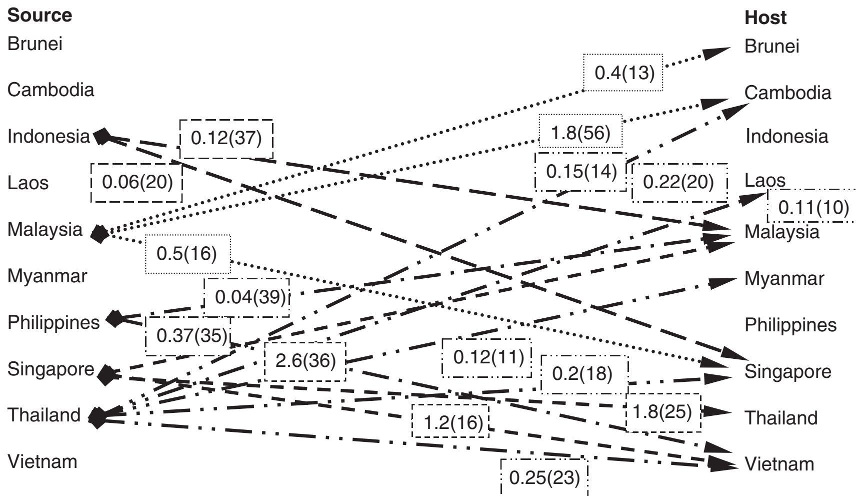

Figure 5.2 Source country perspective of IR FDI flows, from 1995 to first half of 1999. The figures are in US$ billion within box and percentage of total source outward FDI in host country is within parenthesis.

Source: ASEAN (1999).

Table 5.8 Comparative spatial distribution profile of intra-regional source of firms

Rank	*Source of firms*	*Cumulative ASEAN spatial distribution 1995 to first half of 1999*		
		FDI location	*Percentage in host held by source*	*US$ billion*
1	Singapore	Indonesia	63	0.50
		Malaysia	88	2.60
		Myanmar	80	0.63
		Philippines	61	0.23
		Thailand	93	1.90
		Vietnam	69	1.20
2	Malaysia	Brunei	n/a	0.44
		Cambodia	82	1.80
		Singapore	64	0.51
3	Thailand	Indonesia	27	0.22
		Laos	77	0.10

Source: ASEAN, 1999.

counterparts from Malaysia, with a significant presence in Indonesia and particularly Laos.

This spatial distribution summarised in Table 5.8, attests firstly to the 'external wing' economic strategy of 'Singapore Inc.' that has harnessed its government-linked companies (GLCs) to spearhead investment in the region. Secondly, the competitive response by Malaysia can be seen clearly.

Normative issues, pointing to some of the causes of the Asian economic crisis are visible in this pattern, and have policy implications. But before dealing with such issues, it is instructive to look at Figure 5.2. Whereas from the view of percentage of total Intra-ASEAN FDI by source international firms (Figure 5.1), a trichotomous pattern is evident; from the perspective of percentage of total source outward FDI in intra-ASEAN host (Figure 5.2) a broader pattern emerges, although it reflects, by definition, the former pattern. Figure 5.2, which indicates that, depending on their provenance, MNEs in Southeast Asia have distinct preferences for specific host countries. This pattern of preferences reflects distinctively the Uppsala model of international business (Johanson and Vahlne, 1977). International firms from Indonesia prefer to invest in Malaysia and Singapore, reflecting the 'growth triangle' centred on Bintang–Johore Baru–Singapore. In contrast, international firms from Malaysia prefer to invest in Brunei, Cambodia and Singapore. It is suggested that government-influenced growth triangles, as a means to enhance FDI and economic development, is receiving stronger support in Indonesia than in Malaysia. While international firms in the Philippines prefer to invest in Malaysia and Vietnam; those in Singapore prefer Malaysia, Thailand and Vietnam; and those in Thailand have a noticeable preference for Cambodia, Indonesia, Laos and Myanmar. This pattern is summarised in Table 5.9.

Table 5.9 Comparative ASEAN international firms' host country preferences

Source of firms	*Cumulative rank order of preference for hosts, 1995 to first half of 1999*		
	Host to FDI	*Percentage of source outward FDI*	*US$ billion*
Indonesia	Malaysia	27	0.12
	Singapore	20	0.06
Malaysia	Cambodia	56	1.80
	Singapore	16	0.50
	Brunei	13	0.40
Philippines	Malaysia	39	0.04
	Vietnam	35	0.37
Singapore	Malaysia	36	2.60
	Thailand	25	1.80
	Vietnam	16	1.20
Thailand	Indonesia	20	0.22
	Cambodia	14	0.15
	Myanmar	11	0.12
	Laos	10	0.11

Source: ASEAN, 1999.

Source firms prefer to invest predominantly in specific pairs of hosts. It is not entirely clear why, given the received market-orientated motivation for FDI, its empirical support and ASEAN's lack of economic reforms (EIU, 2001; MIGA, 2002), Singapore should be predominant in Myanmar and Vietnam, or Thailand, in Laos, or Malaysia or in Cambodia. This aspect of the pattern is especially puzzling given research that paints a less than wholly encouraging view of the Indochina-4 (Bartels and Freeman, 2000). An explanation may be found in a closer examination of the international capital dynamics of the Chinese diaspora.[37]

The 'Asian Economic miracle' (World Bank, 1993), classified Asian economic performance as High Performance Asian Economies (HPAEs) and Newly Industrialising Asian Economies (NIAEs). Remarkable about their respective economic growth trajectories was collective and individual export performances over the long term, as a direct result of inward FDI, and Japanese MNEs offshore production strategies during the era of the strong Yen following the 1985 Plaza Accord. It is therefore instructive to scrutinise IR FDI in the manufacturing sector over the 1990s for clues to the future. Such an examination, depicted in Table 5.10, should reflect Figures 5.1 and 5.2, and reveal the predominant pattern of IR FDI that gives rise to regional competitiveness (Hobday, 1996), as opposed to the intra-ASEAN FDI in property-related capacity (Ryan, 2000).

Table 5.11, which should also be read with Figures 5.1 and 5.2, indicates, from the centre–periphery theoretical perspective, the regional international division of labour with 'north' as Singapore 'south' as Indonesia (Bintang) and Malaysia

Table 5.10 Cumulative intra-regional manufacturing FDI, 1990–98 (%)

Location	*From Southeast Asia into*	*Into Southeast Asia from*
Brunei	0.13	0.003
Cambodia	5.20	n/a
Indonesia	35.40	4.50
Laos	1.20	n/a
Malaysia	37.80	9.40
Myanmar	3.40	0.05
Philippines	4.40	1.10
Singapore	n/a	50.20
Thailand	4.80	12.70
Vietnam	7.80	0.01
Total value over period 1990–98 = US$35.5 billion		

Source: ASEAN, 1999.

Table 5.11 Comparative spatial distribution profile of intra-regional manufacturing FDI, 1990–98

Rank	*Source country firms*	*FDI host country*	*Percentage of FDI in host held by source country firms*	*US$ million*
1	Singapore	Indonesia	67	1,254
		Malaysia	50	1,340
		Vietnam	50	1,383
		Thailand	50	n/a
2	Malaysia	Indonesia	53	1,756
		Cambodia	18	61
		Brunei	29	n/a
3	Indonesia	Malaysia	68	1,088
		Brunei	52	n/a
4	Thailand	Indonesia	38	1,704
		Philippines	26	1,166
5	Philippines	Myanmar	39	147
		Vietnam	35	136.0
6	Myanmar	Thailand	n/a	19.1
7	Brunei	Malaysia	n/a	1,100

Source: ASEAN, 1999.

(Johor Baru, Penang), and represents some 12 per cent of the total approved manufacturing FDI for the region of US$301 billion (ASEAN, 1999). Figure 5.3 provides more detail to the regional 'north–south' division picture of Indonesia and Malaysia as the 'workshops' of Southeast Asia.

It is instructive to look at the sectoral distribution of IR FDI in each of the host countries to FDI. Notwithstanding the industry structural similarities within the region, international firms from Singapore and Thailand prefer the following

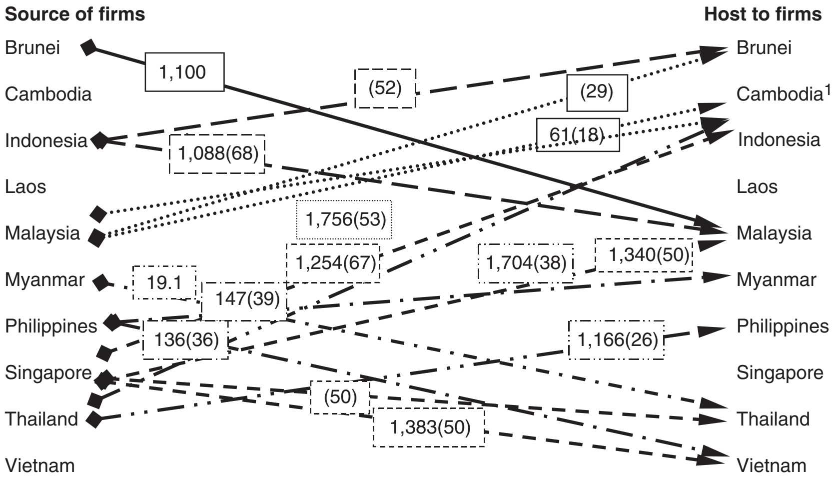

Figure 5.3 Cumulative intra-Southeast Asian manufacturing FDI flows, from 1995 to first half of 1999. Inward FDI figures in US$ million are in box and percentage in host country held by source is given within parenthesis.

Source: ASEAN (1999).

Note

1 71% of inward FDI in Cambodia are Joint International Business Association investments involving firms from two or more ASEAN countries.

sectors for FDI: food/beverages; rubber/plastics; chemicals/non-metallic minerals; wood products; paper; and metal fabrication. Malaysian international firms' sector preferences are: financial services; real estate; manufacturing; and wholesale/retail. By way of comparison, Southeast Asian investors in Thailand prefer electrical components, compared to the heavy Japanese MNEs' FDI in the auto and electrical sectors. It appears that IR FDI is highly asymmetric with respect to sources, and is spatially concentrated with respect to hosts on the one hand, and industrial sectors on the other hand.

Tables 5.12 and 5.13 clearly point to major challenges ahead, regarding asset specificities, in view of longer-term trends in intra-ASEAN FDI flows. Two key trends are: firstly, across all sectors, decreasing net intra-Southeast Asian FDI flows; and secondly, the diminishing share of intra-Southeast Asian FDI in total net FDI to the region. Irrespective of the direction of change in total net FDI to Southeast Asia, IR FDI is shrinking (see Table 5.14). This would suggest that, in the aftermath of the Asian economic crisis, private sector reform and restructuring has not gathered the kind of pace that can permit increased levels of FDI. This is exemplified by Indonesian firms, who in 1997 contributed 37 per cent of intra-Southeast Asian FDI, but contributed less than 10 per cent in 1999.

Reflecting the relatively high homogeneity in industrial locational assets of investment zones and export structures on the one hand and on the other hand,

Table 5.12 Intra-regional FDI flows for select manufacturing sectors (% approval basis), 1999–2001

ISIC code	*1999*	*2000*	*First half of 2001*
32 (radio, television, communications equipment and apparatus)	45.5	30.5	40.8
15 (food products and beverages)	3.3	19.5	12.6

Source: ASEAN, 2001.

Table 5.13 Source and hosts of intra-regional FDI in the manufacturing sector (%)

Source	*Host*	*1999*	*2000*	*First half of 2001*
Singapore	ASEAN	73.6	81.0	87.7
	Indonesia	n/a	79.6	n/a
	Malaysia	n/a	95.6	n/a
	Philippines	n/a	96.6	n/a
	Thailand	n/a	64.9	n/a

Source: ASEAN, *Statistics of FDI in ASEAN*, 2001.

Table 5.14 Net intra-regional FDI flows, 1997–99

Year	*1997*	*1998*	*1999*
US$ million	5,538	2,020	1,218
% Change (−ve)	—	(63.5)	(39.7)

Source: ASEAN, 2001.

the asymmetries in source of – and hosts to – intra-Southeast Asian FDI, in the manufacturing sector, not only does Singapore predominate out-FDI, but it is also ranked number one host (in cumulative terms 1995–99), capturing 20.6 per cent of intra-Southeast Asian FDI, compared with Malaysia at 19.8 per cent, Cambodia at 13.6 per cent, Vietnam at 12 per cent, Thailand at 11.8 per cent, Brunei at 9.7 per cent, and Indonesia (1995–97) at 8 per cent. The trends give rise to more concerns when viewed through the lens of intra-Southeast Asian FDI to manufacturing, on an approval basis. Table 5.15 shows the decelerating pace of approvals.

The argument that this trend is more cyclical than structural is belied by three factors in this manufacturing sector category. First, between 1990 and 1993, flows declined from US$2,390 million to US$1,114 million (a 53.5 per cent decline). Secondly, between 1990 and 2000, there were only two increases (1993/94 and 1995/96) compared to seven decreases year-on-year. Thirdly, between 1990 and 2000, flows declined from US$2,390 million to US$1,367 million (a 42.8 per cent

Table 5.15 Intra-regional FDI to the manufacturing sector (approval basis), 1996–2000

Year	*1996*	*1997*	*1998*	*1999*	*First half of 2000*
US$ million	7,479	3,970	1,869	1,367	266
% Change (−ve)	—	(46.9)	(52.9)	(26.9)	(80.0)

Source: ASEAN 2000b.

Note
Excluding Vietnam.

Table 5.16 Indochina-4 countries as hosts to net intra-regional FDI, 1995–2000

Year	*1995*	*1996*	*1997*	*1998*	*1999*	*First half of 2000*
US$ million	2,048	854	1,115	802	363	49
% Change (−ve)	—	(58.3)	30.6	(28.1)	(54.7)	(86.5)
IR FDI flows to manufacturing sector (approval basis)						
US$ million	647	2,152	721	414	56	25
% Change (−ve)	—	232.6	(66.5)	(42.6)	(86.5)	(55.4)

Source: ASEAN, 2000b.

Note
'Indochina-4' consists of Cambodia, Laos, Myanmar and Vietnam.

decline). There can be little relief from this worrying picture by attention to what is happening with ASEAN's newest members – whose differentiated stages of development might elicit optimism with regards to a repeat of the 'flying geese' strategy for Southeast Asia.

Apart from the one-time shift to manufacturing in 1996, year-on-year comparisons in Table 5.16 show sharp and accelerating declines. The unavoidable implication is that the LSAs gains to Southeast Asian firms from Singapore, Malaysia and Thailand provided by the Indochina-4 (in particular Cambodia and Vietnam) are not evidently sustainable, as the quality of investment class approaches its asymptotic level, and maturity as well as diminishing returns become significant.

As would be expected for a region-wide industrial platform that is relatively homogenous, while intra-Southeast Asian FDI flows have been recording decreases in the last decade, the asymmetric share of those diminishing flows by the already dominant manufacturing sector ISIC 32 (i.e. radio, television, communications equipment and apparatus) has been increasing. While this sector had a 10 per cent cumulative share of intra-Southeast Asian FDI in manufacturing between 1990–97, the share had risen to 15 per cent between 1998 and the first half of 2000.

These interrelated movements and concentrations: Singapore as the overwhelming source of intra-ASEAN outward FDI, as well as its dominant host for

manufacturing; the over-reliance on the same type of industrial locational assets concentrated in industrial parks; and the relatively homogenous export structure in the presence of frictions in implementing AFTA and AIA arrangements, do not augur well for the future of intra-Southeast Asian FDI flows. In an investment environment increasingly shaped by bilateral and regional rule-based arrangements, as well as WTO Treaty obligations, the interventionism of Southeast Asian governments will be less visible and less valuable. Policy implications revolve around issues concerning the generally dependent intermediation industrial trajectory of Southeast Asia in contrast to the autonomous intermediation of South Korea and Taiwan. Despite evidence of endogenous innovations in Malaysian subsidiaries of MNEs (Hobday, 1996; Rasiah, 2001), the structural dependence of Southeast Asia on global rather than regional MNEs suggest high frictions in adjusting the make-up of Southeast Asian competitiveness, and regional inability to either capture from – or prevent the shedding to – China of more capital-intensive stages of production.[38] The fact that Singapore has embarked on implementing technological and R&D upgrading in life and material sciences is evidence of this competitive threat to ASEAN.[39]

In a world of absent factor barriers, what does this prevailing pattern asymmetry, concentration and decline in flows of intra-Southeast Asian FDI hold for the future of the region's continued ability to increase intra-regional FDI, attract FDI in its own right; and compete with China's emergence as the new workshop of the world?[40]

5.5 Conclusion: Southeast Asia's emergent morphology of FDI

The structural rigidities, and intra-firm FDI and trade in Southeast Asia, portrayed here imply that patterns are unlikely to change radically in the immediate term, but will enter a much-delayed phase of asset class rationalisations, thereby further concentrating Southeast Asia's prominence (but diminishing output) in ISIC 32 categories. The key questions are: (a) Given Singapore's preponderance in IR FDI, its evident dependence (as an entrepot) on trade, and the seeming reluctance of ASEAN to institute sufficiently deep and broad economic reforms quickly enough to Singapore's satisfaction, will Singapore continue to provide the bulk of IR FDI? (b) Will Indonesia, Malaysia and Thailand continue to exhibit and improve the kind of LSAs that thus far have attracted FDI? And (c) can the hitherto complementary nature of FDI relations between ASEAN and China be maintained? These questions need to be viewed in the light of the IINs structure of MNEs' industrial organisation that, without significant international barriers to factor mobility, diminishes the value of LSAs, or location factors except large scale 'domestic' markets (which in any case can be served via centralised export modalities). These concerns are far from trivial (Eden and Lenway, 2001), and go to the heart of the Southeast Asian policy-makers' conundrum – how to sustain and strengthen the policy-setting for continuing to attract ever higher quality levels of FDI? Empirical research (Bartels and Freeman, 2000)

suggests that the labour dimension of LSAs FDI motivation/attraction is rapidly loosing significance in the calculations of Triad MNEs, at a time when Southeast Asia's broad lack of higher-order technical skills is becoming increasingly apparent and a constraint on the FDI expansion plans of MNEs.

The demographical disposable income structure of Southeast Asia's national markets are individually insufficiently large. National markets face the added problem of being geographically fractionated with respect to the Southeast Asia archipelago. Persistent high savings rates, and the absence of significantly high tariff barriers, do little to stimulate intra-Southeast Asian market-seeking FDI. Progress on the AIA, while nominally significant in terms of political activities and events, has yet to be described as commercially dynamic, given the reality that 'a business sector AIA council dialogue forum' was required as an initiative at the October 2000 Third Meeting of the ASEAN Investment Area Council, Chiang Mai, Thailand. The exclusion lists prevent firms exercising their market contestability determined rights and modal neutrality options in FDI operating decisions and thereby dampens FDI.

Within the trilateral policy framework of market contestability, modal neutrality and policy coherence (UNCTAD, 1996), ASEAN's AIA exclusion lists represent serious economic distortions. These distortions are unlikely to support greater diversity or volume of intra-Southeast Asian FDI. They will also be increasingly incompatible with ASEAN members' WTO obligations. ASEAN policy-makers, except those in Singapore, are unlikely to change gear in a grouping that is essentially three-speed, unbalanced in its regional patterns of intra-regional FDI, and loosing share of global FDI, and with the historic policy handicap of non-intervention in domestic policy. Furthermore, ASEAN is not yet a single market, does not have in place the design of policy institutions for a single market, and its members are generally not passing or harmonizing laws that move the grouping towards a single market structure. This is despite efforts to express a regional coherence through ASEAN Joint Investment Missions.[41] This is all the more serious because of the diminishing returns setting in with regards to liberalization of FDI regimes.

With such distortions and without single market mechanisms or unique combinations of well-calibrated LSAs, a number of tentative forecasts can be made. First, the identified decreasing volumes and increasing concentration in the asymmetric intra-regional pattern of FDI is likely to persist. Between 1993 and 1998, FDI inflows to ASEAN as a percentage of world total declined from 7.3 to 3.3 per cent; of developing world total declined from 20.3 to 12.9 per cent; of Asia declined from 29.2 to 25.2 per cent; and of ASEAN and China declined from 36.8 to 32.0 per cent (UNCTAD, 1999). Outward flows have also declined. Secondly, it is unlikely that Singapore will continue to be satisfied with continuing to provide the lion's share of investment capital to a region that is failing either to make adequate returns or maintain and upgrade its LSAs in the face of competition from China. And given higher risk-adjusted returns from alternative investment opportunities – particularly in the EU and NAFTA – Singapore seems more likely to divest selectively its FDI stock away from Indonesia, Malaysia, Thailand and Vietnam, rather than further expand its regional investments.

Thirdly, the Asian economic crisis has debilitated Indonesian, Malaysian and Thai firms, and reduced their contribution to intra-Southeast Asian FDI flows. It is unlikely therefore that either diversification within, or away from, Southeast Asia will occur to any great extent. The ASEAN–China complementary and/or competitive FDI relations issue is embodied by the November 2001 agreement for ASEAN and China to negotiate a Free Trade Agreement (FTA), with FDI implications for competition by 2011, and is just one of several bilateral initiatives.[42] However, despite the proliferation of FTAs, without essentially domestic policy responses to eliminate managerial impediments and obstacles to the cross-border transfer of corporate resources and factors, thereby increasing regional integration, it is unlikely that significant demand-led investment stimulus will emerge to draw in FDI and accelerate IR FDI. Furthermore, because of the centre–periphery characterisation of ASEAN, the different sets of problems between each pair of member countries are likely to persist.

Notes

1 See 'ASEAN at risk of becoming irrelevant, seminar told', *The Nation* (Thailand), 23 June 2000.
2 See Michael Richardson, 'Asia storm warning', *The Australian*, 18 January 2001, p. 26; Phillip Cogan, 'Return of the Emerging Markets', *Financial Times*, 17 June 2002, p. 13; and Philip Coggan, 'A vicious circle of investor gloom and mistrust', *Financial Times*, 17 February 2003, p. 6.
3 We define financial and structural globalisation as the twin-track phenomena of increasing asymmetrical interlinkages of domestic financial and productive systems with international financial capital markets, and the multiple transnational service and production networks of multinational enterprises. This phenomenon is most pronounced in Asia among the newly industrialised countries.
4 Frank L. Bartels, Ha Nam Khanh Giao and Benjamin Tan, 'The Strategic Coherence of ASEAN Multinational Enterprises: A Structural Model Analysis', 2002, unpublished research on the dispersed functionalities of international firms from Southeast Asia.
5 In 1991 a search of over 40 major English language newspapers and magazines yielded 158 stories using the word 'globalization' by 2000 this number had risen to 17,638 according to *Newsweek, Special Edition,* December 2002–February 2003, pp. 52–58.
6 See Trish Saywell, 'Powering Asia's growth', *Far East Economic Review*, 2 August 2001, pp. 40–43 for a depiction of China's success, since 1990, in attracting increasing levels of FDI in comparison to the rest of Asia (including Southeast Asia). In 1990, China hosted less than 30 per cent of all inward FDI to Asia, but by 2000 this figure had risen to over 70 per cent. However, when inward FDI flows to China are viewed with greater scrutiny, China's official FDI figures are overstated. See 'China: How cooked are the books?', *The Economist*, 16 March 2002, pp. 61–62. Indonesia, Malaysia, the Philippines and Thailand received US$2.6 billion in net FDI inflows from US MNEs in the year ending March 2001, compared to the US$517 million for China in the same period. Japanese MNEs' FDI to the same group (plus Singapore) has been greater than that to China in the past fourteen years.
7 See the last ten years' of UNCTAD World Investment Reports for an appreciation of the different dimensions of global flows of FDI <http://www.unctad.org/wir/index.htm>.
8 We use the term 'Triad' to refer to the three leading economic regions of North America, the European Union and Japan.
9 Defined here as being less than 'open' economies, dominated by low manufacturing value-added exports.

10 The progressive location of labour-intensive stages of production that hitherto had taken advantage of Southeast Asia's relatively high skills in assembly at low factor cost.
11 See *The Economist*, 2 February 2002, p. 61 and UNCTAD Press Release, 24 October 2002, <http://www.unctad.org/en/Press/pr0263en.htm>.
12 For a profile of private capital flows to emerging markets, see Figure 'Holding up', *The Economist*, 2–8 February 2002, p. 63.
13 ASEAN can be differentiated by policy posture and economic profile into a more advanced group of the 'ASEAN-5', consisting of Singapore, Malaysia, Thailand, the Philippines and Indonesia; and a trailing transitional economy group of 'Indochina-4', consisting of Vietnam, Cambodia, Laos and Myanmar; and Brunei's oil/gas-dependent economy as an outlier.
14 See 'The Tech Wreck Hits Home', *Asiaweek*, 9 March 2001, pp. 20–26; and 'Its Not Pneumonia, But Asia's Deep Chill Could Last', *Businessweek*, 30 July 2001, p. 22.
15 Martin Wolf, 'The recovery myth', *Financial Times*, 12 June 2002, p. 14.
16 Survey of ninety-nine multinational firms with Asia regional operations, conducted by Frank L. Bartels and Nick J. Freeman in the second half of 1999.
17 See 'Trade in Asia', *The Economist*, 2 November 2002, pp. 55–56.
18 For a profile of the Southeast Asia location production output of NASDAQ-quoted US firms, see 'How The Mighty Have Fallen', *Asiaweek*, 9 March 2001, pp. 22–23.
19 For a view on ASEAN's economic structure, see 'The Ultimate Business Survey', *Asiaweek*, 16 April 1999, pp. 40–53.
20 By way of example, about 67 per cent of Indonesia's listed firms are family-controlled, 52 per cent in Thailand, 43 per cent in Malaysia, 46 per cent in the Philippines and 45 per cent in Singapore. By way of comparison, it is 70 per cent in Hong Kong and 45 per cent in Taiwan. Before the Asian crisis 1,247 separate companies had a significant ownership by the Suharto family in Indonesia. Lee Hsien Loong, 'Strategies for Recovery: Building Real Capacities in the Economy', Speech at the Far East Economic Review Conference, Hong Kong, 16 June 1999, and Nick Cumming-Bruce, 'Fishing for Suharto's hidden wealth', *Mail and Guardian* (South Africa), 5–11 June 1998.
21 The 'Flying Geese' model was conceptualised by the economist Kaname Akamatsu. In the 1960s, Japan would use it as a basis for regional economic expansion. ASEAN's growth triangles are: Indonesia–Malaysia–Singapore centred economically and logistically on Singapore; Indonesia–Malaysia–Thailand centred on Penang. Other geographical growth areas are the ASEAN Mekong Basin Development Cooperation centred on Thailand, and the Brunei–Indonesia–Malaysia–Philippines growth area centred on Malaysia's Sarawak and Sabah provinces.
22 See Ha Nam Khanh Giao, 'ASEAN Multinational Enterprises Foreign Direct Investment'. Doctoral thesis, Nanyang Business School, Nanyang Technological University, Singapore, 2002.
23 See 'Singapore's Trade Initiatives Undermine ASEAN Economic Policy', 27 November 2000, 'stratfor.com', Strategic Forecasting LLC.
24 East Timor, having gained independence and nationhood, currently remains outside ASEAN.
25 See 'Direct Investment in Asia: Policy towards FDI converged since 1997', Economist Intelligence Unit, 11 July 2000, EIU website.
26 The platform arrangements are: 1987 ASEAN Agreement for the Promotion and Protection of Investment (APPI); 1996 Protocol Amending the APPI; 1996 Protocol on Dispute Settlement Mechanism; 1998 Framework Agreement on the AIA. These arrangements, *inter alia*, cover legislation, FDI sectors, foreign equity policies, incentives and employment of foreign workers. For a comprehensive view see: <http://www.aseansec.org/economic/invest/compmenu.htm>.
27 For an appreciation of the persistence of ties between business and government in Asia that, in its worst manifestations, has attracted the sobriquet 'crony capitalism', see Michael Sheridan, 'Asia back at the brink', *The Sunday Times*, cited in *The Australian*, 5 November 2001, p. 40.

28 UNCTAD predicts a fall in FDI to developing Asia (excluding China) from US$102 billion (2001) to US$90 billion (2002). See UNCTAD Press Release TAD/INF/PR63, 24 October 2002 <http://www.unctad.org/en/Press/pro263en.htm>.
29 This empirical research suggest that, in an ASEAN unable through its AIA and AFTA mechanisms, to effect greater policy convergence, to continue reform and liberalise both FDI and trade regimes, increasing frustration felt in the policy community of leading Southeast Asian economies (aka Singapore) will find expression in increased external bilateral agreements. This bodes ill for IR FDI. See 'Trade in Asia: Everyman for Himself', *The Economist*, 2 November 2002, pp. 55–56 for the proliferation of bilateral trade deals.
30 Japanese outward FDI (cumulative 1991–2000) into Asia and Pacific was ¥13,862.9 billion (22.4 per cent of total ¥61,916.6 billion); with 9.6 per cent of total Japanese outward FDI going to ASEAN of which Philippines received 0.9 per cent; Singapore 1.9 per cent; Indonesia 3.0 per cent; Malaysia 1.4 per cent; and Thailand 2.2 per cent, respectively.
31 For issues pertinent to regional integration, see Michael Richardson, 'Asia looks to zones of free trade', *International Herald Tribune*, 3 January 2002, p. 9.
32 See Shawn Donnan, Amy Kazim and Douglas Wong, 'Doubts cloud Southeast Asia's free trade dreams', *Financial Times*, 30 December 2002, p. 3.
33 For an analysis of the deteriorating condition of Southeast Asia, see Greg Sheridan, 'Regional malaise: looking out our back door', *The Australian*, 8–9 December 2001, pp. 24–25.
34 See 'Financial Times Survey of Singapore', 11 April 2002, 'Cracks appear in the corporatist model'.
35 For commentary on the declining flows of Japanese FDI into Southeast Asia, and collapsing US capital asset values, see John Thornhill, 'Japan seen as part of Asia's problem', *Financial Times*, 20 March 2002, p. 8; and Martin Wolf, 'Down time', *Financial Times*, 17 July 2002, p. 12.
36 See Daniel Gay, 'The neighbourhood's on fire', *Asiaweek*, 4 May 2001, pp. 32–33.
37 See 'The Five Faces of China', Newsweek Special Report, 28 October 2002, pp. 40–67.
38 ASEAN enjoys a current trade surplus with China, of US$39 billion exports and US$31 billion imports from China. *The Economist*, 2 November 2002, p. 55.
39 See Yang Razali Kassim, 'Why US firms find ASEAN less appealing now', *Business Times* (Singapore), 6 October 2000, p. 16.
40 See Dan Roberts and James Kynge, 'How cheap labour, foreign investment and rapid industrialisation are creating a new workshop of the world', *Financial Times*, 4 February 2003, p. 13.
41 Since 2000 there have been six ASEAN Joint Investment Missions to Japan, the US, UK, France and Germany.
42 See Naoko Manukata, 'Wither East Asian Economic Integration', Brookings Institution, June 2002.

6 Foreign direct investment and the rise of cross-border production networks in Southeast Asia

Axèle Giroud

6.1 Introduction

This chapter outlines the background and current situation of companies' cross-border production networks (CPNs) in Southeast Asian countries, with the aim of providing an insight into the future trends of CPNs in the region. Companies in Southeast Asian economies have adopted complex regional strategies and intricate network structures that have facilitated intra-regional economic interdependence. One characteristic of firms' activities across the region is that of a sophisticated intra-firm division of labour for each corporate function. This regional pattern is interrelated, in many cases, with that of a broader set of activities carried out by firms in Asia as a whole. In this chapter, we consider firms that make an intentional effort to network their own operations and inter-firm relationships on a regional basis, across functions and locations. Thus, CPNs include activities taking place between one firm and other affiliates of the same group within the region, and between one firm and other business partners located in countries of the region.

Section 6.2 looks at interdependence amongst Asian countries, and how the development paths followed by various countries, and the region's attractiveness to international investors have impacted upon the development of CPNs in Southeast Asian countries. The specific regional initiatives launched by the ASEAN Secretariat towards further economic integration are also discussed, in relation to how they will further consolidate CPNs. In Section 6.3, CPNs are further elaborated to highlight the importance of both internal and external activities. The features internal to the firm are looked at with numerous examples of how firms operate across Southeast Asia. The final Section 6.4 tackles the increase in networks amongst firms regionally, which also reinforce CPNs. While most studies focus on East Asia as a whole to analyse CPNs, this chapter aims at focusing on the situation faced by firms within Southeast Asia itself, so as to understand what these networks mean for the region, whether or not they will continue to rise in the future, and if so, under which conditions. I conclude by arguing that further economic interdependence of Southeast Asia will depend on both intergovernmental efforts towards creating the appropriate environment for firms to operate in, as well as on firms' willingness to further deepen regional production systems, even if the latter is part of Asian-wide production systems.

6.2 Regional features favourable for the development of CPNs

In this section, we discuss the global development of CPNs, as well as the factors that facilitated the rise of such networks in Asia, and more specifically in Southeast Asia. This discussion leads us to consider the strategic behaviour of firms and the importance of the division of labour in Southeast Asia.

6.2.1 Growth and significance of international production

Over the past few decades, the world economy has become more globalised, and various trends have been conducive to the development of international production networks. Such trends include increased world investment flows and world trade, progressive liberalisation of world trade through incentives provided by the World Trade Organisation (WTO), and regional and individual countries' efforts (Narula, 1996; Hood and Young, 2000; Mirza, 2000). As Buckley has noted in Chapter 2 of this volume, information technology and other major technological breakthroughs have also facilitated the creation of international and regional networks. Transnational Corporations (TNCs) have, for instance, been able to decentralise and co-ordinate their activities throughout the value chain via cross-border sourcing and offshore production of components, thanks to improvements in informatics and telecommunications. Firms have invested increasingly abroad. Although such trends have taken place on a global basis, regional developments are noticeable, especially in the European Union (EU), North America and Southeast Asia. World investment inflows have also increased steadily over the past three decades, to reach US$1,270 billion in 2000. Inflows into ASEAN, however, have not recovered from their pre-Asian crisis level, and the region's share in total foreign direct investment (FDI) in developing Asia has decreased from over 30 per cent in the mid-1990s to 10 per cent in 2000. This is mainly explained by substantial divestments in Indonesia since the beginning of the Asian crisis in 1997. Nevertheless, total inward stock in Southeast Asia reached US$172,537 million in 2000 (UNCTAD, 2001). More than 87 per cent of FDI flows in Southeast Asia over the 1995–2000 period were from outside the region, with 52 per cent accounted for by flows from Japan, the US and the EU, and 11 per cent from Hong Kong, Taiwan and Korea. Over the same period, intra-ASEAN investment flows amounted to 13 per cent of total investment (ASEAN, 2001).

TNCs have developed the capacity to internalise specialised assets and capabilities on a global scale. International location means that final assembly is most likely dispersed to major growth markets in the US, Europe and Asia. In the case of computers for example, microprocessors are sourced from the US, memory devices from Japan and Korea, motherboards from Taiwan, hard disk drives from Singapore, monitors from Korea, Taiwan and Japan, and keyboards and power switch supplies from Taiwan. Hence globalisation affects the transformation of international production networks (Ernst and Ravenhill, 2000). Within Asia and Southeast Asia, cross-border network activities mean that products (parts, components and intermediate products) can be produced more efficiently through linking production activities located in various parts of the region, supported by the locational strengths and factor endowments of each member country. Each

TNC's investment and management strategies also influence the expansion of operations across the region.

6.2.2 Asia's development experience and CPNs

The development of the ASEAN member countries is often analysed in the light of the experience of the whole of Asia. Numerous studies have applied the 'flying geese' pattern of economic development to the experience of Asia, whereby each country in the region follows successive stages of development. The concept of hierarchical development originated with Kaname Akamatsu in the early 1960s, who described economic development of countries as being interlinked. Originally referred to as the 'flying geese pattern' in the 1930s, Akamatsu later relabelled his theory the 'Catching up Product Cycle' (Kojima, 1996, 2000). Such a description is similar, but not identical, to the Product Life Cycle model (Vernon, 1966).

Asian countries have benefited from a movement of comparative advantage transferred from the developed countries, and in particular from Japan (Rana, 1990; Ozawa, 1991; Kwan, 1994; Yusuf, 2002). They have shown a unity and a fundamental integrity in the effort towards regional development. This effort takes the shape of an inverted V, with a dominating country, Japan, at the apex, followed by second tier countries, the New Industrialised Economies (NIEs) of Hong Kong, Singapore, South Korea and Taiwan. These NIEs become, in turn, dominating countries with successive waves of following countries in Southeast Asia (Malaysia, Indonesia, Thailand and the Philippines), followed by the countries with lower levels of development, mainly Vietnam and China. Such a development pattern is key to the creation of cross-border networks, because capital accumulation and the creation of backward and forward linkages by foreign firms allow indigenous firms in less developed countries to gain access to the technology and know-how related to more advanced methods of production. The country thus reaches a relatively higher level of revealed comparative advantage and it benefits from an improved industrial structure, mainly through the development of these international and regional production networks.

Recently, firms from Japan and the NIEs have been less proactive at creating Asian-wide cross-border networks. Firms from the US and Europe, on the other hand, have been more proactive at creating links in the region, and in a second step, using existing suppliers throughout the region. A key explanatory factor for this is geographical proximity, which has facilitated centralised control (Ernst, 2000: 90), because Asian firms can control their Asian affiliates from their home office/country, as the region is in the same time zone. The facility for centralised control diminishes with increasing distance, because of the difficulty of coordination and the risk of disruptions.

In their development experience, Japan adopted policies of technical catch-up, and similarly the NIEs have used strategies of extensive technological borrowing, export-led growth and FDI. The group embodied by Malaysia, Thailand, the Philippines and Indonesia have focused on export-led growth and a heavy

dependence on FDI. Firms' international expansion in nearby countries represents a key link for the region; hence Southeast Asian countries have relied heavily on insertion into the networks created not only by Japanese, Korean, Hong Kong and Taiwanese TNCs, but also by US and European TNCs. Over the period 1995–2002, Japan was the primary investor in ASEAN, investing US$19,213 million.[1] The US came second, with a total of US$17,994 million (ASEAN, 2001: 14). The third major investor was the UK, followed by Singapore, the Netherlands, Hong Kong, Taiwan, Germany, South Korea and France.

The extent of indigenous technical capacity in Southeast Asia (apart from Singapore, as specified in Konstadakopulos, 2002) is lower than in the case of East Asian countries, but some regional investment is taking place by companies from Singapore, Malaysia and Thailand, with interest in other countries in the region such as Vietnam and Cambodia. Thus, regional networks are starting to be generated by companies from within Southeast Asia. Between 1995 and 2000, Singapore invested a total of US$9,346 million in the region, with these flows going primarily to Malaysia, Thailand and Vietnam. Indonesia invested a total of US$2,344 million in the region, the bulk of which went to Singapore (ASEAN, 2001: 15).

The industrial sectors involved and the type of investment performed by companies are two additional factors important in explaining the creation of cross-border networks in the light of Asia's development experience. The early investments in the 1960s were largely outward processing investments, with limited local added value. Import-substituting investments were of a different nature. In the case of consumer electronics, investments were aimed at circumventing tariff protection, so as to gain access in specific markets. In the 1970s and 1980s, local suppliers developed in Korea, Taiwan and Singapore. TNCs relocated low-end market segments to lower cost locations in the region, following the pattern described by the product cycle and flying geese models. This did take place for some products, such as in the electronics sector; but not for all products. In some cases, TNCs continued investment in their existing operations, but they increased their reliance on local and regional suppliers for a greater range of inputs, processes, and manufacturing steps. Suppliers from the NIEs started to export to other Asian production sites and finally extended their own operations into parts of Southeast Asia (notably Malaysia, Indonesia and Thailand). Thus, East Asian countries' interdependence has also arisen through gains from complementary exports between Japan and the NIEs, on the one hand, and neighbouring developing countries on the other hand. This complementary pattern is the result of the intra-industrial specialisation of the countries in the region.

However, Southeast Asia still differs from East Asia in that the success of specific sectors in the region is almost entirely due to foreign firms. Southeast Asian countries have relied very heavily on foreign capital and expertise as a key pillar in their economic development policies, and this has been particularly evident in the region's transitional economies over the last ten years (Freeman and Hew, 2002).

6.2.3 Differences in strategic behaviour

This difference in the development experience has an influence on the strategic behaviour of firms. In the Asian region, the two major groups of international companies are the Japanese and the NIE firms, although each country in the latter group shows its own specific particularities. Firms from the less developed countries in the region are starting to internationalise, but have not yet become the source of substantial flows of FDI. An important factor behind the increase in firms' productivity is the process of innovation; however, in the case of Asian firms, the degree of efficiency in using foreign technology and the appropriateness and quality of the borrowed technology preceded such further improvements. Each industry has shown specific patterns of development. Thus, in the electronics sector, the competitive advantages of Japanese firms are linked to innovation and technological know-how, whereas NIE firms competed on the basis of production capabilities that allowed for high quality standards, and on improvements in product and production processes that allowed for productivity gains (Hobday, 1995; Van Hoesel, 1999). As for Southeast Asian countries, their industry still relies heavily on overseas subsidiaries, which generate most of the exports of electronics goods. A wider explanation of the distribution of advantages lies in the 'Pacific exchange triangle'. Indeed, until recently, NIE firms have been dependent on Japan for intermediate and capital goods on the supply side, and together with Japan, dependent on the United States as a final market for their finished products. This dependence on Japan on the supply side has led to a new regional division of labour, based on regional production networks rather than on national economies.

The regional strategic behaviour of western firms, mainly from the United States and from Europe, is relatively less well studied in this context of regional dynamics, for several reasons: their originating country is geographically further away; they depend less than NIE firms on Japan for the supply of high technology-intensive parts and components; their home market is located outside the Asian region; and these firms have pursued globalised rather than regionalised strategies and production networks. Despite these factors, US firms have also developed regionalised production networks within Southeast Asia, such as in the electronics sector (Dobson and Chia, 1997; UNCTAD, 2001).

6.2.4 The regional economy in Southeast Asia and CPNs

A key trend alongside globalisation is that of regional economic integration. This has played a role in the emergence of CPNs in Southeast Asia. The Association of Southeast Asian Nations (ASEAN) was created in 1967 with the ultimate aim of creating a prosperous and peaceful community. To achieve this, member states have worked to jointly accelerate economic growth, social progress and cultural development. Internally, ASEAN works through mutual assistance and collaboration on common issues, such as those within the technical, scientific and administrative fields. Externally, ASEAN operates through dialogue forums with non-members. The major ASEAN economic integration schemes include the

ASEAN Investment Area (AIA), ASEAN Free Trade Area (AFTA) and the ASEAN Industrial Cooperation (AICO) scheme. The strategic objective of AFTA[2] is to increase the Southeast Asian region's competitive advantage as a single production unit. The elimination of tariff and non-tariff barriers among the member countries is expected to promote greater economic efficiency, productivity, and competitiveness. The other key objectives for the consolidation of CPNs are within the framework of the AIA, which is in the process of implementation, and is discussed further in Chapter 11 of this volume.

Arndt (2001) argues that ASEAN and the current AFTA agreement may not constitute an optimal economic area, because the elements of trade diversion are likely to dominate those of trade creation. This may result from the fact that the agreement excludes low-cost producers in Asia, such as China, and trade diversion may therefore take place. The argument here is that ASEAN nations have greater economic interaction with other nations in the world than they have with each other. Although governments in the region plan on an increase in trade, which would subsequently boost industrial growth and development, the bulk of policies that encourage growth and industrialisation still take place on a national level, and therefore more regional co-ordination of policies is needed. Southeast Asian countries rely substantially on export-led growth, and the US, Japan and Europe represent their major markets. About 75 per cent of ASEAN's total exports in the period 1993–2000 were to countries outside the region, with 50 per cent of the region's exports going to the US, the EU and Japan alone (ASEAN, 2001: 3). Within the region, firms engage in outsourcing, but TNCs from outside the region are the main initiators of this cross-border sourcing. It is therefore essential to promote further cross-border sourcing, and decrease obstacles to trade and other policy barriers, as well as lower communication and transportation costs (Mirza *et al*., 1997; Arndt, 2001). Clearly, these will be improved when AFTA is fully implemented by all Southeast Asian countries in 2010.

The main remaining challenge for Southeast Asian governments, then, is the consolidation of a regional economy, with regionally structured production networks. The latter will bring substantial benefits, perhaps more than preferential trade liberalisation, since this still leaves the member economies segmented. Overall, further CPNs would increase welfare returns and strengthen the regional economy. ASEAN needs to enable the region's producers to become more efficient and competitive, through location decisions that are not constrained by national frontiers. Thus, countries will further specialise in components and the production of final products according to their comparative advantages. Regional initiatives ought therefore to focus on creating an integrated economic space in which production on a regional basis makes the region's products more competitive in world markets, whether they are produced by domestic or foreign companies.

6.2.5 Division of labour in the region

As mentioned previously, governments must encourage regional production networks based on component specialisation, so that production and assembling activities are conducted according to specific comparative advantages.

CPNs exploit locational advantages by organising the division of labour across borders that reassembles the industry value-chain through specialisation at each mode. Singapore is dominant for the position of regional headquarters (HQs) (and various major support functions, such as procurement, testing, engineering services and training). The city-state has also become a major communications and manufacturing hub for the region, with substantial spill-over effects in neighbour countries (Wong, 1997, 2000). Singapore is the most advanced in the region technologically, as exemplified by being a major pole for production of hard disk drives (HDDs). Seagate established the first significant HDD assembly operation in Singapore in 1982, and by 1996, the six largest HDDs manufacturers in the world were present in the country. Some of these companies have now started operations in neighbouring Southeast Asian countries, but one substantial spill-over impact has been through the suppliers developed by foreign firms. Wong (1997) shows that nearly all of his sample of 109 manufacturing firms known to be suppliers to the HDD industry have internationalised their operations to neighbouring Southeast Asian countries, as well as China.

In the debate on competition versus complementarity between Southeast Asian economies, Singapore is still more complementary, although the situation is changing. Malaysia and Thailand, and to a lesser extent the Philippines, are preferred locations for volume production, especially of mid-level and some higher end products. Finally, Indonesia and Vietnam compete for low-end assembly and simple component manufacturing, although the situation in Indonesia is changing rapidly. The latest entrants to ASEAN (Cambodia, Laos and Myanmar) still attract small amounts of FDI. As of 2000, total FDI inward stock amounted to US$89,250 million in Singapore, US$60,638 million and US$54,325 million for Indonesia and Malaysia respectively, followed by US$24,165 million for Thailand and US$12,688 million for the Philippines. Vietnam's total inward FDI stock reached US$17,956 million in 2000, far ahead of other late entrants in ASEAN, for which aggregate FDI stocks are still below US$3,000 million (UNCTAD, 2001). Since the outburst of the Asian crisis, mid-level countries such as Malaysia and Thailand have become potential locations again for low-technology products. This means that the competitive dynamics amongst countries in the region are still evident.

Additionally, the spread of TNCs across Asia with production networks into new locations, such as China, has given rise to serious problems of duplication of production capacity and product lines. The case of Matsushita provides a good example. The company started its investment activity in China in 1992 and now has nineteen affiliates in the country. Some television sets are smuggled across the borders, many of them ironically, produced by Japanese affiliates in Southeast Asia (Ernst, 2000: 98). One key feature of Matsushita's Asian production networks is the coexistence of 'mini- Matsus', oriented towards servicing the domestic market, as well as more recent export-oriented affiliates in the same countries. In principle, plants could coexist if they were producing different qualities of products for different market segments at different prices. However, domestic consumer electronic markets are open to international competition, and there are substantial surplus capacities in the region (Ernst, 2000; Legewie and Meyer-Ohle, 2000).

Finally, considering the key role played by foreign firms in Southeast Asia – and the fact that an increased share of FDI is now represented by reinvested earnings – building a harmonious environment in which companies will remain in the region and re-invest is essential to the deepening of CPNs (ASEAN, 2001). Of 155 Japanese companies that indicated the sectors for strengthening and expanding overseas business operations through FDI over the medium term in Indonesia, Malaysia, the Philippines and Thailand, 63 per cent mentioned that this would be to strengthen existing bases or expand production lines for existing products (JBIC, 2001: 14). This has been made possible thanks to high levels of profitability of subsidiaries in the region, which has meant that Japanese overseas affiliates are now much less dependent on their parent companies for investment funds. Foreign firms that are familiar with the regional environment are likely to reinforce their operations there, and are also more likely to develop or strengthen CPNs.

In this section, we have shown how cross-border networks have grown globally, and regionally within Asia. The case of Southeast Asia was mentioned in the context of the East Asian development path, in as much as regional dynamics have been important in explaining the rise of production networks within the region itself. In the following section, we adopt a company-based approach to first define and then investigate the background for CPNs in the region.

6.3 Firm–level features and CPNs

The creation of CPNs involves ultimately managing complex and dynamic structures, both within a single firm and amongst various different firms that may belong to the network. These structures are defined next, before we focus on relevant intra-firm features when considering the emergence and development of cross-border networks in Southeast Asia. These will include intra-firm activities, namely the geographical spread of activities by firms across Southeast Asia, intra-firm trade, and the functional scope of CPNs.

6.3.1 Defining CPNs

As indicated earlier, production networks worldwide have increased substantially over the past three decades. Firms increasingly outsource parts of their production to lower wage locations, with consequences and implications for trade flows (with substantial volumes of trade now taking place *within* TNCs). A network can be defined as a number of distinguishable economic activities engaged in significant interaction with each other. The concept of cross-border production networks is an attempt to capture the spread of broader and more systemic forms (which may or may not involve equity ownership[3]) of international production that cover all stages of the value chain.

Networks involve complex combinations of horizontal and vertical linkages among firms, with often a core firm acting as a central agent. Each network will be based on shared authority, goals, expertise, responsibility, accountability, recognition

and reward. In terms of external relationships of the core firm, CPNs cover supplier, buyer and customer networks, but also producer networks (competing producers may co-operate to reduce development and production capacities), coalitions among firms, technology co-operation and other strategic alliances (Borrus *et al.*, 2000b). Some core competencies, such as manufacturing or research and development (R&D), may be conducted outside the core firm; this may bring more stability through long-term alliances, requiring more intimate involvement and greater trust. The primary motive for outsourcing is to utilise the locational advantages of a host country with respect to a portion of the core firm's value chain. The extent and nature of linkages depend on where and how the outsourced production fits into a parent firm's value chain. Absolute location factors of the host country often represent a relatively small part in the decision of the firm to locate there. Endowment factors, such as economies of scale, product differentiation, and location decisions of the TNC have a more powerful impact on the location decision. Apart from the various activities mentioned here that may be involved in the network, firms have recently tended to outsource core manufacturing functions. This can be illustrated by the following:

> Vertically integrated assemblers such as International Business Machines (IBM), Hewlett-Packard (HP), and Apple have disposed of captive production facilities and moved toward the new cross-border production network model for a number of product lines. By 1994, 50 percent of HP's 20 million circuit boards and 11 percent of its 4.5 million final products were being assembled by contract manufacturers, as was fully 50 percent of Apple's production. Some of the newest and most successful systems companies own no volume manufacturing at all, including Dell (PCs), Silicon Graphics (workstations), Cisco Systems (networking), Diebold (automatic teller machines), Digital Microwave (communications), Telebit (modems), LAM research (equipment), and Octel communications.
>
> (Borrus *et al.*, 2000a: 6)

Whilst most analyses focus on the creation of global production networks, there is increasing attention paid to the development of regional production networks. On a regional basis, the effort made by the firm to move away from a loose patchwork of stand alone affiliates and suppliers applies to using comparative advantages in existing locations within a region. Firms make an intentional effort to network their own operations and inter-firm relationships on a regional basis, across functions and locations (Enright, 2000). The advantage of CPNs for the firm is to increase efficiency and performance, as well as lower costs. Markets can be structured to increase profits by removing direct competitors, creating differentiation, erecting entry barriers, and assembling capabilities that other forms of business organisations cannot match. Networks also help the firm to benefit from each locational advantage, by using the specialised technology skills and know-how that are available in these locations.

This regionally fragmented – and linked – activity is part of the firm's 'embeddedness' in the local business environment. For Zhara *et al*. (1999), the basic concept of networks refers to socially binding ties between actors at the individual or the organisational level. Social and personal ties are thus very important. In line with this concept, that of 'embeddedness' is based on trust, reciprocity, and shared expectations that overcome opportunist behaviour and permit co-ordination. This system is commonly found across East Asia (Yeung, 1998). While the networked organisation holds ideas borrowed from the Japanese *keiretsu* system, in which very strict relations between interdependent activities seem to prevail, the notion of social 'embeddedness' is more often association with the activities of Chinese-owned firms. In the case of Chinese firms, CPNs are not motivated solely by cheap factor costs or market access. In summary, we can say that CPNs can be explained by transaction costs, by social 'embeddedness', and by the need for firms to share complementary assets held by other firms.

6.3.2 CPNs through transnational corporations' internal activities

TNC strategies and CPNs

As explained earlier, CPNs arise when firms adopt complex international strategies, based on their internal ability to shift production or supplies to profitable locations. Each operation is judged by its contribution to the regional value chain. Thus, one of the key analysis for CPNs lies in the specific functional scope of the regional production, and the specific roles attributed to subsidiaries located in Southeast Asia, as well as the geographical scope of these subsidiaries. Many TNCs have affiliates scattered around Southeast Asia. Foreign production and/or sales affiliates are usually the earliest to be established in most countries, and this pattern can be seen throughout Southeast Asia. Integrated production systems have grown in Southeast Asia, with geographical specialisation by different parts of the TNC production system (components, sub-assembly, semi-finished products).

One example of these systems is that of Toyota Motor Corporation, which has established affiliates throughout the Southeast Asia, and has set up a regional structure of activities (UNCTAD, 2001: 87). The company's regional HQs are located in Singapore, with assemblers in Indonesia, the Philippines, Malaysia, Vietnam and Thailand. Financing and training centres are located in Cambodia, Thailand and Myanmar, and part suppliers in Malaysia, the Philippines and two affiliates in Thailand. There is substantial intra-firm trade, and affiliates in the region exchange parts and components for production purposes.

The regional strategies of TNCs in Southeast Asia have largely developed not only as a result of firms' own strategies, but also due to encouragement by intergovernmental agreements, in response to the strong presence of TNCs, firstly from the US and Japan, and subsequently from the NIEs, in their strive to access lower cost locations. The two key sectors in which TNCs have followed regional strategies are manufacturing of automobiles and electronics. Japanese firms have been leading in the regional spread of production; they built a system of regional

networks, and they have been particularly active in investing in an intra-ASEAN manufacturing system. Nissan, Mitsubishi and Toyota have had cross-supply arrangements in the region for some time (for example, see details provided in UNCTAD, 1993b). In turn, Japanese firms show two key trends. First, they remain closely related to their parent firm in terms of decision making. Relatively close geographical proximity to Japan has facilitated centralised control between affiliates and their production networks.[4] Secondly, because of the spread of Japanese firms in Southeast Asia, Japanese firms are able to create networks not only with other Japanese firms, but also with TNCs from other countries in the Asian region (Dobson and Chia, 1997; UNCTAD, 2001; Giroud, 2003).

6.3.3 Geographical spread of CPNs in Southeast Asia

Many TNCs have affiliates in more than one country in Southeast Asia (and many firms have more than one subsidiary in each host country). In their survey, Mirza *et al*. (1997) asked companies to state the ASEAN member country or countries in which they had one or more subsidiaries. Out of 214 firms surveyed, 163 had affiliates in more than one ASEAN member country. Multiple locations clearly appears to be a common strategy for TNCs. More than four-fifths of western firms surveyed had multiple locations; the highest share being 92 per cent for North American firms. In comparison, two-thirds of Taiwanese firms were located in only one ASEAN member country. This may reflect their strategy, as a large number of Taiwanese firms are small and medium sized, and are therefore more resource constrained. However, this low percentage also reflects the fact that Taiwanese firms are new investors on the world scene, and have not yet benefited from the learning experience of firms from some of the other source countries. Having said this, experience and strategy clearly count, since about 80 per cent of Japanese firms have multiple locations, even though their average size is small compared to western firms. In this respect, it is worth mentioning that many smaller Japanese firms have entered Southeast Asia as suppliers to larger Japanese TNCs (as part of the *keiretsu* system). In the survey, Thailand, Indonesia, Malaysia and Singapore were the preferred locations for foreign firms, although there were some slight differences according to the TNC's country of origin.[5]

To illustrate the way in which firms expand their operations in Southeast Asia, we can take the example of Samsung. Samsung Electronics first invested in the Southeast Asian region in Thailand, through a joint venture with Saga Group in 1989. It then invested in a first plant in Indonesia in 1990, to produce refrigerators for domestic sales, and then a second plant in 1992 to produce audio equipment and VCR for exports. Samsung established itself in Malaysia in 1991 to produce microwave ovens, and then opened a second plant in 1995 to produce colour monitors. The same year it opened a plant in Vietnam to produce colour televisions. In parallel to Samsung Electronics Corporation's (SEC's) investments, Samsung Display Devices (SDD) invested in a wholly owned subsidiary in Malaysia in 1990, to manufacture picture tubes (Youngsoo, 2000; Jun, 2001).

The move to Malaysia was aimed at restoring global cost competitiveness, and only 22 per cent of SDD's Malaysian production was shipped to SEC's factories in Southeast Asia in 1996. Samsung Corning (SCC) followed SDD in Malaysia in 1990, with a wholly owned subsidiary, to be closer to its customers. The production capacity of SCC increased from 2.4 million sets in 1994 to 4.8 million sets in 1995, with most of the production aimed at its sister company SDD. Samsung Electro-Mechanics (SEM) also invested in Southeast Asia, by setting up a plant in Thailand for the production of tuners, deflection yokes, and fly-back transformers in 1993. As of 1996, around 20 percent of the plant's production volume was consumed by its sister companies in Southeast Asia. The closest links created by Samsung companies was between SDD and SCC, as they chose to be in the same location. SCC benefited from the local operating experience of SDD, and they mutually shared utility infrastructures in the same location. SCC is a captive supplier, as it depends totally for its production on SDD.

What is most interesting is the interrelationships between various subsidiaries, and the flows of goods and services among them. Samsung has created an internal vertical network in Southeast Asia, with two main streams of parts flowing in the vertical chain.

> The one flow starts from Samsung Corning's Malaysian operation, which applies tube glass to the Samsung Display Malaysian factory, as a major input for the latter's colour picture tube production. A proportion of these picture tubes are, in turn, sold to Samsung Electronics' operations in Thailand, Indonesia, Vietnam for colour televisions, and in Malaysia for computer monitors. The other flow begins from the Samsung Electro-Mechanics Thailand operation. It supplies tuners, deflection yokes, and fly-back transformers to Samsung's Electronics' Thailand, Vietnam, and Malaysian operations for colour televisions and computer monitors, tuners to the Indonesian operation for VCR's, and oil capacitors to the Malaysian operation for microwave ovens. The same operation also provides deflection yokes to Samsung Display Devices Malaysian operation for colour picture tubes.
>
> (Jun, 2001: 306)

Overall, one can identify various trends in the example of Samsung. First, the decision making within Japanese TNCs tend to be hierarchical and centralised at HQs, with the television set maker (i.e. SEC's initial investment in 1989) followed by parts makers. Secondly, Samsung's Asian network has been formed over time, in response to changing market conditions and competitive environments. Thirdly, there are strong and weak relations and modes within the networks. Finally, firms strive explicitly to be close to each other, as can be seen when know-how is shared among member firms of the network.

One other way the regional network may develop is through the regional location of production and regional rationalisation of a firm's activities. This happened for the American firm Western Digital. In 2000, Western Digital closed its Singapore manufacturing facility and transferred all hard drive manufacturing

from that site to its facility in Kuala Lumpur, Malaysia. However, the company maintains a presence in Singapore through its electronics design centre, where resources are focused on value-added engineering, as well as a customer service centre.[6] The reason for this move was in response to an increasingly competitive environment that was lowering the cost structure in the hard drive industry. The move to Malaysia allowed the firm to produce high volumes around the clock, with maximum efficiency by having a single manufacturing site for desktop, enterprise and home entertainment drives. Know-how was subsequently transferred from Singapore to Malaysia, and some employees from the Singaporean operations were transferred to Malaysia.

The examples discussed here show how firms from outside the region have expanded over time within various Southeast Asian locations. The time spent in Southeast Asia, the industry, degree of export-orientation, and the firm's overall strategy are factors that explain the different use of the region's geographical space. Legewie (1999) argues that many Japanese electronic assemblers still run multi-product companies in every country where they have served the domestic market since their establishment in the 1960s and 1970s. This contrasts with many western TNCs which started operations in Southeast Asia later. These western TNCs tend to have fewer affiliates in the region, and they tend to be focused on single products, as in the case of Siemens, Philips or Bayer from Europe, or Caltex, Hewlett-Packard or Motorola from the US.

Thus, the three key issues concerning CPNs and internal activities involve the international structure of the individual TNC, final markets (often outside the region), and the intra-firm exchange of goods within national boundaries (as many TNCs have several plants within each nation) and across the regional boundaries of Southeast Asia. With the rise of FDI from Southeast Asian TNCs (also see Chapter 5 of this volume), one has to consider the extent to which these firms have developed regional networks. While there is some investment from Malaysian and Thai companies abroad, this investment is still limited, and their production networks on a regional basis are still immature. Singaporean companies, on the other hand, have followed a similar pattern to firms from outside the region, whereby they have successfully relocated part of their production processes to other areas in Southeast Asia to benefit from the varying comparative advantages. Generally, however, firms need time to develop their capabilities, particularly on international and regional levels, and this partly explains the reason why TNC newcomers from Southeast Asia have been relatively less active in CPNs.

Another key factor in explaining CPNs is size. Small firms have limited resources, many of them lack strong proprietary assets, and international production involves transaction costs that most small and medium sized firms may simply not be sufficiently large to shoulder (Ernst, 2000: 91). Tellingly, Japanese small and medium sized firms have invested in Southeast Asia, to be closer to their key customers, but they have tended not to expand throughout the region. Similarly, Taiwanese small and medium sized firms have followed a similar trend, although their investment motivations have differed.

6.3.4 Intra-firm trade

One key characteristic of the emergence of cross-border networks within firms is that of intra-firm trade. Such trade has been substantial across Asia; for trade between Japan and its neighbour countries, the NIEs and Southeast Asian countries. However, intra-firm trade is not yet fully developed on an intra-Southeast Asian basis, as in the main a large share of intra-firm trade takes place with the parent firm.

Japan's trade links with East Asia and Southeast Asian countries are characterised by a heavy reliance on intra-firm trade and a substantial trade surplus. In 2000, Southeast Asian countries imported a total of over US$61,404 million worth of goods from Japan, against total exports of over US$51,982 million.[7] Official data shows that the trade of Asian affiliates of Japanese electronics firms with Japan to be overwhelmingly dominated by intra-firm trade; 85 per cent of the affiliates' purchases and almost 90 per cent of their sales were intra-firm (Ernst, 2000: 93). Such figures however, do not provide a clear indication of the extent to which Japanese affiliates exchange goods amongst each other in Southeast Asia. Intra-firm trade is likely to be dependent on the industry concerned, the market-orientation of the affiliate, and the company's overall strategy.

Legewie and Meyer-Ohle (2000: 87) provides an analysis of various regional intra- or inter-purchasing behaviour, with clear variations according to the industry. Giroud (2003) found that of eleven firms interviewed in the electrical and electronics sector in Malaysia, nearly all supplied some key inputs from either their parent firm or other affiliates.[8] Only one affiliate from Europe had no intra-firm trade. Other affiliates purchased between 10 and 90 per cent of total input internally. Inputs exchanged internally originated from all over Asia, but the exact share that came from Southeast Asian affiliates or parent firm was unclear. One Singaporean company in Malaysia purchased 90 per cent of its inputs from its mother company in Singapore. In this case, the purchasing office for the group is located in the company's HQs in Singapore, and the inputs exchanged amongst affiliates are not produced in-house, but purchased centrally. Some intra-firm trade was discussed in our example of Samsung, with a large share of SCC's production aimed at its sister company in Malaysia. Intra-firm trade across Southeast Asian boundaries are less substantial. This re-emphasises the importance of complementary exports within countries. An increase in trade is more likely if complementary patterns result from intra-industrial specialisation of each of the Southeast Asian economies, as discussed in the first part of this chapter.

One must note that intra-firm trade only captures part of the integration process within TNCs, as they measure only visible flows between parent TNC's and their foreign affiliates, and among affiliates. Trade between either parent firms or their affiliates and enterprises linked through non-equity arrangements is not properly measured or adequately captured, although it is a further indicator of the integration of CPN. Another important variable that is not fully captured in intra-firm exchange is that of services. Many TNCs across Southeast Asia exchange managerial, legal and accounting services, as in the case of Western Digital, which

relocated employees from its affiliate in Singapore to its affiliate in Malaysia. The exchange of useful environmental information was exemplified in the case of Samsung discussed earlier. This exchange may indeed be just as crucial for Southeast Asian countries as that of goods and services.

6.3.5 Functional scope of CPNs

The extent to which particular host countries in Southeast Asia become part of CPNs managed by TNCs depends upon the interaction of their location-specific advantages with the changing firm-specific advantages that TNCs enjoy, in the context of integrating their functional activities on a regional basis. The locational factors of each country affect the functions performed by foreign affiliates.

> TNCs, by definition, place some productive functions, abroad. TNCs serving host country markets place their necessary marketing distribution functions abroad, traditionally focused on specific (limited) market segments. Historically, strategically critical corporate functions like design, R & D, strategic and financial management on the procurement of core inputs have been kept at the headquarters.
>
> (UNCTAD, 2001: 72)

Within Southeast Asia, many TNCs have located various functions close to each other. Regional HQs play an important part in CPNs, and Singapore has been attracting numerous HQs, which are given substantial administrative and organisational roles. Singapore is a strategic location in as much as it hosts a concentration of TNCs' offices and affiliates, and it offers communication advantages, including access to services and advanced skills. Through initiatives organised by the Economic Development Board, Singapore provides incentives to encourage companies to locate their global and regional HQs within its borders, and to use them as a decision-making centre to manage their businesses in the Asia-Pacific region and beyond. About 60 per cent of 3,600 foreign companies located in Singapore have regional HQ operations there.[9] More than three-quarters of these companies use their regional HQs in Singapore to service not only the Southeast Asian region, but also the Greater China region, and in a few cases, companies have their global HQ there. For example, Caltex Petroleum Corporation, a Texan oil company, made the decision to transfer its entire corporate leadership to Singapore in October 1998, together with its worldwide business units for trading, marketing, lubricants and new business development.[10] Caltex was the first major foreign TNC to base its global HQs in Singapore. Generally, regional HQs are responsible for co-ordinating and supporting all activities of all affiliates in ASEAN. In the case of Japanese firms,

> Electronics companies are leading the trend with most of them building up regional HQs in Singapore since the late 1980s/early 1990s. From the automobile sector, only Toyota, Hino and Denso have followed so far while others

> still co-ordinate their regional activities mainly from Japan; Yamaha motor also established a regional HQs in 1998. A third group comprises a few companies from the chemicals sector like Sumitone, Dainippon Zink or Eisai. Regional HQs of companies in other industries are still an exception. Kao, Lion, or Ajinomoto, for example, still co-ordinate most of their Asian activities from their HQs in Japan.
>
> (Legewie and Meyer-Ohle, 2000: 92)

TNCs may also have functional HQs, which specialise in carrying out a function for all their affiliates in Southeast Asia. However, TNCs generally tend not to relocate their R&D facilities abroad, primarily because of the high costs in relocating these activities, and because they must ensure that there will be strong synergies between corporate R&D and the science and production systems around it. To attract foreign R&D facilities, a host country must show technological strengths, and therefore Singapore is the key location in Southeast Asia to receive such investment. Data on overseas R&D activity by US TNCs in 1994 showed that 77 per cent of the R&D conducted in developing countries was concentrated in just four economies – Singapore being one of them (UNCTAD, 2001: 82). Indeed, Singapore is the only country in the Southeast Asian region that has a cluster of foreign R&D facilities. This has developed because of strong governmental efforts, as well as a generous local supply of scientists, engineers, technicians, universities and research centres.

This concentration in Singapore, however, does not prevent numerous smaller R&D facilities – which are directed primarily at serving production units, and rarely involve pure research activities per se – spreading throughout Southeast Asia. There is already a lot of development work, in terms of product development and improvement, carried out throughout the region, as companies aim to reduce costs and adapt their products to meet local tastes. Between 1996 and 1997, Japanese companies increased their R&D expenses in all of Asia (excluding Japan) from ¥18.4 billion to ¥24.1 billion, which represented 8.6 per cent of all overseas R&D expenses by Japanese firms. Singapore and the ASEAN-4 countries (Indonesia, Malaysia, the Philippines and Thailand) accounted for roughly a third of Japanese R&D in Asia, with an overwhelming part concentrated in the electronics industry (Legewie and Meyer-Ohle, 2000: 89). Hence, Japanese firms seldom give their Asian subsidiaries responsibility for more than incremental process improvements. This contrasts with US subsidiaries, whose parent companies increasingly delegate responsibility to them for product design and development, and in some instances not just for local but also global markets (Ernst and Ravenhill, 2000: 233).

An additional major functional role given to affiliates in Southeast Asia is that of marketing and sales. This function is directly related to CPNs, and plays a key role for affiliates manufacturing for the local market. Still, many manufacturing affiliates located in Southeast Asia do not have any marketing or sales department, as the whole of their production is sold through a central sales office, which may be located away from the production location. Finally, a key functional role

that may be allocated to some affiliates is that of procurement. This function often comes under the regional HQs, and procurement may be centralised and co-ordinated for the whole of the firm's Southeast Asian affiliates.

6.4 Inter-firm features and CPNs

In the previous section, we covered the development of CPNs in the context of factors internal to the firm. We now look at how CPNs develop through inter-firm relationships on a regional level. Indeed, network structures are matrix relationships along a TNC's value chain, combined with horizontal relationships (such as strategic alliances or partnerships) with other TNCs at a single point in the value chain. Networks also combine inter-firm organisational structures. They involve complex combinations of horizontal and vertical linkages among the firms comprising the network, based on shared authority, goals, expertise, responsibility, accountability, recognition and reward (UNCTAD, 1993b: 144). The most noticeable form of inter-firm relationship in Southeast Asia has been that of cross-border purchasing, and we will focus on this aspect in this section.

6.4.1 CPNs and intra-regional trade

In their establishment of operations across Southeast Asia, TNCs enhance regional integration not only through intra-firm trade, as discussed in the previous section, but also through cross-border sourcing of parts and components. Intra-regional imports show that Southeast Asian firms and foreign firms located in the region increasingly rely on the region for supplies of components, equipment, and technology. Intra-ASEAN imports have increased substantially in recent years, from US$38.7 billion in 1993 to US$69.1 billion in 2000. Electrical equipment and computer/machinery represent the two biggest product groups in total intra-Southeast Asian imports, with respective shares of 37.9 per cent and 8.5 per cent in 2000, compared to respective shares of 33.7 per cent and 13.8 per cent in 1993.[11] These data show both the predominance of the electronics sector in the region, and as a share of overall intra-regional trade. The electronics sector is dominated by TNCs and a substantial share of these flows is composed of intra- and inter-firm exchanges of electronic components. What these figures clearly show is that intra-regional trade has increased, and the regional trade integration of the electronics industry in particular within Southeast Asia has deepened over the past decade, given that the major final markets for these products are the US, Europe and Japan. This indicates that companies in the region increasingly rely on the region for supplies of components, equipment and technology for many electronics products.

6.4.2 CPNs and cross-border sourcing

In this section, we consider the up-stream relationships created by firms with other firms in Southeast Asia, whether they are suppliers or subcontractors. There

has recently been an increase in the study of inter-firm supply linkages in Southeast Asia, but on a national basis; that is links with suppliers within each economy (Bederlos *et al.*, 2001; UNCTAD, 2001; Giroud, 2003). Most studies found that, while local purchasing by TNCs has increased, it is still limited, depending on the sector of activity and the strategy of the firm. As seen above, a large share of intra-regional imports takes place in the electronics sector. Within this sector, TNCs dominate across Southeast Asia, except in Singapore, where locally owned firms have developed (Wong, 1997, 2000). In the case of Malaysia, foreign firms represented more than 80 per cent of total fixed assets in the electrical and electronics products sector in 1998.[12] TNCs in this sector have benefited from both the regional concentration of other TNCs, and the specialisation of each country. Within Malaysia, for example, many TNCs are able to purchase low-end products, such as plastic products, from locally owned companies, and higher-end suppliers, as well as high-tech inputs from other TNCs. A similar purchasing pattern has developed across Southeast Asia (Giroud, 2003), which has facilitated the diversified regional production networks of suppliers with far-reaching regional procurement of parts and components (Legewie, 1999). Proximity is key to companies, and it has been shown that automobile assemblers are more profitable the closer the proximity (spatial clustering) of their suppliers (Dyer, 1996).

TNCs' inter-firm relationships have tended to vary according to their origin (Borrus *et al*., 2000a:15–16). In the case of the Japanese *keiretsu*, networks have developed within Japan, with close relationships between firms, subcontractors, suppliers, financial institutions, and wholesale and retail trading companies. More recently, these networks have expanded in Southeast Asia, with suppliers and subcontractors relocating in the region. American networks have differed from Japanese, Taiwanese and Korean networks. However, in response to industrial competitive dynamics, network patterns are changing, and Japanese firms have started to rethink the strategy of relying on intra-firm trade for purchasing components. This is due not only to the need to reduce transaction costs, be more flexible with contracts, and respond faster to changes of technology and market demand, but also because numerous Japanese components suppliers have relocated to Southeast Asia. These relocated suppliers have started to provide for new customers, beyond their traditional *keiretsu* partners. Thus, the US and European firms have relied increasingly on Japanese-owned suppliers located throughout Southeast Asia (Dobson and Chia, 1997; UNCTAD, 2001; Giroud, 2003).

Overall, TNCs – regardless of their origin – have increased regional purchasing as well as regional outsourcing of assembling/manufacturing activities. As an example, a successful change in purchasing behaviour took place for the automotive parts maker Denso. The company raised its Southeast Asian procurement ratio from 30 per cent in 1996 to 41 per cent in 1998, while at the same time reducing imports from Japan by 18 per cent (Legewie and Meyer-Ohle, 2000: 80). This is the result of Japanese endeavours to concentrate activities in key locations, and to specialise each affiliate in different products. Denso has been pursuing this strategy since 1995, as it concentrates production of key components – like starters, compressors or instrument clusters – in different Southeast Asian countries

(Legewie and Meyer-Ohle, 2000: 87). Such specialisation achieved by TNCs on a regional basis has accentuated intra-regional trade flows, both amongst and within firms. Of eleven TNCs in the electrical and electronics sector in Malaysia that were surveyed (Giroud, 2003), seven imported supplies from other Southeast Asian countries. However, they all had a wider perspective in terms of sourcing than Southeast Asia itself. In other words, TNCs located in Southeast Asia, regardless of their origin, still view Asia as a whole when setting up their supplier base.[13] Purchasing behaviour in Southeast Asia has also been affected by the Asian crisis in the late 1990s. Regional purchasing has improved, because of the devaluation of local currencies, and the need for companies to localise their sources of inputs. On the other hand, local purchasing has been slowed down by the difficulties faced by local small suppliers, some of which have had to close down. There is a clear need for governments in Southeast Asia to pursue the development of endogenous firms, in order to strengthen regional purchasing patterns, by offering TNCs competitive local alternatives of supply.

In summary, cross-border sourcing is likely to continue to increase, because of a combination of positive factors. These include: the development patterns followed by Southeast Asian economies (and the subsequent expansion in numbers of locally owned suppliers); regional efforts towards facilitating intra-regional trade; the clustering of foreign firms within specific sectors (namely electronics, automobiles and textiles for the manufacturing sectors); and the endeavours of firms to supply parts and components from close geographical locations.

6.5 Conclusion

There are several crucial considerations when looking at cross-border production networks in Southeast Asia. Perhaps the most important is that the region's countries are integrated within broader regional networks across Asia. There is strong intra-Asian interdependence with respect to inputs and sales, even though Southeast Asia has succeeded in creating a regional dynamic of its own (e.g. through ASEAN), particularly with the key role played by Singapore in attracting companies' regional HQs. The role of Japan is also changing, and with it the role and place of Japanese subsidiaries in Southeast Asia. This is manifest in more specialisation and increased localisation of operations. Overall, the main actors in the development of Southeast Asian CPNs are TNCs, the majority of which are from outside the region.

The future of CPNs rests on foreign firms and their need to further deepen these networks. In the process, foreign firms will accelerate the development of forward and backward linkages across Southeast Asia, with sufficient diffusion of capabilities to strengthen supporting industries. The strategic orientation of the firms creating CPNs is critical, in as much as the network ought to enhance the domestic and overseas competitiveness of production systems. Local firms from Southeast Asian countries must develop further, and acquire sufficient competitiveness if they are to take part in the consolidation of CPNs. This has not yet taken place and leaves Southeast Asian countries reliant on foreign firms

(and vulnerable to their decisions on whether to further develop their networks, or relocate to other locations in Asia or elsewhere in the world). Thus, Southeast Asian countries must not only strengthen existing CPNs, but must also consider how closely linked to the rest of the world these CPNs are.

The extent to which particular countries in Southeast Asia become part of regional CPNs depends upon the interaction of their location-specific advantages with the changing firm-specific advantages that TNCs enjoy, in the context of integrating their functional activities on a regional and worldwide basis. For the moment, most countries have a clear political commitment to develop endogenous industries and foster a favourable environment for foreign firms to operate. Beyond this individual approach, ASEAN member countries need to work together to move towards greater integration, if they are to reap the full benefits of CPNs.

By moving to a model of regional industrial policy, with collaborative perspectives, Southeast Asian countries will see increases in welfare gains and improve their levels of competitiveness. Therefore, ASEAN member countries must start to promote the region (rather than individual nations) as the production base. This involves encouraging component production across the region, using comparative advantages to help increase efficiency, decrease production costs and enhance competitiveness of both foreign and local firms. Further regional integration should support regional production networks and disperse manufacturing processes across national frontiers; hence, governments should support regional industries and possible Asia-wide industries.

Some companies, as discussed in this chapter, have taken the initial step and started using various comparative advantages across the region, but government policies need to reflect these developments. Two types of companies can be considered: those that are located in Southeast Asia mainly to provide for local markets, and those that are mainly using the region as a production base for third markets. For the first group, Southeast Asian countries must develop local markets sufficiently deep to keep existing companies, attract new ones, and create regional synergies. For the second group, emphasis on factors of production is primary, together with cross-border flows, including the flow of people across borders. There must be regional implementation of regulations to facilitate such cross-border movements. Systems must be in place for companies to be able to take decisions for the region as a whole, for trade, investment and people. Finally, as an increased share of FDI is reinvested earnings, governments must pay attention to improving the environment for existing TNCs and encourage them to perceive Southeast Asia as a region, rather than think in terms of the particular nation in which they are located.

Notes

1 This figure is derived from balance of payments flow data.

2 For the six initial signatories (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) to the CEPT Agreement, 2003 is the deadline for full compliance with AFTA. For Vietnam, the deadline is 2006, for Laos and Myanmar the deadline is 2008, and for Cambodia the deadline is 2010.

3 A firm may have the power to co-ordinate and control operations in more than one country, even if it does not own them (Dicken, 1998).
4 Decision making within Japanese TNCs tends to be hierarchical, and centralised in the hands of the HQs.
5 It should be noted that the survey was conducted prior to the Asian crisis, and the situation in Indonesia has deteriorated since 1998. Vietnam, Laos and Myanmar were not members of ASEAN at the time of the survey, and so they do not appear in the survey's statistics.
6 Information on the company extracted from press releases available on Western Digital's website <http://www.wdc.com/company/releases/PressRelease.asp? release=1279>.
7 A substantial proportion of these imports were products in the following categories: 'computer/machinery', 'electrical equipment', 'iron and steel', 'articles of iron and steel', 'cars, trucks and autos' and 'optical/medical instruments'. The figures were taken from: <www.aseansec.org/trade>.
8 Of the eleven companies, two were Japanese companies, one Singaporean, one Taiwanese, one from Britain, two Dutch, and four North American firms.
9 This figure was taken from <http://www.sedb.com/edbcorp/detailed.jsp?artid=3085 &type=8&hide=1>.
10 Information extracted from <http://www.sedb.com/edbcorp/an_1999_18.jsp? hide=1>.
11 The figures for 2000 comprise only Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand. The data for Thailand is for the first nine months of 2000. The data was calculated trade statistics obtained from: <http://www.aseansec.org/>.
12 Figures taken from <http://www.mida.gov.my>, and as discussed in Giroud, 2003.
13 Imports generally come from various Southeast Asian countries, but also from a network of suppliers located throughout East Asia, including: Japan, China, Hong Kong, South Korea and Taiwan.

7 The impact of China's WTO accession on Southeast Asian foreign direct investment

Trends and prospects

Adam R. Cross and Hui Tan

7.1 Introduction

It is now generally recognised that the multinational enterprise (MNE), through its investment and trading activities, is the principal means by which national economies are linked (Dunning, 2001). Not only are MNEs the main beneficiaries of the process we now call globalisation, they are also its key protagonists. Consequently, host countries today – and especially developing countries – increasingly compete to attract certain types of foreign direct investment (FDI). Initially, the aim is to benefit their economies in terms of, for example, the capital and finance, employment, technology, demonstration effects, domestic and international trade linkages, and so forth, which usually accompany the foreign investing firm. The ultimate aim is to deepen the country's participation in the globalisation process.

Historically, the attraction of inward FDI – in particular, export-oriented FDI – has been an important theme of economic development policy for many if not most of the Southeast Asian countries.[1] This is especially true today; greater investment capital is required to reinvigorate faltering economic performances following the Asian crisis of the late 1990s, and FDI represents one of its most mobile, potent and accessible sources. However, as this volume demonstrates, the ability of the Southeast Asian countries to attract inflows of foreign investment, now and into the future, will be shaped greatly by economic and political developments in the Asian region. This chapter explores one of these developments – the growing prominence in the 1990s of the People's Republic of China (henceforth China) in the regional and global economy – and how, if at all, this will be affected by China's recent accession to the World Trade Organisation (WTO). We assess the significance of this event for the Southeast Asian countries, and what the consequences might be for their present and future capacity to draw FDI to their economies.

On 11 December 2001, China achieved a long-held ambition and became the 143rd member of the WTO, almost exactly fifty years after withdrawing from its predecessor, the General Agreement on Tariffs and Trade (GATT). At the time, China's accession was heralded by Mike Moore, Director General of the WTO, as 'a defining moment for the WTO and for the international economic, political and security arrangements that will influence our world in this century and beyond'.[2]

The admission of the world's second largest economy, and one of the fastest growing (predicted by some to be the world's largest by 2015), into the 'rules-based' global trading system undoubtedly has the potential to reconfigure trade and investment patterns in East and Southeast Asia, and perhaps profoundly so. But in what ways will the Southeast Asian countries be affected as hosts for FDI? Three possible outcomes can be envisaged. The first is that accession will be a zero-sum game, in which China's locational advantages for FDI strengthen following accession to the WTO, relative to the Southeast Asian countries, creating the tendency for 'foot-loose' foreign-owned operations in the region to switch to China, and for the lion's share of new FDI to the region to gravitate there. This is the *magnetic effect* argument. The second is that, once the initial euphoria of China's entry has waned, regional investment flows will readjust to bring about a more equitable distribution of FDI across East and Southeast Asia, similar to that seen in the early 1990s. This is the *neutral effect* argument. The third possible outcome is that, should China prove to be successful in attracting greater shares of global and regional FDI flows, the Southeast Asian countries might somehow 'ride on the back' of this, and so negate any detrimental effects to their own economic development that might otherwise occur. This is the *benign effect* argument. As we shall see, which outcome is observed will depend greatly on China's willingness and ability to comply with its accession commitments and, if it does, whether it can make the profound structural and institutional adjustments that this necessarily engenders.

The chapter is mainly descriptive. No formal econometric analysis of data will be undertaken. Rather, we survey extant literature on the topic, and make a few observations of our own. It is also not our intention to portray the Asian economic crisis or FDI trends within Southeast Asia, or to provide detail on the economy and FDI patterns within the region; this is done elsewhere in this volume. Instead, we focus first on China's increasingly progressive policies towards FDI in recent times and the effect of this on inward FDI patterns, in value-terms and by activity and source country. We then describe China's WTO commitments, and assess how this might impinge on China's future investment climate. By relating this to ASEAN's own investment climate, we go on to assess whether China will have a magnetic, neutral or benign effect on Southeast Asian investment flows. Some policy recommendations are then made for Southeast Asia, in light of our discussions.

7.2 Inward FDI to China: policy and trends

For historical, ideological and practical reasons (see Wei and Lui, 2001: 8) China was virtually closed to foreign investing firms for the first three decades of the People's Republic. Consequently, FDI inflows were negligible. However, in a dramatic policy shift at the end of the Cultural Revolution in 1978, China's leadership decided to actively promote foreign capital participation (the 'Open Door' policy) as part of the 'four modernisations' programme of economic development. FDI was viewed as a source of capital (for generating the growth that prevailing levels of domestic savings were too low to instil), and new technologies,

management techniques and capabilities (Tan, 1999). More importantly, export-oriented FDI would produce a continuous flow of foreign exchange, enabling China to boost reserves and finance the importation of capital goods and production inputs that, in turn, would raise productivity and output. These motivations would continue to underpin China's policy towards inward investment until the late 1990s.

In order to appreciate the origins of China's present investment climate, and to understand better the historical relationship between Southeast Asia and China as FDI recipients, it is useful to map key developments in China's policy towards FDI against the investment responses of foreign firms. Table 7.1 identifies four distinct phases of inward investment to China with respect to policy direction (see OECD, 2000; Wei and Liu, 2001). Against this, and in the following account, some generalisations are made regarding the character of FDI in terms of: the prevailing investment climate, the cumulative value of realised investment, regional and sectoral trends, strategic motivation for investment, and source country.[3] China's membership of the WTO will begin a fifth phase, which we call the 'shock period', and this is described in more detail in the next part.

7.2.1 The evolution of China's FDI policy

Viewed in retrospect, these four periods (up to 1999) reflect a pragmatic and carefully staged, incremental and calculated opening of China's economy to foreign firms by its leadership. Contrast this with the Southeast Asian countries, where 'policy towards FDI has tended to react to events rather than shaping them' (Thomsen, 1999, p. 12). The first experimental steps taken in 1979 – the establishment of four Special Export Zones (SEZs) in Guangdong and Fujian Provinces – were cautious and highly constrained in terms of both economic and geographic space. The express aim was to attract investment from the overseas Chinese, mainly those from Hong Kong and Taiwan (Lemoine, 2000). It soon became clear that foreign invested enterprises (FIEs) in China were capable of absorbing foreign capital and advanced technology and therefore proved to be more efficient than state-owned enterprises (SOEs). Consequently, from the 1980s to the late 1990s, tight centralised control of FDI was slowly relaxed. Investment approval decisions and FIE-related matters were progressively devolved to the provinces and municipalities, investment restrictions were eased, larger geographic areas were opened (though still mostly confined to the coastal regions), and FIEs were allowed to operate in more sectors.

Nevertheless, the authorities still felt it necessary to retain aspects of centralised control. This was exemplified by the imposition – or at least the attempted imposition – in the mid-1990s of highly selective regulations and other devices for achieving certain policy objectives. Foreign investment was classified as 'encouraged' (with tariff exemptions and fiscal reductions, for example) when local firms, for whatever reason, could not meet these objectives. Typically, such sectors were mostly export oriented, or were technology intensive, or were those targeted for import substitution policies. By contrast, severe constraints continued

Table 7.1 FDI policy in China and some inward investment trends (1979–99)

Phase and policy motivation	*Main policy developments*	*Investment character and strategic motivation*
Experimental Period (1979–83)		
To attract greater inward FDI as one of the 'four modernisations' and to learn from the experiences of the opened areas.	A series of laws on JVs permitted FDI, defined equity JVs and set out the fiscal arrangements concerning foreign invested enterprises (FIEs). Greater economic autonomy given to Guangdong and Fujian provinces. Creation of four Special Economic Zones (SEZs) at Shenzen, Zhuhai, Shantou and Xiamen. Duty exemptions for imports of intermediate inputs used in production of exports. Special investment incentives available in SEZs. Highly limited domestic market access granted to foreign investors. Ministry of Foreign Economic Relations and Trade (MOFERT) created, responsible for FDI, trade and other foreign economic affairs.	Mostly speculative investment in real estate (hotels and apartment buildings). Some small-scale, resource-seeking, export-oriented FDI in labour-intensive manufacturing industries such as footwear, clothing, toys and electrical appliances. Hong Kong and Taiwan ROC are main source countries.
Gradual development period (1984–91)		
To build upon the success of the first SEZs and to divert FDI away from real estate and into technology-intensive, export-oriented and infrastructure-related sectors.	Law for the Encouragement of Foreign Investment promulgated (1986) and implementing regulations announced (1987). Continued loosening of investment restrictions, mostly in sectors with few domestic firms (e.g. tourism and hotels) and where foreign capital and technology was sought (e.g. oil exploration). Hainan Island and fourteen open coastal cities (OCCs) across ten provinces opened to FDI in 1984. Preferential income tax arrangements for FIEs granted in 1984. The Yangtze River (Changjiang) Delta, the Pearl River (Zhujiang) Delta and South Fujian area become Open Export Zones (OEZs) in 1985, followed in 1987 by Shandong and East Liaoning Peninsulars. Shanghai's Pudong New Area opened in 1989, a flagship SEZ.	Initially some resource-oriented FDI in extractive industries, but a general shift in FDI towards export-oriented and technology-intensive manufacturing industries across the period. Around half of FDI by value in hotel construction and real estate. Hong Kong and Taiwanese investment predominate, but investments from USA and Japan increasingly observed. Equity JVs (51% of contracted value of FDI in 1991), co-operative JVs (18%), WFOEs (31%).

Peak period (1992–93)		
The imperative of Deng Xiaoping to accelerate economic reform and to develop new export industries.	Foreign firms allowed to sell more to China's domestic market. Some FDI approvals conditional on achievement of certain policy goals. Special investment incentives available in preferred sectors. New sectors opened up experimentally to foreign investment (e.g. domestic retail trade, finance, tourism, shipping, resource development). FDI remains tightly controlled by state policy, though approval of smaller projects now devolved to provincial and municipal government. Thousands of new SEZs spring up as a result. Market entry remains regulated through as performance requirements, local sourcing requirements, location restrictions, forced JV establishment. Further opening of 28 cities and 8 regions in the Yangtze River Delta area.	Efficiency-seeking and resource-seeking motives still dominate, but market-seeking motives beginning to grow in importance. Around 60% of inward FDI flows into highly export-oriented and technology-intensive industrial sectors, especially in the coastal provinces. Slowdown in FDI from the Triad regions. Equity JVs (49% of contracted value of FDI in 1993), Co-operative JVs (23%), WFOEs (27%).
Adjustment period (1994–99)		
To adjust the industrial structure of FDI and to provide national treatment for foreign investors.	Special investment regimes abandoned for more nationwide implementation of open policies. State Council decided to categorise sectors into three types: those in which FDI was 'encouraged', 'restricted' or 'forbidden'. Duties reimposed in 1995 on imported machinery, equipment, parts and other materials by FIEs (but repealed in 1997 for FDI in encouraged sectors).	Market-seeking gradually becomes the dominant investment motivation with resource-seeking in relative decline. FDI is more capital-intensive, and FIE production is directed more to China's domestic market than on export markets, although FIEs still make a decisive contribution to export-intensive activity. Growth in FDI from USA, Japan and EU towards end of period. Equity JVs (32% of contracted value of FDI in 1999), Co-operative JVs (17%), WFOEs (51%).

Sources: Graham and Wada (2001), Wei and Liu (2001) and Lemoine (2000).

Note
WFOE denotes wholly foreign owned enterprise.

to be imposed in other sectors, through policy instruments such as performance requirements, location restrictions and entry mode restrictions. The objective was to constrain domestic market access and shelter incumbent local firms; usually large, inefficient and vulnerable enterprises in which the state had a full or partial equity interest. Overall, these policies were successful. By the mid-1990s, some 60 per cent of FDI flowed into highly export-intensive industrial sectors (Graham and Wada, 2001). So, already we can see that for much of its recent history, China has followed a trade policy that resembles the Asian development model. China has also maintained relatively high tariff and non-tariff barriers to limit imports, and has used special trade regimes – notably liberal duty exemptions on inputs – to promote the growth of export-oriented, low value-added industries (Lemoine, 2000). However, as we shall see, this does not mean that the Southeast Asian countries have been in competition with China for this type of FDI activity.

7.2.2 Aggregate FDI flows to China

Figure 7.1 shows the aggregate value of realised cumulative FDI in China since 1984. In the years immediately following China's 'Open Door' policy, FDI inflows were modest, and by 1983 the stock of FDI stood at approximately US$3 billion (Lemoine, 2000). Limited access to domestic markets, non-convertibility of the renminbi, a poorly defined legal environment and a lack of precedence were all major investment deterrents (Wei and Liu, 2001).

Nevertheless, China had revealed comparative advantage in labour-intensive manufacturing, and export-processing industries soon became established in the

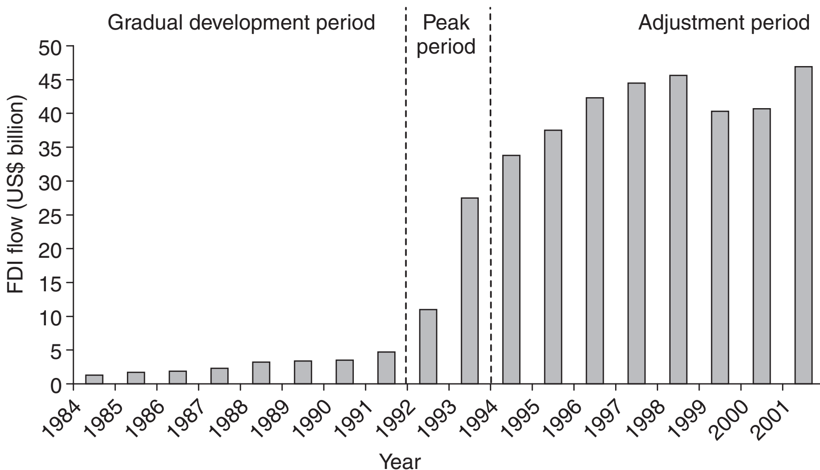

Figure 7.1 Annual inflows of utilised FDI into China (1984–2001).

Source: China Statistical Yearbook (various issues).

Note

Data for 1984 are accumulated stock FDI since 1979.

wake of duty exemptions on the importation of intermediate inputs used in the production of exports. This activity was centred on the SEZs, where numerous small and medium sized FIEs sprung up, largely in the form of equity joint ventures, in industries such as footwear, travel goods, toys and electrical appliances. Officially, the dominant source countries were recorded as Hong Kong (62 per cent of accumulated stock, 1979–91), followed by Japan (14 per cent) and the USA (12 per cent) (Lemoine, 2000). But principal investors also included firms from Macao and Taiwan.[4] What is more, these firms tended to invest in their ancestral homelands in China. So, firms from Hong Kong and Macao have generally favoured Guangdong province as an investment location, and Taiwanese firms have favoured Fujian province. These investors enjoy lower transactions costs in these locations, relative to their counterparts from the Triad countries (i.e. Europe, Japan and the US), because of geographical proximity, cultural convergence and familial ties. The significant contribution of ethnic Chinese-owned firms to total FDI inflows in China's coastal provinces would endure through to the late 1990s (see Table 7.2).

China's FDI levels rose markedly in the second half of the 1980s as the regulatory framework concerning investment improved, and laws were passed to allow full foreign ownership (Lemoine, 2000). Total FDI inflows for the period 1984–88 amounted to some US$10.3 billion, representing an annual growth rate of around 38 per cent, or approximately US$2.1 billion per year (OECD, 2000), much of which was in the hotel construction and real estate sectors. Nevertheless, the investment growth trajectory dipped twice in this period; once in 1986 in response to China's austerity programme, and again in 1989 and 1990 after the Tiananmen Square events and the political inertia that followed. Growth in FDI inflows slowed to just 6.2 per cent in 1989 and 2.8 per cent the following year (OECD, 2000). Most discouraged were investors from the Triad countries.

Table 7.2 Accumulated FDI stock in China, by home country and region (1995 constant prices and %)

	1979–91	*1983–90*	*1991–95*	*1996–98*	*1983–98*
Total FDI stock (US$ million)	25,158	24,528	118,086	126,119	268,733
Source country and region (% share)					
Hong Kong	62.0	58.5	58.8	45.2	52.4
Taiwan	n/a	1.1	9.8	7.3	7.9
ASEAN-5	n/a	1.5	5.1	8.1	6.2
Japan	14.0	13.7	6.9	8.6	8.3
USA	10.0	12.1	7.4	8.0	8.1
Western Europe	n/a	6.6	4.5	8.7	6.7

Sources: OECD (2000) and Lemoine (2000).

Note
'ASEAN 5' = Singapore, Thailand, Philippines, Malaysia and Indonesia.

As Table 7.2 shows, the USA, EU and Japan each recorded a declining share of accumulated FDI stock in China in the period 1991–95 compared to 1983–90, as a consequence of lower investment activity in the late 1980s. This reveals the sensitivity of China's FDI inflows to internal political events.

Despite the volatility in the global supply of FDI (Tan, 1999), investment flows to China began to accelerate again during the first half of the 1990s, particularly in manufacturing sectors. Various promulgations about the commitment to market-oriented reform, new SEZs, strong domestic growth, further liberalisation and devaluation of the renminbi all contributed to enhancing China's investment climate. In the mid- to late 1990s, when government policy sought to adjust the structure of inward FDI and develop new export-oriented industries, FDI inflows continued to arrive, but at rates below those seen in previous periods. Not only was China experiencing greater competition from developing countries for FDI – as Latin America, Eastern Europe and the Southeast Asian nations were liberalising their economies and offering improved investment incentives – but internal policy was also serving as a brake. In particular, the introduction of national treatment in 1995 brought with it the re-imposition (later repealed) of duties on machinery, equipment and spares parts imported by FIEs, which was a significant investment disincentive. A further slowdown in FDI inflows to China occurred in 1998 and 1999 (see Figure 7.1). This coincided with two events; a deceleration in economic growth in China and the Asian crisis. It has been estimated that Asian FDI to China fell by over 10 per cent in the year immediately following the onset of the Asian crisis, mainly because of the cautiousness of investors and shortages of capital (Lemoine, 2000). However, much of this decrease was offset by increases in investments from elsewhere, mainly from the Triad countries. As Table 7.3 shows, the accumulated stock of FDI from Japan, the USA and Western Europe rose between 1991–95 and 1996–98 to stand at broadly equivalent positions, somewhere between 8 and 9 per cent of the total for each.

Overall, each phase of policy liberalisation by China provided fresh impetus to FDI inflows. Between 1979 and 1999, total aggregate inflows of FDI to China amounted to some US$306 billion, equivalent to around 10 per cent of world FDI flows, and around 30 per cent of that received by all the developing countries put together (OECD, 2000). But since 1997 this share has reduced; in 2000, China attracted a mere 3.2 per cent of global FDI flow (see Table 7.4). But this does not necessarily mean that China's role as an investment location waned in the years just prior to WTO accession. As Table 7.4 reveals, Hong Kong experienced a surge in inward FDI from 1997 onwards, the year it became a self-governing 'special administrative region' (SAR), in the form of reinvested earnings and long-term loans to Hong Kong affiliates by MNEs. This surge offset much of mainland China's declining position. Of course, some of Hong Kong's inward FDI inflows will be tax haven motivated (that is, destined for elsewhere). Nevertheless, a good proportion are funds being 'parked on the doorstep' of mainland China by foreign firms, in anticipation of emerging opportunities post-WTO. Clearly, Hong Kong's advantageous economic and geographic position relative to China has continued to influence greatly patterns of FDI in the region.

Table 7.3 Global FDI inflows, by host region and economy, 1989–2000 (US$ million and percentages)

Host region/economy	*1989–94 (annual average)*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*
World	200,145	331,068	384,910	477,918	692,544	1,075,049	1,270,764
Developing countries and regions	59,578	113,338	152,493	187,352	188,371	222,010	240,167
South, East and SE Asia	35,078	73,639	89,406	98,507	86,004	96,224	137,348
China	13,951	35,849	40,180	44,237	43,751	40,319	40,772
As a proportion of world total (%)	7.0	10.8	10.4	9.3	6.3	3.8	3.2
Developing country total (%)	23.4	31.6	26.3	23.6	23.2	18.2	17.0
South, East and SE Asia total (%)	39.8	48.7	44.9	44.9	50.9	41.9	29.7
HongKong, China	4,164	6,213	10,460	11,368	14,776	24,591	64,448
As a proportion of world total (%)	2.1	1.9	2.7	2.4	2.1	2.3	5.1
Developing country total (%)	7.0	5.5	6.9	6.1	7.8	11.1	26.8
South, East and SE Asia total (%)	11.9	8.4	11.7	11.5	17.2	25.6	46.9
Brunei	6	13	−69	2	−20	−38	−19
Cambodia	52	151	294	204	121	135	153
Indonesia	1,524	4,346	6,194	4,677	−356	−2,745	−4,550
Laos	19	95	160	91	46	79	72
Malaysia	3,964	5,816	7,296	6,513	2,700	3,532	5,542
Myanmar	135	277	310	387	314	253	240
Philippines	879	1,459	1,520	1,249	1,752	737	1,489
Singapore	4,798	8,788	10,372	12,967	6,316	7,197	6,390
Thailand	1,927	2,004	2,271	3,627	5,143	3,562	2,448
Vietnam	651	2,336	2,519	2,824	2,254	1,991	2,081
ASEAN-10	13,955	5,285	30,867	32,541	18,270	14,703	13,846
As a proportion of world total (%)	7.0	7.6	8.0	6.8	2.6	1.4	1.1
Developing country total (%)	23.4	22.3	20.2	17.4	9.7	6.6	5.8
South, East and SE Asia total (%)	39.8	34.3	34.5	33.0	21.2	15.3	10.1

Source: UNCTAD (2001).

Table 7.4 Contracted FDI in China, by sectors, as at end-1998

Sector	*Number of projects*	*Share (%)*	*Contracted value (US$ billion)*	*Share (%)*
Manufacturing	249,352	73.0	365,547	59.6
Real estate	33,877	9.9	149,977	24.4
Distribution	21,279	6.2	36,929	6.0
Wholesale, retailing and catering	17,558	5.1	21,960	3.6
Transport, warehousing and telecommunications	3,721	1.1	14,969	2.4
Construction	8,826	2.6	11,860	3.1
Agriculture, forestry, animal husbandry and fishing	9,534	2.8	19,827	1.8
Scientific research and technical services	2,410	0.7	1,874	0.3
Education, broadcasting, film and TV	1,317	0.4	2,040	0.3
Healthcare, sports and social welfare	999	0.3	4,618	0.8
Other sectors	13,944	4.1	23,045	3.8
Total	341,538	100	613,717	100

Source: State Statistical Bureau (1999).

7.2.3 Emerging trends in the character of China's inward FDI

Several interrelated shifts in the character of FDI inflows to China, from the late 1990s onwards, can be discerned that might impact Southeast Asian FDI inflows. First, a shift has taken place away from labour-intensive, export-oriented manufacturing towards market-seeking FDI (Table 7.4). By 1998, just under 60 per cent of the contracted value of China's FDI stock, and the bulk of individual investments, were in manufacturing, followed by real estate at around 24 per cent. Of this, an estimated 50 per cent (by value) was in labour-intensive manufacturing; technology-intensive manufacturing accounted for around 27 per cent and capital-intensive manufacturing, 23 per cent (OECD, 2000). Low cost labour was probably still the main motivating force driving FDI up to the mid-1990s. However, in the late 1990s, firms have shown a greater propensity to undertake market-oriented FDI in sectors in which China has no revealed comparative advantage (Graham and Wada, 2001). Investors have been attracted by China's high rates of growth, its rapidly expanding domestic market and improved market access in some sectors (Lemoine, 2000). According to UNCTAD (2001), FDI in China has also become more capital- and technology-intensive in the late 1990s. This is confirmed in a recent study of FDI in China's electronics industry (Qian *et al*., 2000). The fact that market-seeking investment is increasing in hand with more capital- and technology-intensive investment is not coincidental. Foreign investors will be conducting R&D locally to adapt products and processes to meet the particular needs of the Chinese market. And both long-standing and new investors are establishing miniature replica-type production plants in China, equipped in much the same way as equivalent plants in other

major markets, to meet the strong demand expected following market liberalisation. Whether or not these expectations will be met remains to be seen.

Second, the propensity to move towards market-oriented FDI differs by source country. Table 7.2 shows that Hong Kong and Taiwan together accounted for the bulk (60.6 per cent) of the accumulated FDI stock in China between 1983–98 (OECD, 2000), followed by Japan (8.3 per cent), the USA (8.1 per cent), Western Europe (6.7 per cent) and the ASEAN-5 (6.2 per cent). However, the combined share of Hong Kong and Taiwan in utilised FDI in China dropped to 43.7 per cent in 2000, while the share of the USA and Western Europe (led by France and the UK) rose to 10.8 per cent and 11.2 per cent, respectively.[5] Japan's position weakened slightly to 7.2 per cent, while ASEAN-5 recorded a small increase, to 7.0 per cent (two-thirds of which is from Singapore). Overall, these changes indicate that firms from the Triad countries have been raising their level of equity participation in China in the two years prior to WTO accession. Moreover, while Hong Kong and Taiwanese firms were investing mostly in export-processing activities in China, it is the Western European companies that are now making more capital-intensive investment, mainly to supply goods and services to China's domestic market;[6] US firms fall somewhere in between (Lemoine, 2000; Graham and Wada, 2001; UNCTAD, 2001).

The third trend observed concerns the form of investment. As Table 7.1 indicates, until 1993 the equity joint venture was the preferred entry mode for China, accounting for just under half of all contracted amounts of FDI. However, from the mid-1990s onwards, wholly foreign-owned enterprises have been increasingly favoured, and in 1999 just over half (51 per cent) of the contracted value of FDI took this form, mostly as greenfield investments (OECD, 2000). Graham and Wada (2001) also observe that the average size of individual investments is also beginning to rise, which they attribute to larger-scale Japanese, US and EU investments replacing smaller individual investments from the Newly Industrialised Economies (NIE), notably those from Hong Kong and Taiwan.

Finally, a fourth trend concerns the geographical distribution of FDI within China. In general, FDI has been concentrated in just four coastal provinces: Guangdong, Jiangsu, Fujian and Shanghai, in descending order (Lemoine, 2000). For the period from 1983 to 1998, the eastern provinces together absorbed 87.8 per cent of total FDI inflows, with 8.9 per cent going to the central provinces, and less than 4 per cent to the western provinces. But since the mid-1990s, FDI has become more evenly distributed within the eastern provinces. For example, the share of Guangdong province in total FDI inflows declined from 46 per cent in the 1980s to 28 per cent in the 1990s, while the other coastal provinces and the central provinces recorded an upward share. One interpretation is that more recent investors to China tend to be less drawn to Guangdong and Fujian provinces than their Hong Kong and Taiwanese counterparts, and that a more equitable distribution of FDI in China is slowly underway.

To summarise, a transformation can be detected in the quality and quantity of inward FDI in China in the few years immediately prior to WTO accession. In very general terms, a greater proportion of investment by developed country

firms (notably from the Triad countries) that is larger scale, more capital-intensive and more market-oriented has steadily made inroads on the substantial stock of small scale, labour-intensive and export-oriented investments enacted by Hong Kong and Taiwanese firms since the 1980s. Furthermore, wholly owned foreign operations are supplanting equity joint ventures as the preferred entry mode, and FDI is progressively, albeit slowly, penetrating regions beyond the coastal provinces. For the first time since the Second World War, the general pattern and character of FDI in China has begun to converge on that of the developed countries. The question now is how, and to what extent, these trends will be sustained after China's accession to the WTO, and what the knock-on effect might be for Southeast Asian countries.

7.3 China and the fifth phase of FDI: post-WTO accession as the 'shock period'?

China has committed itself to implementing a comprehensive package of market liberalisation measures on entering the WTO (see Table 7.5). Simply put, China is obligated to open and further liberalise many of its markets, providing foreign firms with greater access to domestic markets and levelling the playing field for foreign and domestic business, either immediately or through a phased implementation, to be completed by 2005.

As with past periods of policy reform, China's membership of the WTO is likely to provide fresh impetus to FDI inflows. In particular, the elimination of severe controls on distribution in China should enhance market access and increase substantially the incentive to make new or sequential market-oriented investments across many sectors. Also, new investment opportunities are likely to arise in sectors previously closed or highly restricted to foreign firms, especially in telecommunications services, wholesaling and retailing, logistics, financial services, travel and tourism, and audio-visual-related activity. But, as we shall see, the effects are complex, and the outcome – for China as well as for Southeast Asian countries – is far from clear.

At the outset, we dismiss as fallacious the notion that China's entry to the WTO will bring about an immediate and dramatic transformation of the world economic order, or indeed that of East and Southeast Asia. Of course, given the length and complexity of the negotiations, some hyperbole from those closest to the accession process is to be expected (cf. the quote by Mr Moore). China first applied to resume its membership in the GATT in July 1986, and full accession discussions with the WTO began in 1995. During these negotiations, bilateral agreements between China and over 140 WTO members were concluded, in addition to the substantial multilateral agreement setting out the accession terms (Eglin, 2000). However, on accession China was already the world's seventh largest exporting nation, with world merchandise exports of US$249.3 billion (or 3.9 per cent of the world total), and the eighth largest importer (US$225.1 billion, or 3.4 per cent of the total) (WTO, 2001). China also enjoyed normal trading relations with most of its trading partners. China was also host to the sixth largest

Table 7.5 China's WTO accession obligations and commitments

- The average bound tariff level for all industrial goods will be reduced to 9.4% by 2005 from the current 24.6%, with a wide range of detailed commitments to lower tariffs on other products. Some tariff reductions will be immediate, and others phased. All will be complete by 2005.
- The average tariff level for ASEAN products will be reduced by 34–47% by 2005, faster than the average reduction.
- Rules on Trade-Related Investment Measures (TRIMs) will be observed immediately on entry. Almost all administrative examination and approval procedures for the import of goods (such as quotas, licenses and other non-tariff quantitative restrictions) will be abolished. Many quotas were eliminated on accession; most of the remainder to be eliminated by 2003 and entirely phased out by 2005. The following devices were eliminated immediately on entry:
  - local content requirements,
  - technology transfer requirements and offsets as a condition for investment,
  - export performance and trade balancing requirements.
- Intellectual property rights – China agreed to Implement Trade-Related Intellectual Property Rights (TRIPS) immediately on entry. Requirements that Chinese partners to a JV gain ownership of trade secrets after a certain number of years are removed.
- Trading rights (the right to import and establish distribution networks) for foreign companies will be eliminated by 2003. Coverage is comprehensive, and includes commission agents' services, wholesaling, retailing, franchising, sales away from a fixed location, and related activities like inventory management, after sales service, repair and maintenance services, with foreign ownership allowed, up to 49%.
- All tariffs on information technology equipment and computers will be removed by 2005, through participation in the WTO Information Technology Agreement.
- Liberalisation of telecommunications, allowing the provision of telephony services by foreign firms across any distance within two to six years; foreign investment allowed up to 49% in all services, and 50% for value-added and paging services.
- Liberalisation of financial services by 2005, opening markets in banking, insurance, securities, fund management and other sectors. Licenses are to be granted on prudential criteria alone, and not on economic needs tests or numeric bases.
- Domestic market access and foreign ownership (majority or up to 49% foreign equity share) is now permitted in sectors such as travel and tourism and audio-visual materials.
- Support for state-owned and state-invested enterprises. China has agreed that WTO rules will apply to firms in which the state has an equity interest. Such firms are required to buy and sell on a commercial basis, such as quality and price. Trade between SOEs and foreign firms will be permitted. Government procurement systems will become more transparent.

Source: ACEGEC (2001) and Nolan (2001).

stock of global inward FDI (UNCTAD, 2001),[7] and in 1998 these FIEs account for around half of China's imports and exports (Lemoine, 2000). So, in many respects China's integration into the global economy was already comparatively advanced by 2001. To this extent, the Southeast Asian countries will already have begun to adjust to China's growing economic influence in the region.

Given its prominence already, it is unlikely that WTO membership will bring about any dramatic change to China's external trade and investment position. Instead, the major and most immediate changes will be internal; these will be wide ranging, and will concern not only China's economy, but possibly the country's social fabric and political order as well. But how will accession shape China's investment climate? Much depends on the extent to which China honours its accession commitments. If the authorities do decide to comply fully, then China will almost certainly experience several simultaneous 'shocks'; namely, the shock of (Nolan, 2001: p. 925):

- 'normal' restructuring, as a consequence of rapidly intensifying competition, especially from overseas;
- having to compete on a global level-playing field with a highly concentrated global business system;
- the IT revolution and modern production systems on employment;
- the drastic impact of the global media revolution upon Chinese culture;
- its people's self-esteem, should China fail to establish a collection of powerful indigenous corporations;
- dealing with the dominance of foreign-owned corporations, especially those from the USA.

Of these, the larger Chinese SOEs will perhaps feel the most dramatic shock. It is likely that most will suffer painful short-term restructuring, as previously protected domestic markets are penetrated by appreciably more efficient MNEs. Many if not most SOEs will be forced to cut costs, adopt modern production methods, eliminate excess employment and reduce overheads. Some will fail or go bankrupt. Few will be able to 'raise their game' and build themselves into globally competitive businesses (Nolan, 2001). Many will be unpalatable merger and acquisition prospects for foreign investors. This will constrain inward strategic asset seeking FDI for a time. Moreover, it is unlikely that other firms, such as China's medium-sized, export-oriented enterprises, will be able to absorb the structural shift in employment away from the state-owned sector. These may have difficulty improving on an already impressive export performance, and they will also experience sharply heightened competitive pressures in home markets. So will early foreign investors, some of whom have become sluggish and complacent behind China's tariff wall. Overall, the social cost of fully complying with its accession conditions will be high for China.

A second and important internal shock will be felt by China's institutions. While China's past performance in attracting FDI is commendable, its ability to provide a business environment conducive to investors is not. MNEs, especially

those in import substituting sectors, report a plethora of legislative, administrative and bureaucratic obstacles to business – their 'litany of complaint' (for good reviews see Rosen, 1999; Luo, 2000). The list is a long one: the excessive degree to which national, provincial and local governments in China can, and do, interfere in a range of commercial decisions; the opaque policy environment; the heavy-handed regulatory regime; the general absence of a rules-based economy; the partial, unfair and corrupt judiciary; poorly defined property rights (especially those arising from contractual relationships or that concern intellectual property); counterfeiting, software piracy and brand name infringement; endemic corruption by officials at many levels of government and in non-governmental organisations; the importance of informal relationships in China. While some of these obstacles are formal, imposed to fulfil certain domestic imperatives, others are unintentional or merely products of history. Nevertheless, each is experienced to a greater or lesser extent by most foreign investors, and they magnify the transaction costs of conducting business in China. By acceding to the WTO, China has agreed to provide and abide by a secure framework of international law within which MNEs in China can operate, especially with regard to government intervention and intellectual property protection. The WTO rules should also help to eliminate many of the mechanisms by which officials derive rents from corrupt practices. Consequently, many if not most of the administrative constraints to foreign business should be removed following accession.

For this to happen, however, and despite the considerable progress already made in this direction,[8] further fundamental and wide-ranging systemic adjustments are required, especially away from the coastal regions. Many of China's administrative systems, practices and bureaucracies need to be overhauled. The modernisation of China's legal frameworks and judiciary, in line with international norms, needs to be accelerated and many laws pruned. Perhaps the most difficult adjustment of all, the mindsets of bureaucrats and administrators at all levels of government, as well as that of much of society as a whole, needs to change; not only to adapt to the 'shocks' brought on by the WTO obligations but to appreciate why these are happening.

China's leadership therefore has many domestic challenges looming. Chang (2001) and others are highly sceptical that the ability or will exists in China to undertake the systemic adjustments and fully embrace the international trade rules required under the terms of WTO accession, given these challenges. Nevertheless, the withdrawal of the Chinese Communist Party (CCP) from microeconomic management leaves a void in China's economy that must be filled. A flourishing socialist market economy with new economic structures and disciplines and a burgeoning private sector, partly foreign owned, is probably the best way to accomplish this. So, herein lies the gamble of China's leadership. By joining the WTO, China is effectively locked into the economic reform process. It will now be difficult, if not impossible, to deviate from this, irrespective of the domestic disillusionment, political nervousness or ideological anxiety that will inevitably ensue. As the Chinese authorities struggle to balance rapid market liberalisation against equally rapid social cost hikes, however, what might occur

instead is a heightening of bureaucratic and technical barriers to investment (cf. Japan in the 1970s and 1980s), patchy implementation of the WTO obligations, and continued arbitrariness amongst local administrators and the judiciary. A less than forthright adherence to the WTO rules would provide established and new foreign investors in China with their own 'shock'; that investment barriers remain high, that accession will not make investing there any more profitable, and that the 'litany of complaint' is far from silenced.

7.4 China's WTO accession: opportunity or threat for Southeast Asia?

The effect that China's accession to the WTO might have on patterns of Southeast Asia's FDI inflows depends largely on how China's locational advantages change relative to Southeast Asia as a consequence, and whether or not China is a substitute for Southeast Asia as a host for certain types of FDI. It is important to consider both export-oriented, labour-intensive (henceforth export platform) FDI, and technology-intensive, market-seeking FDI in both services and manufacturing. Natural resource-seeking FDI is disregarded, as Southeast Asia and China are probably not substitutes for this, at least to any great extent, given the location-bound nature of resource-based factor inputs. It is also important to consider intra-Southeast Asian FDI, as well as FDI from the Triad countries and the NIEs, that might otherwise be directed to Southeast Asia; China may also be a substitute for intra-Southeast Asian FDI. In time, strategic-asset seeking investment, through the cross-border acquisition of SOEs and other Chinese-based firms, should play an increasingly important role in Chinese FDI, as should the role of the recent phenomenon of outward FDI from China. These are touched upon later.

First, was China already a competitive threat to the Southeast Asian countries as an FDI magnet prior to WTO accession? Given that for many years China shared with most Southeast Asian countries an economic development model that emphasised high levels of foreign ownership in export-platform mass manufacturing, this is a possibility. However, it is unlikely that China and Southeast Asia have been substitute hosts for export-platform FDI. In China, this type of FDI is characterised by certain transaction cost advantages peculiar mainly to Hong Kong and Taiwanese investors, and in particular geographic contexts. Although ethnic Chinese firms from these source countries also invest in Southeast Asia, they are much less prominent (Thomsen, 1999). The ownership-specific advantages of these firms are much reduced in contexts outside of mainland China. Up until the 1990s, therefore, the opening of China probably increased the global supply of this type of FDI; that is, it had an FDI creating effect.

Several authors, for example Tan (1999), Cheong (2000) and Palanca (2001), also hold that the emergence of China as a host has not crowded out FDI in general in the Southeast Asian region, and that China's WTO accession offers little threat of this in the future. Cheong goes on to argue that accession should lead to deeper and more intensive horizontal division of labour in the Asian region, as Asian firms continue to locate labour-intensive stages of production in China, just

as the NIEs have done in the past. Data on the share of China and Southeast Asia in certain categories of total investment flow underscores this point (see Table 7.3). As China's annual share of global FDI rose from around 7 per cent in the early 1990s to just over 10 per cent by 1996, so too did that of Southeast Asia, from 7 per cent to 8 per cent. The magnitude of the growth in China's share, and that of Southeast Asia, was matched by a drop in FDI share for the industrialised countries and a positive change in world FDI flows. However, closer examination of the data reveals some evidence of crowding out in the late 1990s. After 1997, and despite rising total values, the annual share in global FDI flows for both China and Southeast Asia dropped, reflecting worsening investment climates in the region compared to elsewhere. However, the rate of decline was much faster for the Southeast Asian countries. This effect is accentuated if we consider Hong Kong and China together in the regional context. In the mid-1990s, Southeast Asia received around a third of the annual investment flow to South, East and Southeast Asia; but by 2000 its share stood at 10.1 per cent. Over the same period, the combined share of China and Hong Kong's FDI inflows to South, East and Southeast Asia rose from around 56 per cent to almost 77 per cent. Notwithstanding the role of Hong Kong as a tax haven route, it seems likely that investment funds allocated at the regional level by MNEs (and perhaps even at the global level) were indeed diverted towards China and, particularly Hong Kong, in the few years prior to accession. The correlation between the rise in market-seeking FDI by developed country firms in China from 1997 onwards, and the decrease in overall FDI in Southeast Asia, implies that at least a proportion of the growth in China's FDI might have been at the expense of market-seeking manufacturing FDI in Southeast Asia. Moreover, this trend may not be confined to the Triad countries as an FDI source. In 1997, China overtook Malaysia to become Singapore's principal FDI destination, and by 2000 Singapore held the fifth largest stock of cumulative FDI in China, by source country, at around 5 per cent of the total, and predominantly in labour-intensive manufacturing (Heng, 2001). Consequently, some intra-Southeast Asian FDI flows may also have been diverted to China at this time.

But will China be a competitive threat to Southeast Asia for export platform and market-seeking FDI activity after joining the WTO? With regard to the former, full compliance with its WTO obligations will bring about a reduction in tariffs and other non-tariff barriers to trade. Therefore, foreign firms will be able to serve China's market by exporting from other close at hand production locations, rather than from production bases within China (Nolan, 2001). Accession may therefore have the effect of strengthening the position of neighbouring countries, including Southeast Asian countries, as hosts for export-platform manufacturing FDI oriented towards serving the China market. This would be accentuated if China's investment climate worsens after accession, because of growing political or social instability or rising factor input costs, for example. On the other hand, if China is unable to fully comply with its accession conditions, and if barriers to trade rise (especially non-tariff barriers), then the incentive for MNEs to continue with import-substituting strategies in China will be strong. With regard

to market-seeking FDI, full compliance should create many new business opportunities for foreign firms, especially in those services sectors where market access is being granted for the first time. Given the inseparability of production and consumption for many services, the propensity to undertake FDI is likely to rise as market access in China is achieved. However, investment in new manufacturing capacity (i.e. greenfield projects) may not grow as fast. Many goods markets in China suffer from overcapacity because structural weaknesses have stifled demand. However, full compliance should see these weaknesses diminish as competitive pressures raise efficiency, as export-led economic growth accelerates, and as inward investors themselves provide a spur to domestic demand.

The extent to which intra- and extra-Southeast Asian FDI inflows might be displaced to China depends greatly on factors such as market growth projections, the relative cost structures of location-bound factor inputs for production, and the respective investment climates in China and the individual Southeast Asian countries. We briefly examine each in turn. Consider first the issue of market growth in China. Ianchovichina and Martin (2001), working for the World Bank, developed a conservative static model to find that WTO accession and compliance will add at least 2.2 per cent to China's income as its share of world exports expands. The study anticipates that, as the multi-fibre agreement is phased out, China's exports will rise by at least 6.8 per cent, driven mostly by huge expected increases in exports of textiles and clothing (over 47 per cent), and also of toys and shoes. Indeed, these figures may be understated, as dynamic considerations – such as the positive effect of accession on wages, economic efficiency and investment – are unaccounted for. Using a multi-region applied general equilibrium model under two scenarios, Walmsley and Hertel (2001) found that worldwide tariff reductions in the textiles and clothing industry will also lead to welfare gains for China, with substantial increases in gross domestic product (GDP); over 8 per cent under one scenario.

However, both studies foresee a gloomier outlook for the Southeast Asian countries. These countries in general – but Singapore, Thailand, Malaysia and Indonesia in particular – benefited considerably in the 1990s by exporting to China. However, Ianchovichina and Martin (2001) predict little further benefit to Southeast Asia arising from China's WTO accession. They find that, while imports to China from Indonesia and the other Southeast Asian countries could increase by around 3 per cent and 14 per cent respectively, this will not be sufficient to compensate for sales lost to China in third markets, as barriers to China's imports are removed, especially in textiles, apparel and electronics. Consequently, they predict a modest 0.1 per cent decline in income for the Southeast Asian countries, with the exception of Singapore, which shows a small increase of 0.9 per cent (along with the other NIEs). Walmsley and Hertel (2001) are even more pessimistic, forecasting declines in the real GDP of Indonesia and the other Southeast Asian countries (excluding Singapore) of 1.57 per cent and 1.76 per cent, respectively. Provided the reform process is not derailed, these studies infer that accession should accelerate China's economic growth. This in turn should stimulate both new market-seeking investments and sequential

investments by foreign incumbents already active in the China market. Concomitantly, and with some exceptions, the relative market attractiveness of the Southeast Asian countries will probably decline in general terms, reducing the propensity for foreign firms to undertake market-seeking FDI in these countries.

Several recent surveys allow us to comment on the relative attractiveness of China, Hong Kong and the ASEAN-5 countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand) as hosts for inward investment. Table 7.6 presents data from the IMD (1999) Annual Executive Opinion Survey of current and expected competitiveness conditions for forty-seven host countries. This uses a wide range of factors to quantify the attractiveness of locations for manufacturing, R&D and service and management-related activity. China is ranked 29th overall as an investment location in the period 1998–99, a position bettered only by Singapore and Malaysia among the ASEAN-5 (the other five Southeast Asian countries being excluded from the survey). As a production location, China has many advantages relative to Southeast Asia. It has reasonably strong reserves of petroleum and other natural resources (though perhaps not on a per capita basis). It also has an abundant pool of low cost labour. Despite certain shortages, in general there are sufficient numbers of workers skilled at each stage of the value chain to satisfy the current needs of most investors, even in more capital-intensive and knowledge-intensive sectors. Because China's economy was formerly closed a certain level of skills and technological capability was developed indigenously. This is now being complemented by China's quickly modernising educational system and overseas education. FIEs themselves are also raising the stock of human capital through company training and development programmes. This means that the skills-base of China's workforce is improving quickly. China's technical and transport infrastructures have also been upgraded considerably in recent years, though mostly in the eastern regions. Production costs should be driven down further if a new wave of foreign investment in services, distribution and logistics occurs after accession. Should manufacturing costs rise in the

Table 7.6 Location attractiveness rankings for China, Hong Kong and the ASEAN-5

	Manufacturing	*R&D*	*Service and management*	*Overall ranking*
China (PRC)	30	29	32	29
Hong Kong	3	17	3	7
Singapore	2	7	4	2
Thailand	34	36	34	34
Malaysia	24	26	25	27
Indonesia	44	47	46	46
Philippines	27	34	31	32

Source: IMD (1999).

Note
Data not available for Brunei, Cambodia, Laos, Myanmar and Vietnam.

coastal provinces, which according to Broadman and Sun (1997) is already happening, the underdeveloped central and western provinces offer substantial and almost equivalent benefits, if not in geographical location and infrastructure, then certainly in respect of labour. By contrast, several Southeast Asian countries are reported to have labour shortages and rising labour and land costs (Yean, 1998).

The IMD survey also presents data on the FDI regimes and transactions costs of doing business in the region (see Tables 7.7 and 7.8). In terms of its FDI regime, China scores lower than each of the ASEAN-5 countries except Indonesia, faring particularly badly on the availability of local capital and foreign ownership of domestic firms. However, WTO accession should bring about considerable improvement in these areas, and in other such aspects as equal treatment and national protectionism. In terms of transaction costs, the overall assessment for China compares favourably to most of the ASEAN-5 countries, scoring better than all except Singapore and Malaysia. While China's poor scores for bureaucracy and levels of corruption offer partial confirmation of the 'litany of complaint', its business environment in general seems to be no worse than those of the ASEAN-5 countries (with the obvious exception of Singapore), and is in some respects better. Importantly, unlike the smaller Southeast Asian economies, many foreign firms will view China's large market potential as sufficiently adequate compensation for the comparatively high transaction costs they experience there.

A second recent survey suggests that China has a generally more favourable investment climate compared to Southeast Asian countries. UNCTAD (2001) calculate the inward FDI Index as an approximate measure of a nation's relative performance in attracting FDI, allowing for its relative economic size and strength in the world (see Table 7.9). This index is the unweighted average of three ratios; the share of a country in global FDI flows divided by its share in global GDP, employment and exports. China's inward FDI Index rose from 0.8 to 0.9 between the periods 1988–90 and 1998–2000; an improvement in its 'revealed competitive advantage' for FDI, and an indication perhaps of the country's resilience to the Asian crisis and its causes. China's overall ranking does worsen over this period, but this is because more countries register a greater improvement. However, the FDI Index declines for each Southeast Asian country over the same period, and for each comprising ratio. This infers a reduction in the attractiveness of the Southeast Asian countries relative to China, especially in market-related areas. This may be as a consequence of the Asian crisis, or an indication perhaps of more serious structural deficiencies in their economies.

Other surveys of MNEs also reveal optimism that China's relative position as an investment location will be sustained. UNCTAD (2001) cites a recent survey of 3,000 regional headquarters and representative offices of MNEs situated in Hong Kong. Some 45 per cent of respondents planned to increase their investment in mainland China, and 93 per cent predicted that the investment climate there would be 'favourable' or 'very favourable' through to 2005. Bartels and Freeman (2000) report similar findings in their 1999 survey of thirty-one retail-oriented MNEs with regional headquarters in Singapore, 71 per cent of whom

Table 7.7 Survey results of the FDI regimes in China and the 'ASEAN-5'

	Local capital market (A)	*Acquisition of control (B)*	*Equal treatment (C)*	*Employment of foreigners (D)*	*National protectionism (E)*	*Investment protection (F)*	*Image of country (G)*	*Overall assessment (H)*
China (PRC)	4.0	4.4	3.9	5.9	4.3	8.1	7.8	5.49
Hong Kong	9.2	9.3	8.9	6.0	9.3	6.9	7.9	8.21
Singapore	7.5	8.2	8.0	7.7	7.6	7.9	9.0	7.99
Thailand	7.0	5.6	5.4	5.0	5.8	6.7	6.4	5.99
Malaysia	6.2	4.6	5.2	5.4	5.6	6.9	5.2	5.59
Indonesia	6.5	6.9	5.2	5.0	5.2	5.7	1.8	5.19
Philippines	7.0	6.4	6.0	6.4	6.2	7.2	5.4	6.37

Sources: IMD (1999), after Dunning (2001: 266–267).

Notes
Survey results are scaled from 0 (least favourable for FDI) to 10 (most favourable for FDI) for each item. Data are not available for Brunei, Cambodia, Laos, Myanmar and Vietnam.
A Access to local capital is restricted for foreign investors (0) / is not restricted (10).
B Foreign investors may not (0) / are free to (10) acquire control in a domestic company.
C Foreign and domestic companies are not (0) / are (10) treated equally.
D Immigration laws prevent (0) / do not (10) prevent your company from employing foreign labour.
E National protectionism prevents (0) / does not prevent (10) foreign products and services from being imported.
F Investment protection schemes are not available (0) / are available (10) for most foreign partner countries.
G Image of your country abroad hinders (0) / supports (10) the development of business.
H Average assessment according to criteria A to G (unweighted).

Table 7.8 Transaction cost-related barriers to FDI in China and the 'ASEAN-5'

	Cultural barriers (A)	*Government competence (B)*	*Legal framework (C)*	*Transparency (D)*	*Bureaucracy (E)*	*Corruption (F)*	*Protection of IP (G)*	*Distribution systems (H)*	*Infrastructure (I)*	*Labour regulations (J)*	*Overall assessment (K)*
China (PRC)	7.2	4.9	5.9	6.4	1.3	1.9	7.9	5.5	5.2	4.9	5.11
Hong Kong	8.2	6.1	8.6	5.5	6.3	7.0	6.3	8.4	7.9	7.9	7.22
Singapore	8.1	9.0	8.6	8.5	7.5	8.5	8.0	9.3	9.2	8.0	8.47
Thailand	7.3	4.5	4.4	5.4	3.1	2.4	5.2	5.3	4.9	6.4	4.89
Malaysia	6.6	5.7	6.7	6.3	4.2	3.7	5.9	7.2	6.6	6.7	5.96
Indonesia	6.7	2.2	3.3	2.7	1.8	0.9	3.4	3.4	3.5	5.5	3.34
Philippines	8.4	3.8	4.5	5.3	2.3	1.6	6.2	3.2	3.4	6.0	4.47

Sources: IMD (1999), after Dunning (2001: 266–267).

Notes

Survey results are scaled from 0 (least favourable for FDI) to 10 (most favourable for FDI) for each items. Data are not available for Brunei, Cambodia, Laos, Myanmar and Vietnam.

A National culture is closed (0) / is open to foreign influence (10).
B Government decisions are not (0) / are effectively implemented (10).
C The legal framework is (0) / is not (10) detrimental to your country's competitiveness.
D The government does not (0) / does communicate its policy intentions clearly (10).
E Bureaucracy does (0) / does not (10) hinder business development.
F Bribery and corruption exist (0) / does not exist in the public sphere (10).
G Patent and copyright protection is not (0) / is (10) enforced in your country.
H The distribution infrastructure of goods and services is generally inefficient (0) / efficient (10).
I Infrastructure maintenance and development is not (0) / is adequately planned and financed (10).
J Labour regulations are too restrictive (0) /are flexible enough (10).
K Mean of score for items A to J (unweighted).

Table 7.9 Measures of Asian FDI attractiveness: inward FDI Index, by host economy, 1988–90 and 1998–2000, and FDI per capita (US$)

Host region/ economy	*FDI inflow share over 1988–90*					*FDI inflow share over 1998–2000*					*FDI per capita (US$)*
	GDP share	*Employment share*	*Exports*	*Inward FDI index*[a]	*Rank (from 112)*	*GDP share*	*Employment share*	*Exports*	*Inward FDI Index*[a]	*Rank (from 137)*	
World	1.0	1.0	1.0	1.0		1.0	1.0	1.0	1.0		
Developing countries	1.0	0.2	0.7	0.6		1.0	0.3	0.7	0.7		
S, E and SE Asia	1.3	0.2	0.7	0.7		1.1	0.2	0.6	0.6		
China PRC	1.0	0.1	1.3	0.8	52nd =	1.3	0.1	1.3	0.9	59th =	240
Hong Kong, China	5.0	11.8	0.7	5.9	4th	6.3	24.5	1.1	10.6	2nd	56,213
Brunei	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Cambodia	n/a	n/a	n/a	n/a	n/a	1.3	0.1	1.0	0.8	65th =	48
Indonesia	0.8	0.1	0.6	0.5	63rd	−0.7	−0.1	−0.4	−0.4	136th	285
Laos	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	104
Malaysia	4.3	2.4	1.1	2.6	17th	1.6	1.0	0.3	1.0	54th =	2194
Myanmar	0.5	0.1	4.0	1.5	35th =	0.1	0.0	1.4	0.5	83rd =	54
Philippines	1.6	0.3	1.1	1.0	46th =	0.6	0.1	0.3	0.3	100th =	135
Singapore	12.7	26.5	1.4	13.5	1st	2.2	7.5	0.3	3.3	13th	19,268
Thailand	2.4	0.6	1.4	1.5	35th =	0.9	0.3	0.4	0.5	83rd =	351
Vietnam	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	199

Source: UNCTAD (2001), and authors' own calculations.

Note
a Calculated by taking a country's share in world FDI flows, and dividing it by its share of GDP, employment and exports.

indicate that 'greater China' was given 'high' or 'highest' priority by the parent firm as a business location.

Three final observations also bear upon China's position as a future threat to the Southeast Asian countries as an investment host. First, there is ample absorptive capacity in China for FDI. FDI stock on a per capita basis is relatively low (US$ 240 in 1998), well below that of Hong Kong and Singapore (US$56,213 and US$19,268, respectively), but also below that of Malaysia (US$2,194), Thailand (US$351) and Indonesia (US$285).[9] The sectoral and geographic distribution of FDI is so uneven in China that much geographic and economic space remains largely untouched by FDI, not least in the central and western provinces where many SOEs are located (Graham and Wada, 2001). Second, up to now strategic-asset FDI in China (that is, mergers and acquisitions involving Chinese SOEs and foreign firms) has been highly restricted by its regulatory regime and underdeveloped stock markets. However, regulatory changes following WTO membership, embodied in the State Council's tenth five-year plan, should see many of these obstacles removed. Providing political opposition is also quelled, this should generate significant inflows in FDI in the medium term, as performing SOEs are partially or totally sold-off. If this occurs, strategic asset-seeking FDI may flood to the central and western regions of China where the majority of SOEs are located, despite relative underdevelopment of the physical and technical infrastructures there. Third, on-going research by the authors on the investment strategies of European firms in China reveals that, for many firms experiencing saturated or slowly growing markets elsewhere in the world, China's considerable market potential is 'the only game in town' for continued corporate expansion of any size. To illustrate this point, the manager of a representative office in Guangzhou for a German industrial machine manufacturer stated that if the company fails in China the survival of the parent would be in doubt. This is a small measure of the importance of China in the strategic planning of many international firms today.

7.5 China as a regional FDI magnet?

It has been written that making predictions is difficult, especially about the future. But for China it is a particularly forlorn task, given the scale and heterogeneity of the country and the challenges of modernisation and market reform. Nevertheless, with certain provisos, our analysis suggests that few benefits derive to the Southeast Asian countries from China's WTO accession, in terms of individual abilities to capture a greater share of regional and global FDI flows. The provisos are that China adopts fully its WTO obligations by 2005, that the social cost of this can be accommodated, and that present political and administrative structures will not be fundamentally destabilised as a consequence.

China currently enjoys the powerful combination of a large, low cost and educated labour pool, strong demand potential and satisfactory investment climate, relative to the Southeast Asian countries. The weight of evidence suggests that, so long as social and political cohesion is preserved, full compliance to the accession

terms will cause domestic demand to rise, market access for foreign firms to improve and the investment climate to strengthen relative to the Southeast Asian countries. This implies that China should be able to attract a greater share of global and regional FDI flows in the future. While a good proportion of FDI will be 'new' (that is, China's continued opening will have an FDI-creating effect), an indeterminate yet potentially significant amount could be displaced from intra-Southeast Asian FDI, or from initial and sequential FDI made by the Triad countries in Southeast Asia. The greatest competitive effect will come from China for higher value-added market-oriented FDI. This is already increasingly taking place in China, and it should accelerate after accession, especially from the Triad countries. Certain structural impediments currently prevent this from taking place in many, if not most, of the Southeast Asian countries (Yean, 1998). The most immediate surge in China's inward FDI is expected in those services-related sectors being opened for the first time. Substantial inflows of services-oriented FDI to Southeast Asia are unlikely while service-based MNEs establish toeholds in the China market. As domestic demand in China expands, more manufacturing-based FDI should also be attracted, mainly from developed country firms undertaking increasingly more capital and technology-intensive production.

It is also possible that some foreign and domestically owned production in Southeast Asia may migrate to China, as its investment climate improves relative to current production locations. Both Singapore – already a major investor in China – and Malaysia have recently registered increased outward FDI flows in labour-intensive manufacturing, as production costs rise at home, a growing proportion of which may soon be directed to China. Likely candidate industries would be export-oriented manufacturing operations in Southeast Asia with relatively few backward linkages to local suppliers and other parties. These are prevalent in textiles and garment production and some in types of electronics manufacturing. Some of the competitive effect for export-platform type FDI in Southeast Asia will come from China's coastal provinces. However, rising wage and non-wage costs here may militate against this. Within a few years of WTO accession, greater pressure should be felt from China's central and western provinces, as the transport and technical infrastructures here undergo further improvement, and as economic development is boosted by the acquisition of SOEs by foreign investors. Broadman and Sun (1997) make a good case for the more central provinces of Hunan and Henan as candidates for the next wave of inward FDI to China, for cost-oriented as well as market-seeking motives. However, coastal locations such as Beijing, Shanghai, Zhejiang and Hebei will retain their appeal for many foreign investors, for obvious reasons. Of course, a certain level of market-seeking FDI will always be maintained in the Southeast Asian region, irrespective of developments in China. For example, MNEs will continue to support and establish subsidiaries in individual Southeast Asian countries, to complement their import function with sales, marketing, and distribution activities. But this is relatively low value-added activity, and generates few spillovers and other benefits for the host economy compared to more capital-intensive investment.

If our analysis is correct, and China does have a magnetic effect on patterns of regional FDI, this will have significant implications for each of the Southeast Asian countries, though to varying degrees and for different reasons. As many of these issues are discussed elsewhere in this volume, we present only a brief account. First, for some Southeast Asian countries, such as Brunei, Myanmar and Indonesia, FDI is mostly natural resource-oriented, notably in the oil and gas extraction and support industries. It is unlikely that China is, or will be, a magnet for FDI in these areas, and to some extent China's influence in Southeast Asia will be least felt by them. If China does prove able to attract a greater proportion of regionally allocated market seeking FDI in services and manufacturing, this will impact most those Southeast Asian countries which themselves have relatively small markets in terms of, for example, population (such as Brunei, Laos and Singapore) or purchasing power (such as Myanmar and Vietnam). Larger Southeast Asian countries like Malaysia, Thailand and the Philippines should continue to attract a proportion of market-seeking FDI, but whether this is in capital- and technology-intensive sectors is questionable. Currently, the FDI stock of these countries exhibit a strong source country affiliation, with a preponderance of European, and especially British-owned FDI in Malaysia and American investment predominating in the Philippines and Thailand. Should these source countries continue to raise their investment in China, to levels normally seen in developed host countries, this may be at the expense of sequential FDI in Southeast Asia. What is more, these Southeast Asian countries may experience divestment, as 'foot-loose' foreign and domestically owned production relocates to China.

Of course, some Southeast Asian countries should benefit directly from market opening in China. An obvious candidate is Singapore, whose firms have expertise in several service-related areas, such as in education, construction, engineering consultancy, business services, transport and logistics. Certain language and cultural similarities should augment the competitive advantage of Southeast Asian firms in China compared to their US and European rivals. Although intra-Southeast Asian FDI is not significant in terms of world flows, it is important to some economies in ASEAN. For example, the newer ASEAN members – Cambodia, Laos, Myanmar and Vietnam – only attract relatively small amounts of FDI in absolute terms (although often large as a proportion of GDP), but their principal source tends to be fellow Southeast Asian countries, particularly Singapore. If China's opening does displace intra-Southeast Asian FDI, and especially Singapore-sourced FDI, these countries could suffer economically. Indonesia and Malaysia, which also host large amounts of Singaporean FDI, could be similarly affected.

7.6 The policy response of Southeast Asia: deeper regional integration as a win–win solution?

What steps can the Southeast Asian countries take to militate against the growing threat of China as an FDI magnet in the region? Today, the priority of MNEs is to

withstand global competition by strengthening their ownership advantages across all markets in which they operate. Thus, the Southeast Asian countries should all aim to provide competitive immobile assets to complement those mobile assets of MNEs. On a unilateral level, this means proactive national policies to enhance the quality of the workforce, infrastructure, supply networks and institutions. Deficiencies in their respective investment climates should also be tackled. As we have seen, transaction costs in Southeast Asia are on a par with those in China, while several Southeast Asian countries lack a compensating economic base of any comparable size. Investment promotion measures targeted at particular industries (in which the host Southeast Asian country has an actual or potential competitive advantage) or source countries (with existing trade or historic connections) should also help. The Southeast Asian countries could compete individually with China as a production site by depreciating their currencies and cutting production costs. However, this solution is probably untenable, given the high social costs and lower living standards that would follow. They could also realign their economies to become more resource-oriented, supplying agriculture and minerals, not only to a growing China, but also the wider region. Although feasible, rigidities and under-investment in several of the Southeast Asian economies limits their ability to accomplish this in the short term. Nevertheless, those countries with a common border to China – Laos, Myanmar and Vietnam – should improve their transport and communications infrastructure with both China and the rest of Southeast Asia, in order to benefit as conduits for the rise in China–Southeast Asian trade flows that should follow accession. So should the Southeast Asian countries in general; not only with China's coastal provinces, but also with those central provinces identified as likely recipients for the next wave of inward FDI.

Although such unilateral initiatives may go some way to offsetting China's improving situation as a host economy, the real gains to Southeast Asia will come by replacing deteriorating individual locational advantages relative to China with a superior regional one. Consequently, the ASEAN Free Trade Agreement (AFTA) or the Asian Investment Area (AIA), or both, should form at least part of the policy solution. For two reasons, more concerted effort is needed to coordinate and harmonise investment regulations and regimes across Southeast Asia. First, this would aid in negating unilateral 'beggar thy neighbour' policies, in which individual Southeast Asian countries 'race to the bottom', by attempting to out-compete each other with improved investment conditions under WTO rules. Second, it could facilitate an improved division of labour across Southeast Asia. This would permit Southeast Asian and outsider firms to allocate resources at a regional level within the region, according to the comparative advantage of member states, in much the same way that MNEs are beginning to do now in China. Both Southeast Asian and non-Southeast Asian MNEs would be better able to rationalise existing production across the region, and to generate greater economies of scale and other efficiencies as a result. Opportunities for intra-industry specialisation would provide a boost to the investment climate of Southeast Asia as a whole, especially for efficiency-seeking FDI. Thus labour-intensive

manufacturing may be encouraged in low cost countries like Myanmar and Vietnam, while high-end, capital-intensive manufacturing could continue to be sited in Singapore, for example. At the same time, a workable AFTA would also create a single market of sufficient size to begin to counter that of China for market-seeking FDI. It could also help to stimulate outward investment in Southeast Asia by Chinese enterprises, which themselves will soon be under growing pressure to develop foreign markets following accession. Indeed, this process is already underway, with the Philippines, Malaysia and Thailand beginning to attract Chinese FDI in resource-based sectors such as agriculture, chemicals, paper and rubber (ACEGEC, 2001). If implemented, greater regional integration in the form of AFTA and the AIA should provide fresh stimulus to both intra- and extra-Southeast Asian FDI, and could go some way towards offsetting China's growing economic weight in the region. The likelihood that these frameworks will be pursued by Southeast Asian countries and ASEAN is discussed elsewhere in this book. However, it is worth pointing out in the context of this chapter that Southeast Asia is a net investor in China. This may mean that investment co-operation both within Southeast Asia, and between Southeast Asia and China, will be directed more to protecting Southeast Asian investors in China and improving the conditions for Southeast Asian firms there than *vice versa*. If so, any further deepening of economic integration within Southeast Asia could be impeded.

7.7 Conclusion

In this chapter, we have sought to describe the likely impact of China's accession to the WTO on its locational attractiveness for FDI, relative to the Southeast Asian countries. Our analysis is limited in that, by focusing almost entirely on two economic regions and on FDI to the exclusion of trade, it disregards the interdependencies that characterise international business today. Also, econometric work is needed to fully understand the extent to which FDI displacement to China might negatively impact the economic performances of the Southeast Asian countries, and what the consequences of this might be for them.

Nevertheless, we detect several changes to the established pattern of inward FDI to China since the mid-1990s that may have had a quantitative and qualitative effect on FDI flows to the Southeast Asian region. We also considered how China's investment climate might evolve as a consequence of acceding to the WTO and complying with its accession obligations. This is a difficult question to answer. Whilst we recognise the possibility that China will not fully comply, and that the market-reform process may indeed be undermined by social, political or other considerations, the thrust of our analysis is that China's investment will indeed be strengthened by WTO accession, relative to the Southeast Asian countries. Consequently, we argue that China will probably have a magnetic effect on FDI in the region, rather than a neutral or benign effect, although this will vary by source country and industry. Initially the effect will be felt mostly in service-related FDI, where much reform in China is taking place. Later, the propensity for manufacturing FDI to gravitate to China should also rise. Further, it will

mostly affect inward FDI from the Triad countries, but it could also have a diversionary effect on intra-Southeast Asian FDI. In order to counter the growing economic weight of China in East and Southeast Asia, and as individual member states will be limited by what they can accomplish alone, we argue that the Southeast Asian countries should act in concert to enhance the attractiveness of the region as an investment location, relative to China. Greater regional integration (in the form of AFTA or the AIA) will be an important, if not crucial, element of the policy solution.

It will also be important for the Southeast Asian countries and ASEAN to bolster economic and political ties with China. Southeast Asia should improve its communication and business links, so that market expansion in China can serve as a boost to China–Southeast Asian trade, and act as an engine of growth for the region. At a political level, China's position and status among the industrialised countries improved markedly during the WTO negotiations, and compliance with the terms of accession should see this strengthen further. Closer co-ordination could see China acting as a spokesperson for the region, providing fresh vigour to East Asian countries' separate and combined bargaining positions in the WTO and elsewhere. It is likely that, by joining the WTO, China will become more prominent as an economic force in the region, and also in the world. This may not happen immediately, and the journey may not be a smooth one. Nevertheless, it is important that politicians and policy-makers on all sides take steps to ensure that it will not be at the cost of economic development in neighbouring countries such as those of Southeast Asia.

Notes

1 Within Southeast Asia, the 'ASEAN-5' comprises of Indonesia, Malaysia, the Philippines, Singapore and Thailand. The 'ASEAN-10' comprises the same five countries, plus the remaining member countries of the Association of Southeast Asian Nations: Brunei, Cambodia, Laos, Myanmar (Burma) and Vietnam.

2 See *South China Morning Post*, 12 November 2001, p. 1.

3 We fully acknowledge the inherent data inadequacies of the China Statistical Yearbook and other official Chinese data sources. It is widely accepted that much FDI in China is illusory and that actual total inflows are significantly lower than that reported. First, capital equipment and intellectual capital (brands and trademarks) contributed by a foreign investor to a joint venture are commonly overvalued, inflating the level of equity invested, and therefore also recorded FDI. Second, mainland Chinese, Taiwanese and western investors are known to steer (or 'round trip') investment funds through Hong Kong intermediaries, so as to avoid certain investment restrictions and to benefit from preferential tax treatment and other incentives available to 'foreigners'. Along with tax haven diversion, such factors are thought to have inflated China's 1994 FDI inflow data by as much as 37 per cent (Broadman and Sun, 1997). In reality, the precise extent is difficult to quantify, so circumspection is advised when interpreting FDI data for China, including that used in this chapter.

4 For political reasons, Taiwanese investment into China was prohibited before 1990, so an unquantifiable proportion of Taiwanese FDI at this time was routed via intermediary investor nations, notably Hong Kong, thereby inflating the latter's share of total FDI inflows by home country source.

5 The position of the Cayman Islands and the British Virgin Islands as source countries improved over this period as well, and in part this accounts for the downturn in the position of Hong Kong and Taiwan. However, as these are not the ultimate home countries of FDI inflows, they are disregarded.
6 For example, Thomsen (1999) reports that around two-thirds of Japanese output in China is sold on the domestic market.
7 Behind, in descending order, the United States, Germany, Japan, France, the United Kingdom and Canada in respect of trade, and behind the United States, United Kingdom, Hong Kong SAR, Germany, and (together) Belgium and Luxembourg in respect of FDI stock.
8 For example, severe nationwide clampdowns have already reduced the incidence of intellectual property appropriation and corruption, albeit as much to meet domestic imperatives as to appease foreign investors.
9 These data suggest that the slowdown in inward FDI to China, observed in the late 1990s, was probably not due to saturation effects (Lemoine, 2000).

8 The future of cross-border mergers and acquisition activity in Southeast Asia

Frank L. Bartels

8.1 Introduction

Whereas the metrics for tracking foreign direct investment (FDI) flows are well established, either under IMF balance-of-payments protocols, or through the recording functions of host country central banks and investment agencies, delineating with certainty the activity of cross-border merger and acquisition (M&A) activity,[1] in terms of volumes and values, is much more problematic. Indeed, the problem has a number of dimensions. First, cross-border M&As form but one option within the FDI policy framework of modal neutrality (UNCTAD, 1996) by which firms can enter and service international markets. As such, cross-border M&As should be arithmetically part of measured aggregate FDI flows. Secondly, disaggregated statistics obtained by tracking cross-border M&A activity are more readily available in Europe and North America than in Southeast Asia, due to limited analytical capacity, albeit notwithstanding the publication of the *ASEAN Investment Report* (ASEAN, 2001).

Thirdly, whereas capital flows are defined as either FDI, foreign portfolio investment (FPI) or bank loans, cross-border M&As – which have become more complex and increasingly constitute the majority of, and driving force behind, global FDI activity (UNCTAD, 2000) – are often financially and operationally structured as a combination of all three types of capital flows, within which different financial instruments are used. Typically, the stock and asset sales (not just of the 'mega-deals') in cross-border M&As may comprise 'the acquisition of shares through portfolio investment, followed by an injection of FDI (which could take the form of additional traditional "green-field" plant and/or licensing and/or joint venturing) partly financed through commercial bank lending' (Freeman, 2000: 8). Fourthly, in the specific regional context of Southeast Asia, the national identities of parties to cross-border M&As can be of three types: both are Southeast Asian firms; both are subsidiaries of Triad-based Multinational Enterprises (MNEs) (one of which is usually headquartered in Singapore, and which could be the result of the global consolidation of mature oligopolies and services sectors); or one company is a Southeast Asian firm and the other is a non-Southeast Asian firm operating in the region. Consequently, reports from different high fidelity institutional and statistical sources can tell different stories and indicate different numbers for cross-border M&A activity.[2]

This problem renders the task of projecting the pattern of intra-regional cross-border M&As in Southeast Asia fraught with potential difficulties, notably of double counting, and confusion of what precisely constitutes regional cross-border M&As. Nevertheless, even though cross-border M&As in Asia constitute a small percentage (in terms of volume and value) of global M&A activity, the Asian economic crisis and the recent rapid expansion in, and then deceleration, of cross-border M&As warrants analytical attention.[3] In this chapter, we are not going to analyse motives for cross-border M&As, or assess normatively the impact on various stakeholders. We take it as given that the forces contributing to the upward pressure on global M&A deal flow, epitomized by a confluence of deregulation, liberalisation and the specific circumstances of the Asian economic crisis, converge into the industrial organisation logic of capturing more efficiently scale economies, and the managerial behaviour of maximizing utility. We refrain also from examining anatomically cross-border M&As from an organizational process perspective. Suffice is to say that this modality of FDI is statistically problematic and presents a 'janus complex' – M&As have been increasing in pace and size throughout the 1990s, up to the end of 2001,[4] and yet simultaneously, empirical analyses continue to point to failure in the majority of M&As.[5] Furthermore, the trajectory of regional economic development by leading countries necessitates an examination of intra-regional cross-border M&As that take their departure from the Asian economic crisis of 1997–98.

8.2 Patterns in intra-regional cross-border M&A activity

Intra-regional cross-border M&As, from an intellectual capital perspective – optimising the make or buy decision (Gupta and Roos, 2001) – have been traditionally avoided by Asian companies (of which significant portions are family owned[6]) in preference for the implicit and informal protocols of collaborative (alliance) ventures, in keeping with cultural propensities for knowledge creation routines (Mowery *et al*., 1996; Venzin *et al*., 1998; Simonin, 1999). Consequently, minority cross-share holdings are readily found in Asia, and the region's share of cross-border M&A activity, in value terms, is modest at less than 2 per cent of the global total in 1999, even allowing for the pick-up in M&A activity in the wake of the Asian economic crisis.

Nevertheless, in conformity with long-term global trends, cross-border M&A activity in Asia – and particularly in Southeast Asia – are destined to rise. As cross-border M&A is one modality of FDI activity, the underlying pattern of intra-regional cross-border M&A activity should reflect the overall pattern of intra-regional FDI activity, in which Singapore is predominant. First, this is due to the restrictive M&A regulations of Southeast Asian countries in general, compared to that of Singapore.[7] Secondly, it is Singapore's strategy to diversify its economic sources of growth by expanding its 'external wing' of overseas business assets, through deploying government-linked companies (GLCs) in overseas and regional FDI, including cross-border M&As. Thirdly, the preponderance of M&A expertise in and around Singapore's capital market stands in contrast to that of other regional capital centres.

Before examining specific Singapore aspects of overall intra-regional cross-border M&A activity, it is instructive to look at the phenomenon before and after the Asian economic crisis. It is widely accepted that intra-regional cross-border M&A deal flow prior to 1998 was modest in scale and scope, averaging below US$5 billion annually (Mody and Neglishi, 2001). Individual country participation was modest, with the exception of Indonesia in 1994 and Malaysia in 1996, as indicated in Table 8.1.

As previously indicated, statistics on cross-border M&As are difficult to disaggregate, and Table 8.1 presents a broad view of the Southeast Asian companies acquired, but not the identity of acquiring companies, which may have been Southeast Asian, non-Southeast Asian but operating within the region, or non-Southeast Asian and wholly from beyond the region.

From FDI inflow indications, we know that cross-border M&A activity has contributed to cumulative FDI flows into Southeast Asian countries. Between 1995 and 1998, cross-border M&As represented cumulatively 41.1 per cent of FDI inflows for Indonesia, 53.3 per cent for Malaysia, 13.3 per cent for Singapore, and 38.5 per cent for Thailand respectively (ASEAN, 2000b). This reflects the larger international picture, bearing in mind that Asia has traditionally shunned cross-border take-over deals. Also, the pressure of managerial utility, evident for North American and European managers with their share option compensation packages, has been largely absent in Asia's executive management practices.[8]

Given the relatively low incidence of intra-regional cross-border M&A deals prior to the Asian economic crisis, it is valuable to revisit the structural reasons for regional firms resisting this modality of FDI which has, at least until very recently, been the preferred market entry strategy in the Triad economies.[9] This permits a better appreciation of the structural changes that Asia – including Southeast Asia, with its ASEAN Free Trade Area (AFTA) and ASEAN Investment Area (AIA) initiatives – is likely to undergo in the coming years.

In general, the dynamics of intra-regional cross-border M&A deal flow requires a number of necessary and sufficient conditions. These conditions are encapsulated by critical capacities and capital markets' capabilities, in conjunction with the development of specific industrial assets, with production profiles

Table 8.1 Cross-border M&A activity in Southeast Asia, by sales and selected economy of seller (US$ million), 1991–98

Country	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Indonesia	275	2,287	1,421	6,507	4,125	2,654	4,312	1,705
Malaysia	1,004	1,197	541	393	821	4,497	2,361	1,693
Philippines	123	576	679	1,824	2,966	2,708	2,835	2,238
Singapore	127	450	2,071	1,145	597	1,692	1,208	548
Thailand	152	2,556	330	605	2,963	2,063	1,405	1,820
Vietnam	49	227	2,329	2,894	1,975	1,300	901	88

Source: ASEAN (2000b): 68.

oriented towards maturity – and hence overcapacity – in the presence of oligopolistic competitive forces. Sufficient conditions are provided by the state-defined regulatory environment that either encourages and/or permits rapid industrial consolidation, and is resistant to special interests and lobbying for protection by various industrial interests.[10]

First, the widely used definition of the region's leading regional economies as newly industrial(ising) countries (Wade, 1990) – despite homogenous export characteristics – implies a less than broadly mature industrial landscape. Further, apart from Singapore's capital market, there is an absence of extensive intermediation with the quality of layers, articulation and instrumental skills found in the major financial centres of the world (Bartels and Freeman, 2000; Freeman and Bartels, 2000). Recent developments in East Asia's economic landscape have been due largely to external agents allowed either to operate independently of host countries, thus rendering hosts as dependent intermediators (Singapore), or dependently on hosts (through collaborative formalities) and thus permitting host countries to develop as autonomous intermediators (South Korea), through the capture of higher levels of technology (Buckley and Mirza, 1988; Berger and Hsiao, 1988). In the main, 'greenfield' FDI and International Joint Ventures (IJVs) have been the main mode of market entry, and overall, neither plant nor capacity had reached the classical economic or technical definition of industry maturity, before being overtaken by the financial misalignments that triggered the Asian economic crisis. This is notwithstanding the similar structure of exports from Southeast Asia in particular, that at first examination might suggest signs of regional industry maturity (Zhan and Ozawa, 2001) and regional over-capacity. Therefore, from an industrial organisation perspective, the industrial landscape of Southeast Asia has not hitherto been generally conducive to cross-border M&A deal flow.

Secondly, the sufficiency condition, of the visible hand of government in economic management has been very much in evidence (World Bank, 1993; Krugman, 1994). The role of the interventionist state and the oligarchic structure of business in East Asia – and particularly Southeast Asia – and generally restrictive ownership regimes for FDI activity effectively ruled out a vigorous market environment for M&As during much of East Asia's recent economic growth trajectory, from the 1970s until the hiatus of the Asian economic crisis.

Intra-regional cross-border M&As should be viewed as US$25.3 billion in Asian sales, against a background of US$720 billion for global cross-border M&As in 1999 (UNCTAD, 2000), with the vast majority being acquisitions (rather than mergers) with horizontal (i.e. same industry sector) formats. Before the onset of the Asian economic crisis, Asia averaged less than US$7 billion in cross-border M&A sales. Interestingly, cross-border M&As in the five countries most influenced by the Asian economic crisis points to only Singapore and Malaysia as active in the period 1995–96, at US$1,140 million and US$448 million, respectively (UNCTAD, 2000). In the period 1998–99, only Singapore was active in M&As, at US$2,463 million. This is broadly reflective of intra-regional FDI patterns (see Chapter 5).

But, rather than dwell on the Asian economic crisis, we elect to look at the key players, as this is more useful in pointing to the likely future pattern of intra-regional cross-border M&As. Bearing in mind the problems of disaggregating data on intra-regional cross-border M&As,[11] the argument that pre-crisis Southeast Asia did not have a vigorous cross-border M&As landscape, (i.e. a shallow depth to, and absence of, mature industries) is supported by evidence that once cross-border M&As had started, both the volume and value of cross-border M&As deals into the region decelerated rapidly, from about 300 deals in mid-1997 to about 190 in mid-1999, and from about US$10 billion in assets to about US$6 billion, respectively (ASEAN, 2000b). Cross-border M&As into Southeast Asia had previously grown from about US$4 billion in 1990 to a peak of about US$14 billion in 1996, prior to the Asian financial crisis and economic downturn.

Two questions suggest themselves. The first being why such a rapid fall-off in intra-regional cross-border M&A deal flow, even after Southeast Asian host countries' general acceptance of the need for liberalisation to permit market forces to operate without the distortions imposed by government regulation? The second being what does this deceleration in M&A deal flow imply for future patterns of intra-regional cross-border M&As, as the region engages – through AFTA and the AIA – in the broader global economy, and within the context of hitherto rising global M&A deal flow.[12]

Table 8.2 indicates the modest role the Southeast Asian region plays in global M&A activity, even during the 'opportunity years' of asset sale bargains in the immediate aftermath of the Asian economic crisis.

Five observations are apposite. First, the distribution of targets 'in play' points to greatest financial distress in Thailand. Secondly, in all cases, Singaporean firms lead in intra-regional acquisitions, ranking first in all cases, and dominating intra-regional cross-border M&A deal flow. In Indonesia, the only Southeast Asian source of acquiring firms was Singapore. Thirdly, Malaysian firms played a minor role as acquirers. Fourthly, Southeast Asian acquiring firms represented 16.7 per cent of intra-regional cross-border M&A activity in the largest deals over the twenty-month period in Asia. Fifthly, the only substantial 'mega-deal' was valued at US$1,920 million – the acquisition by Singapore's QAF Ltd of Indofood PT of Indonesia, in July 1997. The next largest M&A deal came in at US$175 million – the acquisition by Singapore Power Ltd of Asia Pulp and Paper Co. of Indonesia.

The Southeast Asian region is a high capacity host to FDI activity, but its domestic firms are clearly a weak set of players in the cross-border M&As game, in which acquirers from US, the Netherlands and UK have been the dominant firms. Noting the problem of measuring intra-regional cross-border M&As and disaggregating the flows from inward FDI, the most recent evidence available confirms the dominance of Singapore companies in acquisitions, and the dominance of Indonesia in terms of companies acquired. Table 8.3 illustrates this pattern of acquirer and acquired.

Table 8.2 Profile of the largest[a] intra-regional cross-border M&A deals in Southeast Asia, from July 1997 to March 1999

Southeast Asian host country	*Total number of cross-border M&A[b] targets acquired in host country*	*Total number of cross-border M&A deals by Southeast Asian firms*	*Total value of all firms acquired (US$ million)*	*Southeast Asian acquiring firm deals, as a percentage of total deals*
Indonesia	23	4 (Singaporean)	2,098	17.4
Malaysia	31	6 (4 Singaporean, 1 Thai, 1 Malaysian)	128	19.4
Philippines	22	3 (2 Singaporean, 1 Malaysian)	65	13.6
Thailand	50	8 (5 Singaporean, 2 Malaysian, 1 Indonesian)	233	16.0
Total	126	21	2,524	16.7[c]

Source: Zhan and Ozawa, 2001: 96–102.

Notes

a Deals of more than US$1 million in value.

b Includes a minority acquisition, leading to management control.

c Average.

Table 8.3 Intra-Southeast Asian cross-border M&A activity, ranked by acquirer and acquired, cumulative figures from 1999 to first half of 2001 (in US$ million)

Rank	*Acquired acquirer*	*1 Indonesia*	*2 Philippines*	*3 Thailand*	*4 Singapore*	*5 Malaysia*	*6 Vietnam*	*Total*
1	Singapore	636	794	784	—	109	6	2,329
2	Malaysia	374	32	30	16	22	—	474
3	Philippines	—	—	—	183	—	—	183
4	Thailand	—	24	—	—	—	—	24
5	Indonesia	—	—	—	—	—	—	—
	Total	1,010	850	814	199	131	6	3,010

Source: ASEAN, 2001.

Note

— means not available.

It should be recalled that Table 8.3 represents relatively few individual deals, and in relatively few business sectors, again confirming the limited field for cross-border M&As in the region, and which gives intra-regional cross-border M&A deal flow a highly asymmetric morphology. An examination of the business sectors in which firms are acquired shows this skewed distribution, as indicated in Table 8.4.

Table 8.4 Intra-ASEAN cross-border M&A activity, ranked by acquired company's business sector

Rank Acquired	*1 Indonesia*	*2 Philippines*	*3 Thailand*	*4 Singapore*	*5 Malaysia*	*6 Vietnam*
Sector						
Primary	Palm oil					
	Plantations					
	Mining					
Secondary	Chemicals	Energy				
	Food and beverage				Food and beverage	Food and beverage
	Auto manufacturing					
Tertiary		Banking	Education	Property	Financial services	
		IT	Telecom		Health care	
			Property		Property	
			Banking			
Total (US$ million)	1,010	850	814	199	131	6

Source: ASEAN, 2001.

Table 8.5 Cross-border M&A sales in Southeast Asia, 1990–2000 (US$ million)

Year	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*
Total	1,314	656	1,457	1,249	1,923	3,524	2,593	6,091	7,361	8,881	5,746

Source: UNCTAD, 2001, cited in ASEAN, 2001.

What may be inferred from this most recent evidence? From a regional perspective, this skeletal pattern again represents the industrial distress brought about by the Asian economic crisis. Acquiring firms tend to be based in the relatively unaffected economies. In this case, Singapore is widely acknowledged to have been not only the least affected, but also to have exploited opportunities to adjust policy at an advanced pace, and which was taken advantage of by its firms in a manner unrivalled by others in the region. Acquired firms have tended to come from economies seriously affected by the Asian economic crisis – Indonesia, Thailand and the Philippines. The pattern also represents the type of asset qualities available, as well as the 'purchasing' or 'acquiring' power of regional firms, which appears more limited in comparison to Triad-based MNEs, whose purchases enabled Southeast Asia to record much larger cross-border M&A deals, as shown in Table 8.5.

In 1999, intra-regional cross-border M&A deals were only some 11 per cent of total Southeast Asian cross-border M&A deal flow, indicating that the greatest

part of cross-border M&A activity, and the strategic competition entailed, was generated by extra-regional actors who, in becoming intra-regional operators consequently, will pose regulatory challenges for AIA rules. First, what is perhaps surprising is the prominent representation of tertiary sector targets in intra-regional cross-border M&A deals, which outnumber secondary and primary targets. Secondly, in the majority, secondary and primary targets predominate in Indonesian firms acquired, whereas tertiary targets predominate in Thai and Malaysian firms acquired. This suggests further confirmation of an intra-Southeast Asian division of labour.

In attempting to explain the rapid decrease in intra-regional cross-border M&A deal flow from 1995 to 1999, the assessment of Southeast Asia fluctuates between that of 'the next M&A hotspot' (Metwalli and Tang, 2002) with roaring fire-sales, and the evident collapse of intra-regional investment flows (*Business World*, 1999). These opposing views are due in part to the evolution of investor sentiment, rising risk perceptions of emerging markets in general, and reduced investor appetite for some Southeast Asian business assets – which due to continuing problems of due diligence – appear contaminated with hidden debt and other unpleasant off-balance sheet factors.[13]

Part of the explanation for the investor ambivalence and the rapid fall off in intra-regional cross-border M&A deals is due to shifting investor sentiment and diminishing prospects – the best acquisition targets having been acquired in the immediate aftermath of the Asian economic crisis (Scherrer and Bolick, 1999), consequently hitting record volumes for all of Asia, of US$82 billion in 1999.[14] This was followed by a dramatic plunge, of 46 per cent in the value of cross-border M&As in 2001 compared to 2000.[15] Therefore, in terms of intra-regional cross-border M&A deals, reflecting intra-regional inward FDI sources and host countries depicted in Chapter 5, Singapore is the only significant player in intra-regional cross-border M&As (Freeman, 2000). This situation has serious policy implications for Singapore in particular, and Southeast Asia in general, which are addressed later in this chapter.

Why the rapid deceleration in deal flow, when the promise of intra-regional cross-border M&As was so high? The simple answer is because of poor quality assets that were considerably over-priced, and which presented prospectors with due diligence difficulties that could not be effectively resolved. These poor quality business assets were not subsidiaries of Triad-based MNEs (usually not for sale in the circumstances) but locally owned companies. The price gulf between potential buyers and sellers in the majority of cases could not be bridged, largely because of asset price inflation during the years of growth and the 'psychology of fire sales' which lowers the price willing to be paid by buyers, as well as the 'moral hazard' factor that intervention would be forthcoming from Asian governments (in terms of either reneging on earlier reform intentions or business bailouts). Poor standards of corporate governance and due diligence remain a major headache in Asia (Bartels and McGovern, 2002) and Asian economic nationalism – the concern with ownership, rather than the location and the manufacturing value added nature of the investment – puts a brake on

intra-regional cross-border M&A deal flow.[16] This brake on intra-regional cross-border M&As, and continuing regional political instability, had by 2000 helped shift cross-border M&A activity noticeably away from Southeast Asia and towards Northeast Asia[17] while enabling Singapore to be a major market for cross-border M&As – where in 1999 the number of deals reached 191, compared to 143 in Malaysia, 95 in Thailand, 71 in Philippines and 52 in Indonesia (Freeman, 2000). Table 8.6 provides a sectoral view of this limited cross-border M&A picture, for the top ten industries.

The target industries for regional cross-border M&As reflect the first phase of targets, the momentum of investment regime liberalisation in the aftermath of the Asian economic crisis, and continuing privatisation and corporate restructuring programmes (even though some programmes have subsequently been trimmed in pace and coverage), as well as broader multilateral agreement considerations. Is there going to be a second phase to the region's cross-border M&A deal flow? With Singapore's international firms being the only significant regional players, evidence points to an answer in the negative.[18]

This is likely to remain the case unless substantial progress on AFTA and the AIA enable further M&A deals across the region, and assist in transforming Singapore's perception of being 'a good house in a poor neighbourhood' and thereby refocus development of the external wing of its economy back onto the surrounding region.[19] Singapore's government-linked companies have been very active in M&A activity beyond the region, notably with equity plays for Air New Zealand, Ansett, and Virgin Atlantic that have been successful; while attempts at wider Asian M&As – notably Cable & Wireless Hong Kong Telecom and Time Engineering of Malaysia (notwithstanding some success in the Philippines with Globe Telecom, and in Indonesia with Bukara SingTel) – have been notable failures.[20]

Table 8.6 Top ten industries for Southeast Asian cross-border M&A sales, 1998–2000 (US$ millions)

Rank	*Industry*	*1998*	*1999*	*2000*	*Total*
1	Postal services and telecoms	837	3,990	1,328	6,155
2	Banking and finance	1,262	2,613	1,021	4,897
3	Non-metal manufacturing	1,830	1,141	235	3,206
4	Food, beverages and tobacco	1,518	69	14	1,600
5	Utilities	921	155	262	1,339
6	Real estate	25	625	477	1,128
7	Extraction minerals, oil and gas	140	900	24	1,064
8	Business services	588	213	201	1,02
9	Retail distribution	302	242	110	654
10	Transport support services	22	520	48	590

Source: ASEAN, 2000b: 76.

In terms of the larger regional investment policy framework, considerable outstanding issues concerning intra-regional cross-border M&As remain related to the AIA, and the treatment of investors on 'national' basis. Despite the beneficial aspects of M&As which, to some extent, assisted in the recovery from the Asian economic crisis (Agami, 2002) and their value acknowledged by regional policy-makers,[21] as far as ASEAN is concerned members tend to promote their own individual country as an investment host, rather than the region as a whole as an integrated investment location for FDI inflows. Investors who think in regional terms continue to be disappointed in Southeast Asia. Whether a base in the region defines an investor as national intra-regional, irrespective of the ultimate ownership of equity, is yet to be fully clarified within the protocols of the AIA agreement.

A further question presents itself. Does the liberalisation undertaken – by the Thailand Board of Investment since its establishment in 1997, for example – represent an intra-regional irreversible policy shift, or will the Asian interventionist tendency regain influence, if and when full recovery from the Asian economic crisis is assured? A return to interventionism is more likely given signals from commentators on the 'centralised allocation of resources'.[22]

8.3 The future of intra-regional M&As in Southeast Asia

The peak in intra-regional cross-border M&As that occurred in 1996–97, and in particular the cross-border M&As that took place in the aftermath of the Asian economic crisis, can be attributed to very specific circumstances and opportunistic reasons. These were: (a) currency depreciations, leading to a cheapening of regional asset values; (b) the collapse of stock market equity values, making corporate capital affordable; (c) liberalising changes to investment regulations, permitting M&As and 100 per cent foreign ownership in a broader range of industrial sectors than was possible before; (d) distressed and over-leveraged Southeast Asian firms unable to continue as going concerns without capital injections from foreign investors (either existing partners or suitors); and (e) opportunistic behaviour by MNEs in continuing their geo-economic spatial coverage and presence in the Southeast Asian markets (Agami, 2002).

We need to take each reason in turn, and see whether conditions are conducive for its repeat under 'normal' cyclical economic determinants. First, while Asian exchange rates are low compared to levels before the Asian economic crisis, they have stabilised and probably can only appreciate, as export performance and/or wider economic growth rapidly strengthens from a low base line.[23] Thus, once best targets have been acquired, this reason is unlikely to trigger further significant volumes of intra-regional cross-border M&As, especially given prevailing conditions in the US economy.[24]

With respect to undervalued assets, the better acquisition targets have been acquired and retired from the prospects list, and Southeast Asia's gradual pace of industrialisation is unlikely to generate rapid replacements in the immediate future. Given the relatively narrow range of industrial intermediation and low

capacity utilization rates – epitomised by Thailand's industry, which declined from an average of 72.4 per cent in 1996 to 52.1 per cent in 1998 (Bank of Thailand, 1999), with the lowest utilization in the automotive, food and construction sectors – prospects for intra-regional cross-border M&As in this regard seem weak. Furthermore, with respect to assets already under foreign ownership and reinvestment of earnings – a proxy for further FDI or M&As – according to Morgan Stanley, lower reinvested earnings point to diminishing FDI activity by US-based MNEs in Southeast Asia.[25] In the period 1995–2000, reinvested earnings averaged over 65 per cent by US-based MNEs for their operations in Singapore, in comparison with much lower rates (below 20 per cent) for Indonesia, Malaysia, Philippines and Thailand.

Secondly, the still troubled regional stock markets are still not particularly attractive to international capital. For example, in 2000, investors sold off US$1 billion net in Thai listed equities.[26] Thirdly, changes in the region's various FDI regimes towards greater liberalisation, including permitting increased foreign participation, are structural not cyclical – a one-time stimulus to cross-border M&A deals. Room for further liberalisation outside the AFTA and AIA frameworks appears limited. Arguably, for ASEAN it might be possible to speed up its time-table for full compliance with these agreements, but pragmatically this is only an option for the ASEAN-5 countries, and besides, the situation indicated above with respect to capital replacement remains unresolved. Tellingly, FDI capital formation ratios for provincial China are outstripping those for Southeast Asia.

Fourthly, distressed Asian firms in need of capital injections have either succumbed, or have been removed from, the prospectus of likely M&A acquisition targets. The best prospects have now been acquired, and cross-border M&As are unlikely to be executed for their own sake, especially given the degree of corporate distress being felt in the US and Europe.[27]

Lastly, by definition, the opportunistic behaviour of MNEs implies a re-direction of attention away from the Southeast Asian region because, from a competitiveness perspective, abnormal returns are available only from non-contested or latent economic arenas with rapid growth prospects, and hence it is unlikely that the first waves of cross-border M&As will be repeated. Consequently, Triad MNEs are looking elsewhere and many are consolidating their trans-Atlantic operations.[28]

The foregoing view is broader than a strictly regional perspective, as within Southeast Asia only Singapore's industrial and services sectors really have noteworthy M&A capacity. Intra-regional cross-border M&As are thus skewed, and because of measurement issues and other problematics, the precise morphology of the dynamics is clear only with respect to Singapore, and must be read with due regard to intra-regional FDI flows (see chapter 5).A view that the underlying causal factors of the Asian economic crisis have been eliminated in the past five years, and intra-regional cross-border M&As are poised to continue needs to be seen in the light of serious outstanding problems.[29] Intra-regional cross-border M&A deal flow is likely to reflect the global downturn in M&A activity for the foreseeable future.

8.4 Policy implications

Zhan and Ozawa (2001) draw some comprehensive conclusions on cross-border M&As for non-Japan Asia in general, and specifically for the Asian economic crisis countries (four of which are Southeast Asian). Going forward, what are the likely future patterns and policy implications for intra-regional cross-border M&As? The various dimensions that need to be addressed are: domestic investment and enterprise; domestic capital markets; FDI regulations; and domestic competition policy. Of course, within the ASEAN context, the domestic is in fact regional, given anticipated AFTA and AIA provisions.

Although the prevailing conditions support a lower level of regional cross-border M&A deals, for the reasons outlined here, global cross-border M&As – and especially Atlantic plays – in the long term are likely to increase in scale and scope (notwithstanding the current collapse in M&A deal flow).[30] Southeast Asia, even in anticipating AFTA and the AIA, is likely to remain a relative 'side show' for M&A activity. Nevertheless, intra-regional cross-border M&As carry serious implications for the region's competitiveness as an open economy.

The historically low levels of intra-regional cross-border M&As, notwithstanding the activity peak observed, points to weak regional capital market capacities and M&A capabilities. The major issue is the need for a 'thickening' of a broad range of intermediation services that enable sophisticated financial instruments to occur at lower valuations, and to be deployed for intra-regional cross-border M&A deals (Freeman and Bartels, 2000). Without intra-regional cross-border M&A transactions at the level of small and medium sized enterprises (SMEs) within the regional economy, adjustment to greater diversification across conglomerates' horizontal and vertical trajectories is likely to be severely stunted. This diversification is considered strategically important, to facilitate growth and increase competitiveness among regional SMEs. The counterposition that should be put reflects the 'presence of government' in Singapore's M&A plays that could be resented by other Southeast Asian countries. Given the 'fire sales' that drew popular negative reaction in some parts of the region – for example in Thailand (Godement, 1999) – the notion of FDI is welcomed in Southeast Asia, but that of foreign ownership is not. This requires managing a shift in the mental landscape of the region, to reduce emotional resistance to intra-regional cross-border M&As. This goes hand-in-hand with compliance with WTO obligations.

A second area of implications is that of mergers monopolies and competition (MMC) policy. The AFTA and AIA provisions, while cognizant of MMC, are arguably weak in articulating a robust MMC policy, able to defeat narrow nationalistic protectionist tendencies. Given ASEAN's history of non-interference in domestic issues, it is hard to conceive how it can forge a valid region-wide MMC policy and accompanying institutions, capable of regulating intra-regional cross-border M&As.

A third area is that of corporate governance and disclosure[31] in relation to the requisite due diligence without which M&A deals are rarely consummated.

Unless corporate governance attitudes, standards and processes improve, intra-regional cross-border M&A deals are unlikely to occur at the rate that would constitute a healthy Schumpterian economic dynamics. A fourth area of concern for policy-makers is the efficiency of regional capital markets and their intermediation roles. A number of issues are evident regarding regional capital markets' capacity, such as: the trading volumes of some stock markets; the ability to develop or adapt new financial instruments; the 'back-office' support structures (not only in relation to markets, but also banking operations); and the sectoral imbalances that constrain broad-based intra-regional cross-border M&A activity (Freeman and Bartels, 2000).

A fifth area of policy formulation is encapsulated by the issue – does modal neutrality (allowing MNEs to select their entry mode, rather than hosts distorting economically that decision via incentives, policy regime bias and laws) matter for increasing intra-regional cross-border M&As and 'greenfield' FDI alternatives, in ASEAN? The response to this question is a function of industrial organization and its temporal characteristics, in the context of widespread liberalisation and falling trade and investment barriers in emerging markets. This process devalues the competitive advantages of companies' organic growth towards increased market share (because this is a longer-term process), and enhances the competitive advantages of 'buying' market share through acquisitions (because this is a shorter-term process). For the host country, organic growth trajectories enable derived localisation benefits to be more deeply rooted over the shorter-term, whereas this is generally not the case with intra-regional cross-border M&As (Appelbaum *et al*., 2000). From a classical international business perspective, whereas 'greenfield' FDI alters the Porter (1990) dynamics of industry competition, intra-regional cross-border M&A activity does not alter industry competition, because existing capacity merely changes title once the M&A deal has been executed.

The foregoing indicates clearly that, in absolute terms, intra-regional cross-border M&A deal flow in Southeast Asia is limited in industrial scale and scope, as well as in its spatial and temporal manifestations. In comparative terms, Southeast Asia's cross-border M&A activity is diminutive with respect to the European and North American economic space. These two fundamental characteristics are not going to change radically in the foreseeable future, as the region's only major M&A player – Singapore – is likely to continue looking for diversification opportunities beyond the immediate confines (and disappointments) of the Southeast Asian region.

Notes

1 Cross-border M&A is taken to be the financial transaction of acquiring more than a 10 per cent equity stake in a company incorporated in one country, by a company incorporated in another country.

2 Information on M&A activity can be found from a variety of sources, including: Thomson Financial; Done Deals; M&A-oriented publications; Bloomberg; and Standard & Poor's.

3 FDI activity grew rapidly in the 1990s, partly because the bull markets in industrialised country capital markets allowed firms to use their overvalued shares to finance cross-border M&As. However, according to the *Financial Times* (27 June 2002) the value of global M&A activity fell by 41 per cent, to US$621 billion, in the first half of 2002.
4 The Economist, Special Report Wall Street, 8 June 2002, pp. 63–66.
5 Of the 40 recent researches into M&As, 57 per cent of businesses had a failed M&A, and in 40 per cent of cases the M&A was subsequently sold as part of a restructuring. See Angus Knowles-Cutler and Rob Bradbury, 'Why Mergers are not for amateurs', *Financial Times*, 12 February 2002, p. 10.
6 The extent of single family controlled business in Southeast Asia is considerable making the commercial landscape highly oligopolistic. In Singapore, just under 45 per cent of a 221 sample of listed firms were controlled by a single family. The comparable figures for family control of regional stock market capitalization indicated in Claessens *et al*. (1999) is 25 per cent for Malaysia, 46 per cent for Thailand, 53 per cent for the Philippines and 58 per cent for Indonesia.
7 With the benefit of not having an M&A law per se, in contrast to other countries in Southeast Asia, but instead a code on takeovers and acquisitions (administered by the Securities Industry Council), and no restrictions on foreign equity ownership – except in areas of national security (such as munitions, utilities, banking, telecoms, insurance and media) – as well as the region's most active capital market, Singapore is the Southeast Asian leader in cross-border M&A activity.
8 See Elfren S. Cruz, Framework, Business World (Manila), 28 August 2001, p. 1 for an appreciation of how family conglomerates act as a brake on M&As, rendering them 'impossible in the Philippines so far'.
9 See Robert Frank, 'Merger market might stagger until fall in U.S.', *The Wall Street Journal Europe*, 26 June 2002, for the view that growth by acquisition is going out of favour as a business model for shareholders who are increasingly looking to 'organic growth' and 'pure earnings', uncontaminated by issues of due diligence.
10 See Alan Beattie and Tom McCawley, '"Solution" leaves legacy of bitterness', *Financial Times*, 9 August 2002, p. 2, for the example of Indonesia's 'Intertwining of politics with economics'.
11 Most of the widely published data portraying cross-border M&A deals and the Asian economic crisis emanates from KPMG's 'Dealwatch' database.
12 The number of global M&A deals falling below 5,200 for the first time since 1995. 'Bankers on way out as cuts hit home', *Financial Times*, 8 May 2002, p. 18.
13 Rebecca McCaughlin and Joe Quinlan, 'Global: emerging markets Decoupling?', Morgan Stanley on Emerging Markets, 18 February 2002, <www.morganstanley.com/GEFdata/digests/latest-digest.html>.
14 Asia Mergers and Acquisitions Hit Record Volumes, *The Wall Street Journal* (European edition), 23 December 1999, p. 10.
15 Liz Rudall, 'Asia's merger activity plunged last year, hurt by slowdown – value of announced deals fell 46 per cent from 2000', *The Asian Wall Street Journal*, 9 January 2002, p. 5.
16 Robert Frank, 'What happened to Asia's great fire sale? – Most US firms return empty-handed after scouring region', *The Wall Street Journal*, 21 January 2000, p. A.14; and 'Trail turns cold for overseas firms seeking hot deals in Asian fire sale' *The Asian Wall Street Journal*, 24 January 2002, p. 1.
17 Robert Frank, 'Asia's investment spotlight sweeps North – China, Japan and Korea supplant Southeast Asia as sites of opportunity', *The Wall Street Journal*, 18 February 2001, p. A.17.
18 See 'Minnows easy prey for patient giants', *South China Morning Post*, 23 December 2001, p. 6 for the view that Southeast Asia's small and medium sized enterprises are likely to loose competitiveness while missing out on becoming linked, through M&A deals, to large MNEs.

19 As it accounts for about 1.5 per cent of global trade, and faced with disagreements within ASEAN, since 1998 Singapore has been pursuing bilateral trade arrangements with various countries outside the region (Australia, Canada, Chile, Japan, Mexico, New Zealand, South Korea, USA), thereby aiming to become more independent of ASEAN, and create a 'Pacific-5 Free Trade deal incorporating Australia, Chile, New Zealand, Singapore and the United States'. Stratfor.com, 'Singapore seeks pivotal trade role', 13 September 2000.

20 Matthew Montagu-Pollock, 'Singtel's marriage of Inconvenience', *Asiamoney*, June 2000, pp. 14–19.

21 Saridet Marukatat, 'ASEAN investment: mergers and acquisition beneficial, say Ministers', *The Bangkok Post*, 5 October 2000, p. 1.

22 See John Burton, 'Singapore sticks to state planning in restructuring strategy', *Financial Times*, 7 February 2003, p. 6 in which Dominique Dwor-Frecaut, regional economist with Barclays Capital in Singapore states 'You need to end the centralised allocation of resources to achieve diversification'.

23 See John Burton, 'East Asian economies stay optimistic despite dollar's fall', *Financial Times*, 15 August 2002, p. 4.

24 See Martin Wolf, 'The recovery myth', *Financial Times*, 12 June 2002, p.14.

25 Joe Quinlan and Rebecca McCaughrin, 'Plant or harvest? That is the question for multinationals', Morgan Stanley, 18 February 2002, <http//www.morganstanley.com/GEFdata/digests/latest-digest.html>.

26 See John Thornhill, 'Asia and its "warrant" on world growth', *Financial Times*, 19 August 2002, p. 26 for the view that Asian capital markets outperform their OECD counterparts in periods of global economic growth, and underperform during global downturns.

27 Barons of bankruptcy, parts I, II, and III, *Financial Times*, 31 July 2002, 1 August 2002, 2 August 2002.

28 *Financial Times*, 5 August 2002.

29 See *The Economist*, 'Special report: East Asian economies', 6 July 2002.

30 Global M&A activity is at its lowest for seven years, according to Thomson Financial's Lina Saigol, 'Bankers on way out as cuts hit home, *Financial Times*, 8 May 2002, p. 18. According to UNCTAD Press Release TAD/INF/PR63, 24 October 2002, between January and September 2002, completed cross-border M&A deals decreased in value terms by 45 per cent, to US$250 billion (from US$460 billion in the same period 2001).

31 A subject that is very much in focus. See 'America Inc. in Crisis', *TIME*, 8 July 2002 p. 22; and 'The wickedness of Wall Street', *The Economist*, 8 June 2002, p. 11.

9 The prospects for foreign direct investment in the transitional economies of Southeast Asia

Nick J. Freeman

9.1 Introduction

Cambodia, Laos and Vietnam all actively welcome foreign direct investment (FDI) activity, and have done so for a number of years.[1] FDI inflows are regarded as an important method of boosting economic development and growth, and assisting in the transition process – consisting of both economic reforms and business liberalisation measures – currently underway in these three countries. On paper at least, the (still evolving) laws and regulations pertaining to FDI activity are relatively liberal, such as permitting 100 per cent foreign-owned business ventures across a fairly wide range of business sectors. As FDI inflows have accrued, and the confidence of policy-makers has grown, the foreign investment regimes in these transitional economies have continued to improve, in tandem with marked improvements to the wider business environment in these host countries.

This chapter does not seek to delve too deeply into the specifics and mechanics of FDI activity in these three Indochina countries.[2] Rather, it attempts to place this activity within four pertinent contexts: (i) of history; (ii) of more recent global trends in foreign investment flows and investor sentiment; (iii) of the differing FDI experiences of the three countries; and (iv) of the current international business environment. The chapter ends with some proposals as to how Cambodia, Laos and Vietnam might build on their recent success in attracting relatively substantial FDI inflows to the sub-region, and best harness future FDI activity in the next phases of their economic development programmes.

9.2 The history of FDI in Cambodia, Laos and Vietnam

When looking at FDI activity in the Indochina sub-region, one tends to focus on the inflow of foreign capital that has occurred over the last decade or so, as part of the economic transition process that the three countries have been undergoing since the late 1980s. As foreign private capital was generally not permitted into these countries in the years preceding their 'opening up', the policy-makers of Cambodia, Laos and Vietnam have been on a relatively steep learning curve; learning how to attract, retain, sustain, manage, harness, monitor – and then attract yet more – FDI inflows. This process is partly a science, and partly

an art, as policy-makers in the other Southeast Asian countries will testify. It is also a fairly relentless process, as the extremely competitive environment for attracting FDI flows poses ever-new challenges for host countries that wish to stay ahead of the game. However, it is worth keeping in mind that the territory that currently spans the Indochina sub-region – if not these actual states – has witnessed relatively significant foreign capital inflows before, as part of the French colonial empire. Indeed, some interesting parallels between the FDI inflow patterns of today, and those of the first three decades of the twentieth century are worth noting briefly.[3]

The industrial revolution helped drive the first major investment foray into 'emerging markets' – in the form of colonial possessions – as the major European economies sought out new territories from which to source resource inputs and as markets for their manufactured products. Industrial capitalism brought the need for a greater commitment of resources, and the enactment of long-term investments in these new markets, and France and its colonies were no exception. Much of the first wave of foreign investment in colonial Vietnam was oriented towards communications and mining activity, later followed by trading firms, rubber and tea plantations, processing companies, and subsequently a few textile companies (Callis, 1942: 76).[4] Funding came from taxes on the inhabitants, some financial support from the French government, and from entrepreneurial private investment. In terms of private investment, a mixture of loan financing and equity rights issues were used to raise funding for a spectrum of business ventures. At least in the initial period of colonial expansion into Indochina, the anticipation that Vietnam might provide a back door into the massive Chinese market was a major driving force behind the French colonial exercise (Murray, 1980).[5] The attraction of finding a land route into China was also almost certainly spurred by a nagging doubt that the commercial merits of the Indochina region itself were not very prepossessing. And although Vietnam became a viable business concern in its own right, the proximity of the mighty Chinese market persisted, as evidenced by the onerous construction of the Hanoi to Kunming railway line between 1901 and 1910.[6]

The most vigorous period of foreign investment activity in colonial Indochina was in the decade leading up to the Wall Street crash of 1929. In Vietnam, 'private capital flowed into the colony in an unprecedented stream, [and] Indo-Chinese securities found their way into the safes of stockholders great and small' (Robequain, 1944: 131). The establishment of rubber plantations, mines, banks, trading firms and real estate companies burgeoned during this period, with over 3,800 million francs of new capital issues recorded between 1924 and 1930, of which over 90 per cent were funds raised by private business (Callis, 1942: 78). Within the agricultural sector, rubber plantations were the dominant focus of foreign investment, along with coffee, tea, rice, sugar cane, teak, rattan, and various other commodities. In the Mekong delta, irrigation works permitted a marked increase in paddy production, and with it, rice exports. Within northern Vietnam's mining sector, coal became the primary output, along with tin ore, zinc, phosphate, lead, iron ore and gold. Industrial activities included rice milling,

sugar refining, the grading and processing of various agricultural products, the manufacture of soap and dyes, cement, as well as power and transportation activities. Investment conglomerates and finance corporations were formed, such as the Societe Financiere Francaise et Coloniale, which had diverse business interests that spanned tea plantations, rubber plantations, sugar refineries, paper and glass factories, power stations, coal mines, and even railways (Norlund, 1991: 80).[7] And there was the mighty Banque de l'Indochine, which arguably became the most powerful business force in Indochina (Murray, 1980: 144).[8] In addition to dominating the trade financing business in Vietnam and Indochina, the bank developed a remarkable spectrum of investments within the sub-region and beyond.

Initial expectations of Indochina's mineral wealth were lofty, and a first wave of 'mining fever' hit Vietnam as early as the 1890s, although much of the initial eagerness had dissipated by the early 1900s (Thompson, 1937: 115). However, the mining industry in Indochina enjoyed a revival in the 1920s, and by the middle of that decade Vietnam had become the largest coal exporter in East Asia (Thompson, 1937: 116). For Laos, tin mining was the only business sector that received substantial foreign investment under French colonial rule (Stuart-Fox, 1995: 135–136), and Cambodia saw fairly vigorous gem mining activity. In total, it is estimated that France invested 7 billion francs in 'profit-yielding assets of foreign companies' in colonial Indochina, up to 1938, of which the majority would have been expended in Vietnam. The scale of both state and private sector investment activity in Vietnam was so substantial that one commentator has suggested that by the 1930s, it 'had become the most intensely exploited of all European colonies in Asia' (Murray, 1980: 131). But it should not be assumed that all foreign investment in colonial Vietnam proved to be a profitable exercise. Between 1929 and 1937, it appears that company dissolutions worth over 500 million francs were recorded, and just under 750 million francs in capital reductions were also registered, prompting one commentator to say 'it is impossible not to appreciate the magnitude of the losses suffered by private investments in Indo-China' (Robequain, 1944: 164–5).

As Callis (1942: 82) points out, 'the story of foreign investments in [colonial] Indo-China is really a story of French investments.' Non-French investment in Indochina was deterred through the use of tariff and non-tariff barriers and currency regulations for non-French businesses; and subsidies and assistance for French businesses. As a result, by 1937, 97 per cent of all foreign investment in Indochina was sourced from France (Lindblad, 1998: 14–19). Indeed, these protectionist policies meant that colonial Vietnam – and Indochina as a whole – became somewhat divorced from the East Asia region in matters of trade and business. As Norlund (1991: 89) depicts it, French colonial rule '…succeeded in detaching Indochina from the Far East and attaching it to the French economy'. The wave of foreign investment activity that Vietnam witnessed in the first three decades of the twentieth century began to peter out in the 1930s, as the global economic recession took its toll. Global prices for almost all the commodities exported by Indochina dropped markedly, and the value of Indochina's exports

contracted by almost 60 per cent between 1929 and 1931. Not surprisingly, the 'Indochina index' on the Paris bourse plummeted from 106 in 1929 to just 22 in 1933 (Murray, 1980: 201). For anyone familiar with FDI activity in Indochina over the last fifteen years, the sub-region's FDI experience during the first three decades of the twentieth century contains some uncanny parallels, as will be evident later.

9.3 Recent trends in FDI flows and investor sentiment

Although the trend of substantial FDI flows to Southeast Asia began around thirty years ago (led by Singapore's contrarian stance towards foreign investment, and its pioneering policies to attract FDI), the 're-opening' of Indochina to foreign investment, in the late 1980s and early 1990s, coincided with a particularly strong 'bull market' period in most forms of private capital flows – FDI, portfolio investment and commercial bank lending – to the emerging markets in general. And within the emerging markets universe, Southeast Asia was a major recipient of private capital inflows, buoyed by a consensus view that the region was a particularly fertile ground for investors seeking attractive risk-adjusted returns. In 1990, for example, Southeast Asia attracted 36 per cent of all FDI flows to developing countries, and the region exceeded China's FDI inflows by more than threefold.[9] Another group of emerging market countries attracting foreign investor excitement at this time was the transitional economies of the former Soviet Union, Eastern Europe and Asia. Therefore, as transitional economies located in Southeast Asia, it is not surprising that the Indochina countries stimulated considerable foreign investment appetite, when the sub-region opened its doors to private capital inflows in the early 1990s. The Indochina countries not only stood at the nexus of the emerging markets and transitional economies growth 'investment stories', they were also well positioned to capture the beginnings of a substantial intra-Southeast Asian FDI flow phenomenon. The domestic corporate sectors of Malaysia, Singapore and Thailand had started to generate fairly significant FDI outflows of their own in the early 1990s, until the Asian financial crisis brought an abrupt end to much of this activity – with the marked exception of Singapore. It is worth noting that, even today, other Southeast Asian countries are ranked as the top investors in all three Indochina countries (as measured by approved capital inflow pledges): Singapore leads in Vietnam, Malaysia is in top of the rankings in Cambodia, and Thai investors almost dominate FDI activity in neighbouring Laos.

Therefore, Indochina's most recent 'debut' on the international investment stage was fortuitously timed, and explains in large part why fairly considerable FDI flows were registered, as foreign investors sought to capture new business opportunities in the under-developed sub-region. Push factors, as well as pull factors, were involved in this process. For example, major corporates in those home countries that had missed out on much of Southeast Asia's earlier economic rise, regarded Indochina's opening as an opportunity to 'get in on the ground floor' of what they hoped would be a similar high-growth story.[10] A herd instinct

could also be discerned, as companies operating in the same business sector – such as automotive assembly – followed each other into the sub-region.[11] And although this chapter primarily focuses on FDI activity, relatively substantial commercial bank lending activity and equity portfolio flows to the sub-region supported the FDI inflow trend.[12] For example, between 1991 and 1995, roughly ten different investment funds pertaining to Indochina were launched, raising in excess of US$500 million of portfolio money, with insufficient thought given to exactly how all this money could be sensibly invested.[13] Investor appetite for exposure to the Indochina sub-region was extremely high in the first half of the 1990s. Indeed, the rush of FDI inflows into the Indochina sub-region would probably have been even more intense in the early 1990s, had it not been for the lingering effect of various business restrictions (such as the US investment embargo on Vietnam). Instead, the sub-region saw a more phased inflow of foreign investors, as these business restrictions were gradually lifted, one by one. The FDI inflows were also phased in terms of their sectoral patterns, in ways very similar to the sectoral flow patterns seen during the first thirty years of the twentieth century.

For Vietnam's FDI inflows, the inflection point came in 1996, when foreign investor sentiment – which had become much too lofty in the first half of the decade – began to be replaced with increased concern within the business community that economic reform momentum had been lost. Foreign business perceptions of the risk–reward ratio radically altered; away from the potential rewards and towards the perceived risks. Previous straight-line growth projections for the sub-region's economies and domestic markets were also exposed as being overly optimistic. As a cumulative result, a more sober appreciation of the kinds of obstacles that foreign investors faced in generating attractive, risk-adjusted rates of returns on FDI projects in Indochina was forming. Finally, the onset of the Asian financial crisis in mid-1997 caused investor sentiment to deteriorate even more, and FDI inflow pledges contracted markedly further.[14]

So where is foreign investor sentiment towards Indochina today? There are clear indications that foreign investor sentiment towards the Indochina sub-region has improved markedly since 2000.[15] A number of developments have been perceived by the international business community as leading indicators that economic reform momentum has been regained, and that Indochina's economies have survived the Asian financial crisis in relatively good shape.[16] But if investor sentiment has improved over the last two years, why has that not translated into a substantial pick-up in new FDI inflow pledges to the Indochina sub-region over the last few years? Part of the answer clearly lies with the fragile state of the global economy, on which the Indochina countries have little influence. Also, the extremely propitious conditions that existed in the early 1990s no longer exist: although FDI flows to global emerging markets have held remarkably steady since the financial crisis of 1997, commercial bank lending flows have been reversed, and portfolio flows to Asia and emerging markets remain distinctly anaemic. In this respect, the ebb and flow of FDI activity in the Indochina sub-region during the 1990s has a number of parallels with the 1920s. But part of the

answer also lies in the need for policy-makers in the sub-region to revise their perceptions of the changing international business environment, Indochina's current position in global business networks, and the way in which foreign investors' host country needs are evolving. These are discussed in Section 9.5 of this chapter.

9.4 Differing FDI experiences in Cambodia, Laos and Vietnam

All three countries broadly opened up to foreign investment at very roughly the same time, issuing (and subsequently improving) quite liberal foreign investment laws and implementing regulations. These efforts have been reciprocated with relatively substantial investor interest from the international business community, albeit prone to changing moods. Foreign capital was relatively quick to respond to the promulgation of foreign investment laws in the three countries, and aggregate FDI inflows have been quite admirable. Tables 9.1 and 9.2 show FDI stocks per capita for the three Indochina countries compared (in 2000) and FDI stocks as a percentage of GDP during the 1990s compared, respectively.

Table 9.1 FDI stock per person in Indochina compared, 2000

Country	*US$*
Malaysia	2,341
Thailand	388
Indonesia	286
China	271
Vietnam	225
Philippines	167
Laos	122
Cambodia	62

Source: UNCTAD.

Table 9.2 Inward FDI stock as percentage of GDP in Indochina compared, 1990–99

Country	*1990*	*1995*	*1999*
Cambodia	13.4	17.0	19.4
Laos	1.4	11.9	42.8
Vietnam	3.6	31.1	55.6
China	7.0	19.6	30.9
Indonesia	34.0	25.0	46.2
Malaysia	24.1	32.9	65.3
Philippines	7.4	8.2	14.9
Thailand	9.6	10.4	17.5

Source: UNCTAD.

However, all three Indochina countries have seen much of the FDI activity cluster in a relatively few geographical locations and business sectors, and have registered mixed success in their attempts to better disburse this FDI activity, partially through the use of various fiscal incentive schemes and the creation of industrial zones.[17] Since the late 1990s, all three countries have been members of the Association of Southeast Asian Nations (ASEAN), and are committed to various initiatives that relate – directly or indirectly – to foreign investment activity, including the ASEAN Free Trade Area (AFTA) and the ASEAN Investment Area (AIA). These regional initiatives will have some influence on the overall FDI profiles of the three Indochina countries, and partially drive future FDI policies, such as in the field of national treatment. Other agreements relating to economic reform and business liberalization efforts – for which external assistance is being provided, or on which subsidised loans are dependent – should also help these countries tackle at least some of the host country obstacles that foreign investors often identify. For example, the bilateral trade agreement (BTA) that Vietnam has signed with the US contains a tranche of business liberalization measures that relate directly to foreign investment activity.

Another similarity in Indochina's FDI experience relates to foreign investment data itself. Although great strides have been made in improving the foreign investment data in the sub-region, it remains quite difficult to get an accurate and up-to-date profile of FDI activity in Indochina.[18] The disparity between the lofty approved/pledged FDI inflow figures – typically recorded by the relevant licensing body in the host country – on the one hand, and the more humble disbursed/committed FDI inflow figures – often captured in the balance of payments data – on the other, are quite considerable (particularly in Laos, where a handful of mega-projects have been approved but not yet implemented), and yet this important distinction is not always made clear to the casual observer. Just capturing and collating FDI data can be tricky, if multiple agencies are given the authority to issue FDI licences, as is the case in Vietnam.[19] But things get even more blurred when one considers a range of factors that are not always being captured by the official statistics, such as: increasingly substantial FDI activity being funded through reinvested earnings of existing projects; joint venture projects where the local equity contribution – commonly in the form of land use rights – is often included in official FDI inflow data; funding assistance through local or foreign bank loans, or inter-company loan components; stalled FDI projects that may or may not have had their licences revoked; exaggerated or inflated equity commitments by investors; and informal, small-scale investment activity enacted by overseas nationals that often goes unlicensed. These sorts of data limitations are by no means unique to Indochina, but they are common to all three countries in the sub-region, and make it quite difficult to get anything more than a broad impression of FDI patterns.[20]

The Indochina countries also share a paucity of FDI activity in the business sector that largely dominates their domestic economies – agricultural activity – for a variety of reasons.[21] This feature, along with the clustering of FDI activity in a handful of locations, means that foreign investment activity does not directly impact on a large proportion of Indochina's total population (slightly under

100 million), although some indirect impact has undoubtedly been felt. Relative to other measures of FDI activity, foreign capital's role as a major source of employment in Indochina still remains quite modest. The Indochina countries have also found it quite difficult to attract private capital into major infrastructure projects, despite the promotion of BOT (build–operate–transfer) and similar contractual agreements, and the assistance of such initiatives as the Asian Development Bank's Greater Mekong Sub-Region Programme. Some FDI activity has been oriented towards serving the domestic market in Indochina, particularly in the early part of the 1990s in Vietnam, but a considerable element has been attracted to the Indochina countries as platforms for export-oriented production. In this regard, the FDI profile in the Indochina sub-region broadly conforms to the 'Southeast Asian model' seen in Indonesia, Malaysia, the Philippines, Singapore and Thailand. Where the Indochina countries differ from most other countries in Southeast Asia is that their FDI has not occurred in tandem with – or supported by – foreign (equity) portfolio investment in the host country's stock markets. Neither Cambodia nor Laos have ever had an equity market, whilst Vietnam's three-year-old equity market remains small, and effectively closed to foreign institutional investors and foreign-invested projects alike.[22]

However, the business sectors in which FDI activity has been most prominent have differed across the three Indochina countries, largely in conformity with the perceived resource strengths and comparative advantages of the respective host economies. In Laos, for example, less than ten individual FDI projects related to energy generation (primarily hydropower) have dominated the country's aggregate FDI inflows, as measured by capital pledged, thereby making the country's annual FDI statistics quite 'lumpy' and volatile.[23] It is no coincidence that the two years in which Laos recorded 'bumper' FDI inflow pledges were the two years when a number of large power projects were approved by the FDI licensing authority. Conversely, years when no power projects were approved tended to be considerably leaner years for total FDI inflow pledges in Laos. In Cambodia, more than half the FDI projects in the manufacturing sector relate to garment projects, and garment-related FDI accounts for almost a quarter of total FDI inflows, thanks in large part to large garment export quotas for some export markets. The other manufacturing sector to have seen substantial FDI activity in Cambodia is wood and wood products, accounting for over 20 per cent of total foreign investment. In Vietnam, the distribution of FDI activity across sectors is more widely spread, with fairly substantial foreign investment activity recorded in such areas as: oil and gas, construction, tourism, garments and footwear.

The home country sources of FDI in Indochina have also differed quite substantially in the three Indochina countries. Only Taiwan features in the top three home country sources of FDI of more than one country of the sub-region. However, as the major 'capital exporter' in Southeast Asia, it is no surprise that Singapore features in the top ten ranking of FDI sources for all three Indochina countries.[24] The other home countries that feature in the 'top ten' ranking of FDI sources for all three Indochina countries are Taiwan, South Korea, Thailand, Britain, and the sub-region's former colonial ruler – France. It is worth noting, that despite being neighbours

with close fraternal ties, no Indochina country ranks amongst the largest investors in another country of the sub-region. In other words, relatively close political affinities and geographical proximity have not yet translated into substantial long-term equity-related business synergies, and intra-Indochina business relations remain largely – but not exclusively – at the trading and contract level.[25] Not only are there relatively few business synergies that currently exist between domestic firms in the sub-region, but the three countries are largely competing with each other to attract FDI inflows in certain business sectors.

In both Cambodia and Laos, a small number of home country sources appear to dominate FDI activity, as measured by capital pledged. In Laos, Thailand accounts for almost half of total inflow pledges, and just five countries – Thailand, the US, South Korea, France and Malaysia – together account for over 93 per cent of total FDI inflows. In Cambodia, Malaysia accounts for over 40 per cent of total FDI inflow pledges, and although not quite as extreme as in Laos, a handful of home countries dominate the sources of FDI inflow pledges. Vietnam, in contrast, again appears to have a better (i.e. more diverse) distribution of FDI inflow sources, with no single home country accounting for more than 19 per cent of total inflows.

As in the first thirty years of the twentieth century, Vietnam has had the lion's share of FDI flows to the Indochina sub-region during the 1990s. And as a country with a population of roughly 80 million people, Vietnam's market size should continue to attract FDI activity that seeks to serve the domestic market. This large domestic market – at least in terms of numbers, if not yet spending power – helps keep Vietnam on the global FDI 'radar screen'. Cambodia and Laos, however, are likely to have a slightly more peripheral position, due to their much smaller domestic markets. However, as Laos has found, having a small economy means that a single large FDI project can have a potentially substantial impact on its entire economy, even adding whole percentage points to national GDP. Put another way, a small economy may only need a peripheral position on the global FDI 'radar screen', by focusing on niche business sectors in which it can attract strong foreign investor interest. (And the growth of cross-border production networks (CPNs) is breaking down production into smaller incremental steps, so that the range of potential niches appears to be increasing.)

In marked contrast to Vietnam, Laos has achieved a degree of integration between its FDI inflows and its privatization programme for state-owned enterprises, with a number of 'flagship' former state enterprises having been partially divested to strategic foreign investors over the last decade.[26] And in contrast to both Laos and Vietnam, Cambodia has implemented a very attractive tax regime in its bid to attract FDI inflows, with a low standard corporate income tax rate, and an even lower rate for export-oriented FDI projects.[27]

9.5 Looking ahead: better linking the transitionals and transnationals

The impressive economic growth trajectory of Southeast Asia over the last twenty years or so has been due in part to significant FDI activity (Jomo, 2001: 1–29). It

therefore comes as no surprise that the transitional economies of the Indochina sub-region have sought to emulate this, and harness the considerable inputs that foreign investment can bring to developing and transitional economies, as part of their own economic development drives.[28] It could even be argued – as Yasheng (2001) has done for China – that FDI activity can play the role of an ersatz private sector for a transitional economy, when the domestic private sector is not yet sufficiently robust to make much macroeconomic impact, and the state sector remains lethargic.[29] In such a context, welcoming FDI is rather like importing a ready-made private sector, capable of having a fairly immediate and positive impact on a transitional country's macroeconomy. In Vietnam in particular, it is hard to envisage the recent economic reform process without the presence of a growing community of foreign investors, as evidenced by their role in the country's industrial production growth and corporate tax receipts. At their zenith in 1996, Vietnam's FDI inflows as a percentage of GNP were the second highest in the world. And across the Indochina sub-region, the presence of foreign-invested projects is particularly visible in various export-oriented business sectors, where they now account for a considerable proportion of total foreign currency earnings and export volumes.

The above notwithstanding, the degree of coordination and integration between FDI policies and other elements of the economic reform and business liberalisation process in Indochina has generally not been particularly strong.[30] For example, the anomaly of slight increases in the scale of the state enterprise sector in Vietnam during the 1990s comes as a surprise to many observers. How could state enterprises be increasing, at a time when a major element of the economic reform process has been to downsize this sector, through the 'equitisation' (i.e. partial divestment) and other means? The answer seemingly lies with FDI, and the joint ventures that have been established between foreign investors and state enterprises, and which have buoyed the local partners.[31] In this particular case, it might appear that FDI activity in Vietnam has been working at cross-purposes to other elements of the economic reform process. Yet experience shows us that FDI policies should not operate independently or in a vacuum, but rather 'in conjunction with … macroeconomic and other policies to create a country's investment environment' (Iboshi and Plummer, 1994: 19).

It is not only the transitional economies of Southeast Asia that are going through major changes. As Buckley shows in Chapter 2 of this volume, international business activity is also undergoing considerable transformation. Forces of globalisation and advances in technology are driving this transformation process, with production processes becoming increasingly 'internationalised', and companies and countries becoming increasingly specialised in what they produce (World Bank, 2003b). This impacts on the kind of FDI activity that occurs: where it comes from, where it goes to, in what form it is enacted, the size and pattern of flows, and so on. The implications are potentially profound, and are as important to policy-makers and local companies in developing and transitional economies as they are to business executives working inside large multinational enterprises (MNEs). Buckley has argued that investment agencies in Southeast Asia – including those

in the Indochina sub-region – need to better understand the hub and spoke strategies of multinational firms, their dynamic market entry strategies, and their reliance on networks and clusters, amongst others. No longer does FDI simply seek access to natural resources and new markets, as today's foreign capital also attempts to tap comparative advantages that come from placing very specific business assets within a host country.

The 'bad' news here for Indochina is that such changes demand policy-makers develop a much more detailed understanding of how increasingly complex and fluid international business activity is evolving. The 'good' news is that policies aimed at improving the host country business environment for foreign investors are likely to reap more wide-ranging rewards for the local business community too, as the artificial dividing line between FDI and domestic business continues to evaporate. The factors that make for a good enabling environment for local companies are increasingly becoming the same factors behind a good environment for foreign investors, and vice versa.

However, there is still a general impression in Indochina that FDI activity primarily entails foreign firms establishing 'greenfield' projects in the sub-region, in order to generate new production capacity. But in a global environment of overcapacity in many business fields where FDI activity in Southeast Asia has been vigorous, this kind of FDI activity has been in short supply for several years now, and shows no immediate sign of picking up. Rather, MNEs are seeking to create elaborate and flexible CPNs with local companies in developing countries, sometimes with equity links and sometimes without. The AFTA is partly designed to support this trend, and will oblige the Indochina countries to lower their import tariffs on a range of products that had prompted some foreign firms to establish manufacturing and assembly plants in the sub-region. But as AFTA becomes a reality, some of this activity in Indochina is likely to cease, at least in its current form.

As Bartels notes in Chapter 8 of this volume, the global 'FDI growth story' of recent years has largely been a story about cross-border mergers and acquisitions (M&As), not of greenfield projects. And in this regard, it could be argued that the Indochina countries are not very well prepared, as current laws and regulations make such cross-border activity difficult to enact. Tellingly, most M&A deals witnessed in the sub-region have been between foreign firms, entailing the sale or acquisition of business assets in Indochina. This explains why Laos appears a remarkable three times in UNCTAD's table of the thirty largest M&A sales conducted in less developed countries between 1987 and 2001; all three related to power projects enacted by European companies (UNCTAD, 2002e: 7). Notably, foreign investment directly into existing local companies, rather than as joint ventures or wholly foreign-owned projects, remains constrained by various regulations in the Indochina countries. In the case of Vietnam, for example, local companies may currently only issue shares to foreign investors if they operate in one of thirty-five business sectors, with a ceiling of 30 per cent of their registered equity (and even less if they are listed firms).[32] And in Laos, there are no regulations to permit foreign investors from acquiring a stake in a local company, other

than as a joint venture under the foreign investment law. This potentially constrains the aggregate scale of FDI and other foreign capital inflows, and hinders local companies in tapping foreign capital and other non-financial inputs from overseas investors.

Foreign investors in Indochina get treated comparatively well, relative to local companies. For example in Vietnam, foreign investors currently face standard corporate income tax rates that are 7 per cent below those for domestic companies, and are potentially eligible for additional tax incentives and holidays.[33] Such a situation often comes about because the host country is competing directly with other developing countries trying to attract FDI inflows, and feels it must at least match the corporate tax rates and fiscal incentives offered by other Southeast Asian countries to foreign investors. But this can become a vicious, cyclical 'beggar thy neighbour' exercise – as countries respond and counter-respond to each others' latest incentives, resulting in a downward spiralling effect, mutually nullifying each others' incentives – with insufficient thought given to the actual merits of doing so; quantifying the additional business activity gained as a result of sector- or location-related fiscal incentives offered, versus the tax receipts foregone.

It should be noted that evidence to support the utility of incentives in attracting FDI inflows is less than wholly convincing. For example, a recent study by Beyer (2002) of the transitional economies of Eastern Europe and the former Soviet Union found no relationship between tax incentives offered and FDI levels. Although it is widely agreed that, all things being equal, incentives may work in attracting FDI inflows to one country ahead of another, rarely are things equal. Bergsman (1999: 1–7) argues that despite their popularity, FDI incentives 'in most countries are simply not effective. They attract very little additional investment. And they have costs: they are a drain on the Treasuries of the countries that grant them, they are sometimes counterproductive because they make investment procedures too complex, and they sometimes lead to significantly greater corruption'. He concedes, however, that they may have some public relations effect, particularly for 'a country that wants to change its image from one that seems unfriendly or unwelcoming to investors, to one that is welcoming and is ready to facilitate private business in general and FDI in particular…'.

One alternative would be to more clearly identify specific areas in which the host country has competitive advantages – something that foreign investors are usually more adept at doing than host country investment agencies – and then try to leverage more closely on these. In the case of Vietnam, these areas are likely to relate to the country's large and relatively well-educated labour force, its burgeoning community of local entrepreneurs and private companies, easy access to coastal ports, and its industrial zones and export processing zones. In the case of Cambodia, low unit labour costs, favourable export quotas to the US and EU markets, and high tourism potential immediately come to mind. And for Laos, the country's natural and latent power resources, and equally high tourism potential are perhaps its greatest strengths. In other words, rather than competing head-on with numerous other Asian countries (including China), across a wide spectrum

of business sectors and host country attributes, there would be more mileage in the Indochina sub-region trying to better differentiate itself instead. It could be argued that the Indochina countries have not yet really identified what intrinsic qualities differentiate their economies and business profiles from other Southeast Asian countries, and how they might use these to best effect.[34] When FDI inflows were substantial – and arguably greater than the host economies could absorb – in the first half of the 1990s, the utility of differentiation may have seemed less important, but as inflows have failed to revive markedly since the mid-1990s,[35] and as international competition for FDI becomes increasingly more intense, then more effort could be focused in this direction. This is not to suggest that Indochina's policy-makers should get into the game of 'picking winners', but that they should become more focused in their FDI attraction and hosting policies.

There is also a need for FDI strategy in the Indochina countries to be more integrated with other economic and industrial development objectives, so that FDI policies are consistent with – and ideally, also mutually supportive of – various macroeconomic, industrial, corporate and other reform policy agendas in these transitional economies. Ideally, a host country's FDI policy agenda should dovetail with its policies towards developing the domestic corporate sector (including state sector divestment), as well as a spectrum of other social and economic development agendas. This should help avoid contradictory policies emerging, and ensure that all pertinent organisations (including local and central government, local and foreign businesses, and domestic and overseas financial institutions) are all pulling in roughly the same direction. This is probably the next big agenda for the Indochina countries in the field of FDI promotion. As they now stand, the FDI laws and regulations are very liberal and continue to improve, the incentives offered are quite generous, and foreign investors are often treated better than domestic investors. Nonetheless, FDI inflows continue to contract, or at least not return to the highs of the period from early to mid-1990s, for various reasons. And there is relatively little more that the Indochina countries can do in the specific field of FDI promotion, as diminishing returns have started to set in for FDI regulatory reform.[36]

Instead, policy focus needs to shift towards bringing greater consistency to the business environment for both local and foreign investors (á la Singapore[37]), and tackling constraints to business development in general, for local small firms and large MNEs alike.[38] In other words, the future policy agenda for promoting FDI in Indochina may actually shift outside the direct sphere of the foreign investment regime per se. This notion is supported when one looks at the sorts of issues that foreign investors usually cite as the main obstacles they face when conducting FDI projects in Indochina, most of which pertain to the wider host country business environment. They include: excessive regulation and red tape, inadequate legal infrastructure and weak enforceability, poor physical infrastructure, weak banking and financial markets, privileges still enjoyed by state-owned firms, inadequate local input suppliers and service providers, poor and/or expensive communications, high land costs, corruption, high tax rates (although not in Cambodia), inadequate property right protection, currency controls, etc.

Arguably, the Indochina countries have made slow progress in this realm, and may explain in part why FDI inflows are not picking up sufficiently.

Although some FDI-specific policy measures, such as offering tax holidays, may act as a temporary palliative to mitigate these sorts of problems, they still need addressing in the long term. And if the FDI policy agenda is no longer focused on entirely FDI-specific issues, this means that a wider range of government and other agencies will need to coordinate their efforts to improve the host country environment. Of course, the added attraction in tackling these sorts of issues is that any gains made should be of benefit to more than just foreign investors, but to the wider business community as a whole. Besides, as international business forms mutate, and CPNs proliferate, making a clear distinction between the two (local and foreign firms) and their differing needs is becoming increasingly difficult and redundant.

9.6 Concluding remarks

The host country investment agencies of Indochina would benefit from becoming better informed of the international business environment, and acquiring a more advanced understanding of their economies' and corporate sectors' competitive strengths – where can Cambodia, Laos and Vietnam best fit into the 'global food chain'? There is little utility in continuing to generate lengthy lists of projects that these countries wish to see FDI input, as has been done in the past.[39] It has to be recognised that FDI flow patterns are driven as much by 'push factors' as they are by 'pull factors'. The industrial revolution in Europe did much to push FDI activity into the 'emerging markets' of colonial possessions – French Indochina included. Another mini-revolution is underway in the field of international business today, which will have an impact on the kinds of FDI activity we are likely to see in developing countries, including the Indochina sub-region, in the coming years. This is not well appreciated by policy-makers in Indochina, partly because the recent distractions of the Asian financial crisis served to temporarily cloud the more long-term factors influencing FDI flow patterns in the Southeast Asian region. As a consequence, the Indochina countries are 'marketing themselves' to the international business community as attractive host country destinations for some kinds of foreign investment activity that are no longer prevalent. And this may explain in large part why the improvement in general investor sentiment towards the sub-region in recent years has not translated into improved FDI inflows.

Current excitement surrounding China's continental-sized economy is obliging all Southeast Asian countries to reassess their relative merits in attracting FDI inflows (and thereby clearly distinguish business sectors in which China has an absolute advantage but may not have a comparative advantage. In the late nineteenth century, the initial driving force behind French investment in Indochina was a hope that the sub-region would provide an avenue into that great, elusive China market. Might Cambodia, Laos and Vietnam provide an equivalent economic 'avenue' in the near future? Rather than competing with China in

attracting FDI inflows, are there ways in which the three Indochina countries can seek to 'ride the China growth story' immediately to the north of the sub-region? Ultimately, China is likely to become a substantial source of FDI for the Indochina sub-region. Indeed, the activity of Chinese investors in Cambodia and Laos has become much more pronounced since 1997, partly taking advantage of the vacuum left by the withdrawal of other Southeast Asian investors from the sub-region. However, it will take time for China's FDI inflows into Indochina to gain real momentum. And in the meantime, the most vigorous business activity between China and the Indochina countries will remain in the area of trade. The current concern within the Indochina countries is of Chinese products both flooding their domestic markets and seizing third country export markets, and thereby inflicting severe damage on their own manufacturers. This threat is real. However, China will increasingly source more inputs from overseas, and the Indochina countries could be part of this phenomenon. Much will depend on the ability of their policy-makers to position the Indochina countries to take advantage of changes in the international business arena. Judging from the relative success of the first decade of FDI activity in Indochina, there is room for guarded optimism that the next episode in the sub-region's 'FDI story' will be one of further growth and development.

Notes

1 Vietnam first began attracting FDI in 1987, and Laos followed one year later. Cambodia's current foreign investment law dates from 1994.
2 The term 'Indochina' is simply used here as a collective noun to depict the three countries of the sub-region (Cambodia, Laos and Vietnam), without any political, historical or other connotation intended.
3 'FDI in French Indochina before 1900 appears to have been utterly insignificant' (Lindblad, 1998: 13).
4 Robequain (1944: 158–161) dates the commencement of mining-related foreign investment in Indochina (primarily in Tonkin) to 1888, with French investment in other business activities following at least a decade later. Investment in agricultural cultivation was relatively scarce before 1910. Textile production (centred on Nam Dinh in Tonkin) came later, and began to compete with business interests in the metropole. But this was unwelcome by those who thought Indochina's role was to serve France – through the supply of raw commodities and as a market for French products – rather than be an alternative and competitive production base. As a result, 'the French did little to promote the modernization of manufacturing industries in Viet-Nam' and after 1930, 'they even allowed the traditional Vietnamese activities of sericulture and silk-spinning to decline' (Smith, 1968: 130). Also see Tertrais, 2001.
5 Murray asserts that the 'principal motivation [of the colonial annexation of Indochina] was France's desire for a passable route into China's Yunnan province' (Murray, 1980: 55).
6 Murray depicts the construction of the Yunnan railway line as 'one of the most costly and laborious feats of colonization' (Murray, 1980: 173). Despite numerous cash injections, the private company mandated to build the railway was ultimately dissolved and the colonial administration took over.
7 'The principal aim of these giant firms was to seek fresh investment opportunities in the colonies, to facilitate the issue of shares and bonds on the Paris capital market, and to

directly supervise the organisation of production undertaken by their multifaceted subsidiaries in the colonial territories'. Murray, 1980: 124.

8 For a telling depiction of the rise and rise of the Banque de l'Indochine, see Murray, 1944: 132–154, and Thompson, 1937: 222–223.

9 This relative position was steadily diluted during the 1990s, and by 2000 Southeast Asia's FDI inflows were less than 6 per cent of global flows to developing countries, and were just a third of China's inflows.

10 This was true of Australian and French companies in particular.

11 Over a dozen automotive companies signed FDI licences in Vietnam, anticipating aggregate car sales that were well beyond anything that the country could hope to sustain, even in the medium term.

12 The 'interest spread' on some bank credit was remarkably low, relative to the level of risk, as banks also sought to gain loan exposure to the sub-region. As for the investment funds, their shares traded at substantial premia to their underlying asset values, as portfolio investors tried to gain exposure to the sub-region.

13 The Vietnam-oriented investment funds comprised: the Vietnam Fund, the Vietnam Frontier Fund, the Beta Viet Nam Fund, the Templeton Vietnam Opportunities Fund, Vietnam Enterprise Investments Limited, and the Lazard Vietnam Fund. Other listed funds that had a mandate to invest in Indochina as a whole included the Beta Mekong Fund and the Southeast Asia Frontier Fund. In addition to these listed country funds, a small number of private investment funds oriented towards Vietnam were also launched in the early 1990s. Also see Freeman, 2001b: 7–10.

14 As an indicator of how low investor sentiment dropped after 1996, by 1998 the listed Indochina funds were trading at the steepest discounts to NAV in the entire emerging markets universe for closed-end funds.

15 For example, see Margot Cohen, 'Vietnam: New and Improved', *Far Eastern Economic Review*, 30 January 2003.

16 Such leading indicators include: the resumption of IMF lending in both Laos and Vietnam; the opening of a stock market in Vietnam; the signing of a bilateral trade agreement between Vietnam and the US; Cambodia and Vietnam's active pursuit of WTO accession; and various positive changes to the domestic business environments in the Indochina countries.

17 In the case of Vietnam, roughly 60 per cent of all FDI stock is located in Ho Chi Minh City, Hanoi and Dong Nai province. Although it is not surprising that some of the more distant rural provinces have missed out on Vietnam's FDI inflow phenomenon, even cities like Haiphong and Danang have seen less FDI activity than one might expect for such major urban centres. Beyond the hydropower sector, both Cambodia and Laos have also found a large proportion of their FDI activity clustered around their respective capital cities, Phnom Penh and Vientiane.

18 This section of the chapter draws in large part from work contained in Freeman and Nestor (forthcoming), which although focusing wholly on Vietnam, is also broadly applicable to Cambodia and Laos.

19 In Vietnam, most major cities, provinces, export processing zones and industrial zones now have the authority to license some FDI projects located within their territory, and within certain capital limits. In the case of Vietnam, more than 30 different agencies have reportedly issued investment licences to foreign investors.

20 It should be recognised that the difficulties of collecting, collating and interpreting FDI data are a perennial problem for most countries, including advanced ones. For example, see 'Hong Kong's $64bn question', *The Financial Times*, 29 March 2001. As Lindblad (1998: 6) noted, 'patterns of FDI can only be identified if FDI is measured properly and that is often more easily said than done.'

21 These reasons include the low rate of return often associated with agriculture-related businesses, issues relating to land use by foreign investors, and government restrictions on FDI activity in some areas of agri-business.

22 At the time of writing, twenty-one companies were listed on the Vietnam stock market, with a market capitalisation of below US$200 million. Total foreign ownership in shares of a listed company is capped at 20 per cent, with single foreign institutions not permitted to hold more than 7 per cent of shares in a company, and foreign individuals capped at a mere 3 per cent.

23 Just seven FDI projects – all relating to energy generation – account for over 65 per cent of total FDI inflow pledges in Laos, of which only a few have actually commenced operations.

24 A proportion of FDI accredited to Singapore as the home country will be investment by genuine Singapore firms, and some will be FDI enacted by MNEs that have their regional headquarters located in the city-state.

25 One notable exception would be the Lao–Viet Bank, a joint venture bank headquartered in Vientiane, primarily mandated to provide financing for trade flows between Laos and Vietnam. The two partners in the joint venture are state-owned commercial banks.

26 For example, the country's telecommunications company and the Beer Lao brewery. Indeed, equity in the latter has been sold to foreign investors on two separate occasions (Freeman, 2003).

27 The standard corporate income tax rate is 20 per cent, but can be as low as 9 per cent for eligible companies. Cambodia's policy conforms with Bergsman's assertion that small and 'otherwise less attractive countries that have potential as export platforms may need to have effective rates [of corporate income tax] not higher than 10 or 15 percent, or maybe even less for exporters, if they hope to get a lot of FDI' (Bergsman, 1999: 7).

28 Such FDI inputs go well beyond just funding, and can (potentially at least) span a range of other non-financial attributes: new technology, skills and design, organisational and management techniques, overseas market information and access, etc. Some of the most valuable non-financial inputs, such as advanced technology, are kept as proprietary knowledge within the closed equity networks of multinational firms. See Campos and Kinoshita (2002) for an interesting discussion of the impact that FDI has had on the economic growth of transitional countries in Eastern Europe and the former Soviet Union.

29 Yasheng (2000) argues that 'China's FDI is not a sign that its economy is strong and healthy. Rather, it underscores some fundamental distortions.'

30 A notable exception would be state enterprise divestment in Laos, and the role played by strategic foreign investors (Freeman, 2003).

31 During the 1990s, joint ventures with private companies in Vietnam accounted for less than 2 per cent of total FDI activity. In the initial period of FDI activity, foreign investors were strongly encouraged to establish joint ventures with state enterprises.

32 Under Decision 260/2002/QD-BKH, issued by the Ministry of Planning and Investment, which updates a previous list, issued in June 1999, which identified just twelve business sectors in which foreign investors could acquire stakes in local firms. The current list of permitted business sectors differs from the list of sectors permitted for FDI activity in the form of joint ventures or wholly foreign-owned projects. In Vietnam, a foreign investor may acquire up to 30 per cent of a local unlisted company, and up to 7 per cent of listed company.

33 At the time of writing, the standard corporate income tax rate for local companies in Vietnam is 32 per cent (plus a 25 per cent surcharge on after-tax income), compared with a standard rate of 25 per cent for foreign investment projects.

34 Intrinsic qualities would not include temporary windows of opportunity that might subsequently close, such as advantageous trade quotas for specific export products into specific overseas markets. Michalet (1997) provides an analytical checklist of country attractiveness (p. 24).

35 In the first half of 2002, Vietnam's FDI approvals were down over 55 per cent on the previous year. *Saigon Times Daily*, 1 July 2002.

36 This is not only true for the Indochina sub-region. As UNCTAD (1998: xxvi–xxvii) noted, 'diminishing returns has set in [for the liberalisation of FDI frameworks] and liberal FDI policy is increasingly losing its effectiveness as a locational determinant of FDI', as 'adequate core FDI policies are now simply taken for granted'.

37 In many respects, Singapore stands as Southeast Asia's example of best practice in most policy issues and strategic initiatives pertaining to FDI, although the relative affluence of the government does allow it to pursue various kinds of non-fiscal incentives and even direct co-investment activities that are less feasible for the Indochina countries.

38 For example, regulatory consistency could be established in the following areas: (lower) corporate income tax rates for local and foreign-invested companies; (more selective and targeted) fiscal incentives for local and foreign-invested companies; (higher) foreign equity caps for listed and unlisted local companies; (more) business sectors that are open to foreign investment in existing local companies and conventional forms of FDI activity (e.g. joint ventures).

39 For instance, in late 2001 Hanoi issued a list of 160 projects calling for foreign investment in the Vietnamese capital, including a US$30 million golf course, a US$110 million entertainment park complex, a US$85 million 'eco park', and a US$150 million 'centre for auto racing and football betting'.

10 The future of foreign portfolio investment in Southeast Asia

Nick J. Freeman

10.1 Introduction

This chapter sits at a slight tangent to the others in this volume, with its primary focus on foreign portfolio investment (FPI), rather than foreign direct investment (FDI).[1] In this regard, foreign investors tend to be financial institutions, rather than manufacturing or other kinds of service companies; and the recipients of the capital inflows tend to be relatively well-established local companies, rather than newly established foreign-invested entities. In their most stereotypical forms, a multinational company investing in a joint venture or wholly owned 'greenfield' FDI project is a markedly different exercise than a fund manager taking a minority equity stake in a domestic company that is listed on the local stock market. However, this sort of distinction is becoming increasingly less common, as the fine line between FDI and FPI begins to blur, such as in the structuring and financing of cross-border mergers and acquisition (M&A) deals. In the course of a single cross-border M&A deal, for example, the acquiring company may initially take a stake in the acquiree company by buying some of its shares listed on the local stock market, before making a full acquisition bid, possibly financed in part by bank credit from either local or overseas commercial banks. The end result is a foreign-invested enterprise operating in the host country (possibly using both local and foreign funds as leverage), but the means of enactment is unlike the 'plain vanilla' FDI activity that Southeast Asian countries – and their investment promotion agencies – are most familiar (and perhaps most comfortable) with.

Another hybrid of FDI and FPI seen in Southeast Asia is venture capital (VC) activity, also sometimes referred to as 'private equity'.[2] Although Singapore has made considerable strides to develop a local community of VC companies, much of the VC investment activity in the region is conducted by overseas companies, using capital that has been raised overseas, and thus can be regarded as foreign investment. Typically taking equity stakes in selected private companies, the management of a VC fund will usually attempt to directly assist these companies in increasing shareholder value, and subsequently seek to exit these investments at a profit, often through public share issues and stock market listings, or through strategic sales (including M&A deals).[3]

However, the main platforms for equity-related FPI activity in Southeast Asia are the region's stock markets, and hence these are the primary focus of this chapter.

The rest of this chapter is divided into four parts. Section 10.2 briefly surveys the development of Southeast Asia's stock markets within the wider context of the rise of emerging markets as a mainstream asset class for FPI during the 1990s. Section 10.3 discusses changes that have occurred in recent years in the field of FPI, and the extent to which these are posing new challenges for Southeast Asia's stock markets and their listed companies. Section 10.4 suggests a number of policy options stemming from these challenges. And Section 10.5 concludes.

10.2 The development of Southeast Asia's stock markets

Since the opening of a fledgling stock trading centre in Vietnam in mid-2000, all of the region's larger economies now have official equity markets operating.[4] Just Brunei, Cambodia, Laos and Myanmar (and East Timor) are currently without formal stock markets, and the scale of their corporate communities tends to suggest that they lack the necessary economies of scale, or the need, to develop their own equity markets. The rise of Southeast Asia's stock markets during the 1980s and 1990s should be seen within the dual contexts of economic development in the region, and also a global trend in the financial industry that has seen emerging markets – including Southeast Asia's equity markets – recognised by portfolio investors as a mainstream asset class in their own right (International Monetary Fund, 1999). Not only has the economic rise of the region provided a 'pipeline' of attractive local companies seeking to enact public share issues, and a growing number of local investors with sufficient pools of savings to invest in listed equities, but institutional investors have also developed an appetite for exposure to companies operating in relatively high-growth economies.

Spurred in part by the end of the Cold War, this phenomenon has been apparent on a global scale, with over forty new stock markets opening during the last two decades of the twentieth century, including twenty in Central and Eastern European transitional economies during the 1990s (Claessens *et al*., 2000b).[5] And the view that governments should not be in business gaining orthodoxy, the privatisation campaigns in a number of emerging and transitional economies have helped provide a pipeline of companies seeking to list their shares after enacting initial public share offerings (IPOs).[6] The gradual lifting of capital controls and remittance taxes by countries, the increasingly free flow of funds across national borders, and advances in information and communication technology have also served to underpin this trend. As a cumulative result, the flows of portfolio capital to emerging markets burgeoned from effectively zero in 1980 to US$100 billion in 1993 – the 'bull market' year for emerging market equity investors (Weber and Davis, 2000: 4). And as a consequence, the total capitalisation of the thirty-two 'developing country' equity markets tracked by what was formerly the IFC's global composite index rose from US$67 billion in 1982 to US$2.1 trillion in 1997 (Naughton, 1999: 23).

Within Southeast Asia itself, the number of companies listed on the region's five leading equity markets – Jakarta's JSX, Kuala Lumpur's KLSE, Manila's PSE, Singapore's SGX and Bangkok's SET – rose considerably during the 1990s, from 800 in 1990 to slightly over 2,100 by the turn of the century. In tandem, the

aggregate capitalisation of the region's five leading equity markets also rose markedly during the 1990s, from around US$122 billion at the beginning of 1990 to US$444 billion by the end of 2000, driven by the increasing volume of shares listed and rising share prices. However, the capitalisation of these five markets actually peaked in February 1997, several months prior to the onset of the Asian financial crisis in July 1997, at US$837 billion. Tellingly, the total capitalisation of Southeast Asia's main equity markets almost halved in the three years following the outbreak of the Asian financial crisis, in US dollar terms.[7]

Not surprisingly, the region's main stock market indices tell a similar story, with substantial increases registered between the mid-1980s and mid-1990s (including the 'bull market' run of 1993–94), but disappointing performance after around 1994. This 1990s dichotomy – of strong performance in roughly the first half of the decade and poor performance in the latter part of the 1990s – was replicated throughout the emerging markets universe for portfolio investors, partly as a consequence of a spate of financial crises during the second half of the decade, commencing with Mexico in 1994. As the International Monetary Fund (2002: 59) has noted, emerging markets 'provide global investors with attractive absolute returns as well as an avenue for diversifying their portfolios. The evidence indicates that investors reaped such benefits in the first half of the 1990s, but that the gains disappeared between 1995 and 2001.'

The development of the equity markets in Southeast Asia has been much more evident than the development of corporate bond markets. Nonetheless, the region's equity markets tend to remain quite small as a source of funding for Southeast Asian companies when compared with commercial bank lending (possible exceptions to this regional trend being Malaysia and Singapore). As the Asian financial crisis clearly displayed, the corporate communities of Southeast Asia have generally depended too much on bank debt as their principal source of funding, sometimes using short-term bank loans (usually more appropriate for working capital needs) for their long-term investment capital needs – the so-called 'maturity mismatch' problem – and resulting in loan defaults for companies and non-performing loan portfolios for banks.

Also, from the global perspective of major portfolio investors, Southeast Asia's equity markets remain relatively small scale. In January 2003, the five main equity markets in the region combined had an aggregate capitalisation of US$224 billion: roughly 90 per cent the size of Taipei's market, 97 per cent that of Seoul, 60 per cent the size of either Hong Kong's Hang Seng (even though Southeast Asia's equity markets have roughly three times more listed companies than Hong Kong) or Sydney, and less than a fifth of Tokyo's Nikkei 225.[8] The total market capitalisation of the Manila stock exchange (the smallest of the region's five main equity markets) is less than that of McDonald's, and half the size of the trading website Ebay. Even the Singapore market – the region's largest equity market – has a value that is smaller than Coca Cola alone. Southeast Asia's five main equity markets have a combined market capitalisation that is less than that of General Electric, Microsoft or Exxon Mobil in the US; their cumulative value is similar to that of the Wal-Mart retail chain.

Such low capitalisations also have an impact on the general liquidity of these stock markets. The issue of providing adequate trading volume is an important one for most major portfolio investors, who tend to shun illiquid equity markets, and therefore also the companies listed on them.

10.3 Challenges arising from recent changes in FPI activity

> …people want exposure to something big that has a conveyor belt in Southeast Asia, not just property and banks.
>
> ING Barings, 'AsiaTalk', 4 November 1999

The challenges that currently confront Southeast Asia's stock markets, and therefore inhibit greater FPI activity, stem from both internal capacity weaknesses and external changes in the way global investment portfolios are allocated and managed. First, as the quotation here implies, the five main Southeast Asian stock markets – consisting of over 2,100 listed firms – have been less than wholly successful in building up an adequately diverse spectrum of companies in which portfolio investors can gain exposure through listed shares. Banks, finance and property companies tend to be very well represented on the region's main stock markets and constitute a substantial proportion of their total value, whilst other business sectors are much less well represented. As a result, when banks, finance and property companies – either in a specific country or the region as a whole – encounter a cyclical downtrend (or a more rapid deterioration in their performance, such as during the Asian financial crisis), which they tend to do at the same time, there is a paucity of other kinds of listed companies that portfolio investors can 'rotate' their funds into. And if investors cannot 'rotate' into other business sectors, then foreign portfolio investors will tend to exit from the stock market altogether, in search of better returns from other countries or asset classes.

This may explain in part why the equity market indices of the Southeast Asian countries have largely remained lacklustre in recent years, even though the broader macroeconomic situation in most of these countries has markedly improved. There is an apparent disconnect between the performance of the stock markets and the economies in which they are located, as the former are still constrained by the difficulties faced by those business sectors most heavily represented in the indices. Put another way, if a portfolio investor wishes to gain exposure to those business sectors powering economic growth in a Southeast Asian country today, the local stock market may not currently provide an adequate vehicle for doing so. It could be argued that Southeast Asia's strong emphasis on FDI activity, as discussed in the other chapters of this book, has to some extent been at the expense of developing a more robust and sectorally diverse domestic corporate community that could provide suitable candidates for stock market listing. Although some foreign-invested companies do seek to list on the local stock market in a host country, their propensity to do so is generally less than for domestic firms.[9] As a result, Southeast Asia's mixed success in developing linkages between foreign multinational enterprises and local companies is

evidenced by the lack of depth and sectoral imbalances in the region's stock markets. (This imbalance is not wholly unlike the kinds of product and export market asymmetries, such as electronic goods destined for the US market, that some Southeast Asian countries have been seeking to overcome.)

One response to this has been attempts by some Southeast Asian countries – amongst numerous others around the world – to develop second or alternative equity markets, offering less stringent listing criteria that will allow a wider universe of local companies to enact public share issues. In general, however, these stock markets have not been particularly successful (both within Southeast Asian and beyond), with few companies seeking to list on markets such as the Malaysian Exchange of Securities Dealing and Automated Quotation (MESDAQ) and the Labuan International Financial Exchange, both in Malaysia, and the Market for Alternative Investment (MAI) in Thailand. The MESDAQ (with seventeen firms listed) was merged with the larger KLSE in March 2002, whilst the MAI had just nine companies listed by the end of 2002, having commenced operations in mid-1999. Part of the problem has been that the main stock markets have themselves been liberalising their listing criteria, and thereby competing with these alternative equity markets. Greater success might have been achieved if more effort had been focused on developing local VC capacity, rather than creating secondary stock markets. With their appetite for higher risk, VC investors can play an important role in bringing relatively small but promising companies up to a scale where an initial public offering and stock market listing on the main equity market is both feasible and attractive. This sort of mezzanine financing for 'up-and-coming' firms can be an important source of listing candidates for stock markets.

Secondly, foreign portfolio investors have become much more critical of the levels of corporate governance and transparency displayed by Southeast Asia's corporate sector, and particularly the treatment of minority shareholders. Some of the survival strategies adopted by Southeast Asian listed companies adversely affected by the Asian economic crisis of 1997–98 appeared to strongly favour the founding majority shareholders, and were seemingly at the expense of minority shareholders. The complex cross-shareholding structures of both family- and state-owned enterprises seem to further complicate the picture for portfolio investors, with suspicions that the more lucrative businesses within conglomerates remain in private hands, while the less profitable firms have been listed in order to raise funds for the former.

The treatment of minority shareholders by founding shareholders, and its potential to deter FPI inflows, has been brought to the fore by recent changes in the way the global indices companies compose their asset allocation – or 'weighting' – recommendations. A considerable proportion of total portfolio funds now directly track, or are benchmarked against, various indices that provide recommended 'weightings' for stock markets, such as the MSCI, S&P, and FTSE International indices. One estimate suggests that approximately US$3 trillion in portfolio funds is currently benchmarked against the various MSCI indices alone, of which US$500 billion is directly tracking these indices.[10] In recent years major global indices companies have been reconfiguring their weightings, to take more

account of the number of company shares available for trading by minority shareholders (the so-called 'free float'). Since mid-2002, for example, the MSCI's recommended weightings for listed companies have been based on their free float, rather than purely their aggregate capitalisation previously. For listed companies that are closely held, either by the company's founding family or the government, or though complex cross-shareholding agreements, their recommended weightings have been reduced, or dropped altogether.[11] This can have a marked impact for stock markets in developing countries, such as those of Southeast Asia, where global portfolio investors often use an index-tracking investment strategy (and consequently ignore 'out-of-index' stocks), rather than incur the not inconsiderable costs of conducting fundamental and company-specific research on the wider universe of listed firms. Securities companies often provide such research for their clients on a wide spectrum of listed companies. However, with the shrinkage in Southeast Asia's stock markets and reduced investor appetite for regional equities, the number of major securities companies active in the region has declined, and the range of research provided to clients has also contracted. Institutional portfolio investors have also become increasingly skeptical of research provided by securities companies in recent years, for various reasons.[12] Such developments have only served to reinforce the trend towards more passive index-tracking investment strategies pursued by many institutional investors in smaller equity markets.

Another development in asset allocation methods has been an increasing emphasis on business sectors, rather than countries, as the primary method of investment portfolio diversification. The kind of financial contagion seen across countries during times of crises, and the increasing correlation that exists between the world's stock markets, have both served to suggest that diversifying an equity portfolio across regions and countries – the conventional diversification method within a single asset class, such as equities – provides less investor protection than previously thought.[13] Besides, in the case of a transnational corporation, the country allocation can be rather subjective: is it where the company is headquartered, where it is listed on a stock market, where its main production activities are located, or where it generates most of its sales? The company may have multiple listings, manufacture products in numerous countries, and register sales across several continents. As Brooks and Catao (2000: 3) have noted, there is a 'growing conviction in the investment community … that globalization and the new economy are raising the importance of global industry effects in explaining return variation, at the expense of country-specific factors'.

Therefore, the attraction of investing a proportion of an equity investment portfolio in Southeast Asia, primarily as a defensive hedge against poor stock market performance in the more industrialised countries, is becoming much less apparent. As international production networks and the forces of globalisation increasingly integrate national economies and corporate communities with the wider international business community, the merits of geographical diversification are being increasingly lessened for portfolio investors. Instead, greater emphasis is being placed on sectoral diversification, where different kinds of companies tend

to experience differing business cycles and offer different attractions to different kinds of investors: growth stocks, momentum stocks, defensive stocks, value stocks, etc. But as noted earlier, Southeast Asia's stock markets are asymmetrically weighted towards a relatively small number of business sectors, and tend to lack an adequate spectrum of companies.

This phenomenon is not helped by a recent trend that has seen some of Southeast Asia's larger companies listing on overseas stock markets, rather than in their 'home country'.[14] For those companies that can meet the listing criteria of the world's larger stock markets, the attractions of doing so are multiple, including: being closer to the larger pools of portfolio investment funds, both in terms of distance and time zones; higher visibility and greater coverage by securities analysts; being listed on markedly more liquid equity markets that fund managers clearly prefer; potentially lower costs; and greater cachet stemming from a listing in a premier equity market.[15] Should the migration of Southeast Asia's leading corporates to the major global stock markets persist, this may only serve to reinforce the perception that the region's equity markets are increasingly unattractive to institutional investors, lack liquidity, and may be in terminal decline. As Claessens *et al.* (2002b: 1) note, '…migration can leave too little domestic activity to sustain a local [stock] exchange. Therefore, the functions and forms of stock exchanges in many economies need to be rethought'. And this is no less true for Southeast Asia's stock markets.

10.4 Some policy options

This author would suggest that the kinds of challenges identified in the previous section indeed necessitate a re-evaluation of the region's stock markets by policymakers. To date, perhaps only Singapore's – the region's leading financial centre – has really undergone any kind of serious re-evaluation exercise, and adopted a strategy for its integrated SGX that seeks to overcome some of these challenges.[16] At the very least, it entails repositioning the region's stock markets to benefit from recent changes in capital flows and asset allocation methods. At most, it entails considering a wholly different approach towards hosting domestic equity markets, and the equity financing of local corporates. Indeed, the agenda goes beyond just the equity markets themselves (and the companies currently listed on them), and encompasses changes to the wider corporate community, most notably in terms of improving corporate governance and transparency standards. A change in mind-set may also be necessary, given the sort of emotional 'collateral' that is often invested in stock markets, by the governments of industrialised and developing countries alike, as totems of their economic development and national identity. Rather like large infrastructure projects, refineries and tall office towers, stock markets are sometimes seen as tangible symbols of countries' economic aspirations, and the performance of their indices taken as pulse readings of the corporate community's health.

Therefore, to undertake major policy initiatives on the stock market may require a leap of faith by some Southeast Asian countries. Such a leap may appear

unattractive and/or perilous, but is it any less attractive than the danger of hosting a largely moribund equity market?[17] The primary benefits of a stock market for most Southeast Asian countries is to act as a conduit (other than bank credit) for investing both local savings and foreign capital in the domestic corporate community, and thereby provide long-term financing for domestic companies. If the local stock markets are failing to perform this role, then their practical utility – and the considerable fixed costs of operating them – become debatable. One might argue that a stock market has other, indirect roles. For example, the stock market listing criteria and reporting regulations may serve as a useful benchmark for improved corporate governance and transparency standards in the wider business community. But if anything, listing criteria are gradually being relaxed in many countries, as they seek to attract new companies to enact initial public offerings and become listed on local stock markets.

Either individually or collectively, Southeast Asia's equity markets will probably need to establish alliances or full-blown mergers with other stock or capital markets, either within the East Asian region or beyond, if they are not to run the real risk of becoming irrevocably sidelined from the major capital flow routes. A pan-Southeast Asian equity market might be expected to generate a number of benefits. First, merging would allow both market liquidity and capitalisations in the region to be pooled, as well as widen the investor base, and thereby help keep Southeast Asian companies on the radar screen of global fund managers and the increasingly influential benchmark indices. A deeper and broader regional stock market would also lessen the temptation for local firms to migrate their share listings to the major overseas stock markets, or 'cannibalise' the local stock markets by issuing American Depository Receipts (ADR) and Global Depository Receipts (GDR).

Secondly, a merger would provide an opportunity for more efficient trading, clearing and settlement systems to be established. Thirdly, the region's equity markets and their regulators could work together towards upgrading various regulatory and listing requirements to a higher regional benchmark level, so as to offer a more attractive environment for FPI. This could be part of a wider drive to improve corporate governance standards as a whole in the region, the gains from which would extend well beyond the strict confines of FPI and stock market activity, and extend to the wider business and banking community. Fourthly, it would give the Southeast Asian stock markets a united voice in negotiations with other equity and capital markets in any future global consolidation process of the capital market industry. Finally, there should be some positive repercussions for FDI activity in the region, notably with regard to cross-border M&A activity, as M&A deals can be much easier to enact if both companies have their shares traded on the same equity market.

Needless to say, any concerted attempt to merge together the stock markets of Southeast Asia would require considerable commitment by policy-makers and regulators.[18] Bringing uniformity to the differing listing criteria, reporting requirements, trading, fee and commission structures, clearing and settlement systems, accounting standards, market regulatory codes and their enforcement,

computer hardware and software systems, currency denomination and so on, would clearly require an investment of time and effort. But these should be regarded as technical hurdles rather than insurmountable obstacles, and in areas such as listing criteria there is already an organic process towards global harmonisation. On some other technical and regulatory issues, individual stock markets in the region need to upgrade anyway, and so why not work towards a regional standard, and share the costs of doing so?

In some respects at least, the ASEAN Free Trade Area (AFTA) and the ASEAN Investment Area (AIA) frameworks envisage and entail a similar process for trade flows and FDI flows, respectively. Therefore, a regional equity market would provide an equivalent platform for FPI flows. The initiative could be pursued in a gradual form, either in terms of specific stock markets piloting certain elements of the process, or all of the region's main stock markets moving towards a regional benchmark in specific areas, or individual listed companies from different countries participating in a pilot regional equity market. An existing stock market in the region could play host to this initiative, or a wholly new equity market could be gradually developed. Given Singapore's leading position as a financial centre, the city-state might be the most obvious candidate as host to a regional equity market, although the development of electronic trading and virtual trading systems means that the possibly contentious issue of country location becomes somewhat irrelevant and can therefore be largely side-stepped.

There has been much discussion within Southeast Asia, and the wide East Asian region, in recent years as to whether closer financial integration needs to be actively pursued by policy makers. (As earlier chapters in this book have illustrated, companies are well ahead of governments in the field of regional integration, with policy-makers trying to catch up with their corporate peers.) This debate is partly in response to parallel initiatives in other regions, most notably Europe, but is also a logical extension of Southeast Asian integration already achieved in such fields as trade and direct investment, as well as tentative forays into currency swap agreements and early warning systems for financial crises. Much of this regional financial integration debate has been focused around the thorny issue of currency integration, but the issue of capital markets – including stock markets – is equally pertinent, and arguably more manageable in the near term. It is also an area where some international experience has been gained, such as: Euronext (the merger of several European bourses); Virt-x (entailing the migration of most major Swiss firms from the Zurich stock market, and some other European firms, to a new stock market in London); and even talk of merging the various Caribbean equity markets.

Should there be insufficient appetite amongst most ASEAN member countries to pursue such an initiative, it is conceivable that select Southeast Asian stock markets will seek to enact alliances or mergers with each other, or go it alone in striking agreements with equity markets in other parts of Asia or even beyond the region (in an echo of the bilateral trade agreements that Singapore has been spearheading, outside of ASEAN). For example, Singapore's SGX, the leading Southeast Asian stock market, has already made some tentative steps in this

regard. Just as some Southeast Asian companies are seeking to enact public share offerings and listings on the world's major equity markets, so too might some of the region's equity markets attempt to better plug into the larger pools of portfolio funds. The primary aim of such a repositioning process would be to capture sufficient economies of scale to maintain a competitive and attractive platform for Southeast Asian companies to raise equity finance through public share issues, and for institutional investors to trade these listed shares.

However, any direct attempt to revive the fortunes of the region's equity markets will also require more indirect – but no less important – initiatives, as part of a holistic policy approach towards equity financing and FPI inflows. First, local stock markets should ideally have both domestic and foreign pools of funds that they can tap. A domestic investor base that is largely made up of individual retail investors – typically with fairly short-term investment strategies, and employing less fundamental analysis techniques – is not a very robust basis on which to rely. Therefore, developing a wider 'hinterland' of both local financial institutions (e.g. life insurance companies and pension funds) and financial products (e.g. mutual funds) that can attract and sensibly allocate domestic funds is essential, as is their sound and consistent regulation. To some extent at least, efforts to foster an equity investment culture has already occurred in a number of Southeast Asian countries, such as Singapore, but much more can be done in this regard, notably in developing local investor appetite and confidence. Care should also be taken in designing additional regulatory demands for foreign investors, such as those intended to inhibit flows of so-called 'hot money'. Whilst the aim of such restrictions may be wholly commendable, they can inadvertently act as a major deterrent towards FPI, particularly if other countries have more liberal regulatory regimes towards foreign investors.[19]

Secondly, stock markets are largely a vehicle for investors to acquire and trade equity positions in local companies. Therefore, efforts to attract FPI must also focus on the underlying 'bed rock' of listed companies – and potential listee companies of the future – in such areas as improved legal rights for minority shareholders, better levels of transparency and corporate governance, and more robust implementation of improved regulations pertaining to corporate behaviour. Here again, Southeast Asian countries could work independently, or a regional effort to attain a higher benchmark could be facilitated through ASEAN. Strides in these directions should be rewarded by increased FPI activity, as perceived investment risks are reduced, and therefore the risk-adjusted returns of local companies become much more appealing to fund managers sitting in the world's financial centres. However, the benefits to be derived from progress made in the field of shareholder protection and legal systems would go well beyond just FPI activity, and extend to improvements the activities of the financial industry and corporate sector as a whole. Further, if the region's stock markets were to ultimately wither, clear improvements made in the regulatory regime (and its enforcement) pertaining to corporate governance, transparency and shareholder rights would allow Southeast Asian firms to enact public share issues and stock market listings overseas more easily and cheaply.

Thirdly, strategies should be found to encourage more companies to list on the stock market, as a way of attaining a better mix of equity and debt financing in the corporate sector. One of the lessons stemming from the Asian economic crisis was that excessive dependence by the corporate sector on commercial bank credit for investment capital needs, as witnessed in a number of Southeast Asian countries, can be perilous, particularly if a credit crunch were to occur. There is often a temptation to offer incentives for companies to list, but these should be used sparingly and with care. Far better to identify and communicate ways in which companies will benefit from a stock market listing, most notably in terms of raising cheaper, more long-term financing, from both public share sales and bank credit alike.[20]

10.5 Concluding remarks

The heavy emphasis placed by Southeast Asian countries on attracting conventional foreign investment projects, and the region's relative success in attracting substantial FDI inflows, is arguably reflected in the region's stock markets – as trading platforms for shares in domestic companies – that currently lack economies of scale and an adequately diverse spread of listed firms. The successful enactment of policy initiatives that would increase and strengthen linkages between local and foreign-invested companies in the region, and support domestic firms in becoming much more integrated with international production networks, might be expected to also strengthen the region's equity markets, primarily through more new listings.

The forces of globalisation – notably with regard to freer capital flows and the spread of international production networks – are making it increasingly difficult, and arguably superfluous, to make distinctions between local and foreign companies. For example, it is difficult to talk meaningfully about the 'nationality' of a company that is headquartered in country A, has dual stock market listings in countries B and C (along with GDR trading in country D), has most of its production assets distributed across subsidiaries and affiliates in countries E to M, generates the majority of its sales in countries and N to Z, and has minority shareholders residing in countries A to Z. The same could also become true of stock markets, where the distinction between local and foreign equity markets – and the companies listed on them – becomes increasingly unclear, and of little relevance. Just as companies are listing on multiple overseas equity markets, stock markets themselves are behaving more like these companies, by fully merging or being acquired, striking alliances, or investing in each other's shares.

The survival of companies primarily depends on the quality and price of the goods and services that they offer, and this is no less true of stock markets. More specifically, the future of FPI flows in Southeast Asia will depend in large part on providing liquid equity markets that offer efficient and cheap trading platforms for both institutional investors wishing to invest, and corporates seeking to raise equity financing.[21] If Southeast Asian countries can consider how they wish to attract institutional investment and develop their equity financing capacity, and

enact the sorts of bold policies that are required, then the future of FPI in the region could be very promising. However, with the exception of VC activity, it may be that future FPI flows into Southeast Asia's corporate sector will be enacted through equity markets that are no longer physically sited in each – or even any – of the region's economies. And if such a development were to radically improve the ability of companies located in the region to raise cheap investment capital for their long-term development, then it is an initiative that probably should be welcomed and embraced, rather than feared and resisted.

Notes

1 As this book focuses on investment activity, portfolio investment in this chapter will pertain solely to equity-related portfolio investment, and not debt instruments, such as corporate or government bonds.
2 The size of the venture capital fund pool in Asia (excluding Japan) was estimated to be over US$68 billion in 2002, according to the 2002 year-end special issue of *Asia Private Equity Review*, although much of this is oriented towards Northeast Asia.
3 Rather like FDI, VC usually entails a 'hands on' investment and can be regarded as particularly attractive, in that the foreign investor provides supplementary non-financial inputs to the investee company in addition to an injection of equity capital. Although a VC investor will not usually seek to get involved in day-to-day management decisions, it typically will assist an investee company in developing its long-term strategy, as well as providing guidance in other areas where it might have prior experience and developed expertise.
4 The terms 'stock market' and 'equity market' are used interchangeably in this chapter.
5 In contrast, in the two decades between 1960 and 1980, just 14 stock markets were opened. Before 1950, there were less than 50 stock markets operating worldwide, of which roughly half were in Europe, and roughly a dozen more were in former British colonies. See Weber and Davis, 2000.
6 Of course, not all countries have sought to divest their state enterprises through IPOs, for various reasons. For example, in countries where insufficient domestic savings and investment pools existed, FDI has often been used as a means of divesting the more attractive state enterprise assets. However, a substantial number have done so, when and where feasible, motivated by both economic and socio-political factors.
7 This halving in their US dollar value was the combined result of both share price reductions and local currency devaluations, which are equally important for foreign portfolio investors that are mostly looking for (risk-adjusted) US dollar returns. The lowest point for Southeast Asia's main equity markets was August 1998, when their aggregate capitalisation dropped to just US$241 billion.
8 Calculations derived from stock market statistics quoted in The *Asian Wall Street Journal*, 15 January 2003.
9 There are a number of plausible reasons for this. Most obviously, for foreign-invested projects enacted by large multinational enterprises (MNEs), it is likely that they have relatively good access to cheap capital in the home country, and therefore the need to conduct an initial public offering in a host country is markedly less than for a local firm.
10 See 'MSCI introduces coming changes for index family', in *The Asian Wall Street Journal*, 11 December 2000.
11 Companies with a free float below 15 per cent are generally excluded from MSCI's indices.
12 A major factor in the growing cynicism towards company research produced by securities companies (the 'sell side') is that the interests of the clients (the 'buy side') may

not always be paramount. For example, frequently changing recommendations on a company, so as to encourage clients to 'churn' their portfolio, from which the securities company then earns commissions on trades. Or in the case of securities companies within larger investment banks, there is concern about the independence of research analysts, and potential pressure placed on them to generate research reports on a listed company that facilitate the bank's relationship with that company in other areas of business.

13 The correlation between the S&P 500 and MSCI Europe–Asia–Far East indices has increased very substantially in recent years, from 25 per cent in 1995 to 78 per cent in 2000. See Brooks and Catao, 2000: 3.

14 For example, the NASDAQ has eight companies from Southeast Asia listed, and the NYSE has five Southeast Asian firms.

15 Such overseas listings are in addition to American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) enacted by some Asian firms, which allow investors in the US and Europe to gain investment exposure to these companies without having to go through the relevant host country stock market.

16 Established in late 1999, the SGX was formed from the merger of the Stock Exchange of Singapore (SES) and the Singapore International Monetary Exchange (SIMEX), and is the region's first integrated securities and derivative exchange. Having been 'demutualised', the SGX is a company, with its shares listed on its own exchange. As Singapore's SGX has noted, increasingly 'issuers and investors are migrating to markets that provide the greatest liquidity and best execution. The traditional value of an exchange is being eroded by the proliferation of electronic communications networks which are positioning themselves as virtual exchanges, and providing a single electronic access to multiple markets.' Quote taken from the SGX website <http://info.sgx.com>

17 The danger of being left with a dormant stock market is a very real one, as a number of countries in Eastern Europe will testify. See Claessens *et al.*, 2000b. In a recent survey of financing in central Europe, *The Economist* (14 September 2002: 10) stated that 'most stockmarkets around Central Europe are dying'.

18 This notion first received public attention in May 2000, when the then central bank governor of Thailand suggested integrating the stock markets of Thailand, Malaysia and Singapore.

19 Whilst there appears to be a tendency for policy-makers to regard stock markets as avenues for hot money, evidence from the Asian economic crisis of 1997–98 is decidedly mixed on this point. If anything, commercial bank credit showed the greatest propensity to withdraw rapidly and substantially from economies impacted by the crisis. Although some foreign portfolio investors (as well as local investors) in the stock market did seek to withdraw their funds during the crisis, there were others (e.g. 'contrarian' investors) who sought to enter at this time, in the hope of acquiring some business assets cheaply. Notably, no foreign commercial banks took similarly contrarian stances in providing new credit during the Asian economic crisis, although some did seize the opportunity to acquire large strategic stakes in troubled local banks.

20 A stock market listing can also make it easier (and cheaper) for a company to raise additional credit from banks, as having met the necessary criteria for listing, banks will usually perceive it as having a lower risk profile than an unlisted company.

21 The chairman of the NYSE was quoted as saying: 'The real battle between exchanges … is no longer about electronics, still less about floors against screens: it is about liquidity and price'. See 'Rise and Fall' (A Survey of Global Equity Markets), *The Economist*, 5th May 2001: 11.

11 ASEAN investment cooperation

Retrospect, developments and prospects

Kee Hwee Wee and Hafiz Mirza

11.1 Introduction

Globalisation means different things to different people. It affects companies and countries in a variety of ways. Increasingly, it imposes on companies and countries the need to be focused, competitive and efficient, in order to better equip themselves for meeting newer and stronger challenges. The globalisation process, changes in corporate investment strategies in servicing global markets, the advancement of technological development, the global liberalisation process and growing competition have pushed companies and countries to search for – and implement – suitable strategies to compete for 'market shares'. It is not uncommon today to see adversaries or competitors cooperating or forming strategic alliances among themselves to service markets, support greater product development and to create value. In a similar way, more and more countries are cooperating to attract foreign direct investment (FDI), partly because of greater competition, and partly as a response to changing investment strategies of multinational firms (MNEs) and the proliferation of regional economic groupings or free trade area arrangements.

The Association of Southeast Asian Nations (ASEAN) is one of the few regions that have long supported regional cooperation in promoting FDI. This chapter describes ASEAN's commitments to strengthening regional investment cooperation by highlighting key developments in the region's concerted efforts in promoting FDI since the 1970s. The chapter also examines how such regional investment cooperation has added value and supported regional competitiveness. The next section describes the dynamics of regional cooperation in attracting FDI. Section 11.3 offers the reasons for ASEAN investment cooperation. Section 11.4 discusses the areas of ASEAN's investment cooperation and the major activities achieved thus far. Section 11.5 evaluates how the regional investment cooperation has contributed to improving the region's – and individual member countries' – competitiveness in attracting FDI. Section 11.6 discusses future prospect for the region's investment cooperation and Section 11.7 concludes.

11.2 Dynamics of regional cooperation in attracting FDI

The potential contribution of FDI to development has been well documented in the literature. The cost–benefit debate on the subject has also been widely argued in

various international fora. While FDI does bring about negative effects to economies, increasingly more and more countries are accepting that, on balance, FDI can generate net positive effects for development.[1] Since the 1980s, worldwide competition for FDI has become more intense, and the promotion strategies employed by countries have also changed. In particular, they have become bolder and more innovative. For instance, promotion strategies have moved from the adoption of market friendly policies centred on liberalisation and the standardisation of treatment of foreign investors, to the establishment of investment boards and the adoption of strategic marketing involving industrial clustering and investment targeting (UNCTAD, 2001). In further responses to the changing global environment and increasing competition, countries continue to develop or adopt ever more aggressive promotion strategies to better market and position themselves in attracting FDI. There is a greater use of digital and communication technology to effectively promote or disseminate timely information to more prospective investors than before. Geo-economic changes in various parts of the world (e.g. the proliferation of regional economic groupings, Free Trade Agreements (FTAs),[2] and sub-regional growth zones) have helped bring about greater and different styles of competition for FDI. The influence in technological development, the changing global FDI environment (including the changing geography of FDI flows), changes in the global industrial landscape, and the volatile international economic situation, are all factors shaping the present and future FDI competitive environment.

The emerging strategy in attracting FDI is on cooperative style arrangements among groups of countries. The future will see heightened cooperation among countries in this form of FDI promotion, and some may form formidable strategic alliances to improve their competitiveness or attractiveness. Another distinguishing feature is that competition for FDI is no longer confined to between countries, but increasingly between regions. For this, and the realisation of synergistic benefits, more countries are likely to submit to a regional approach in attracting FDI. This kind of regional investment promotion will be further shaped by increased regional integration or regional enlargement processes, and the desire to increase competitiveness by providing complementation of locational advantages among integrating groups of countries. Further, the growing network type of investment strategies pursued by MNEs, in linking production units located in different countries across a region, reflects the changing investment strategy of MNEs; and that could further influence promotion strategies in favour of a regional approach. All these factors imply that countries will need to adapt their promotion strategy in response to changing circumstances, new industrial structures and the investment behaviour of MNEs.

The increase in the number of MNEs engaging in regional production networks is, in part, a response to 'synergistic investment opportunities' offered by an integrating region, and the opportunities that an agglomeration of countries within a region creates for greater reductions in operation costs (e.g. automotive investment in ASEAN, Mexico and Latin America). The ability of MNEs to more efficiently utilise regional locational advantages, that complement their overall

production network activities in a total value chain process, is another reason worth emphasising. Regional production strategies enable MNEs to enjoy more conducive investment conditions than in a single country location operation. This allows them to optimise the benefits of economies of scale, maximise production capacity utilisation, increase cost efficiency and internalise ownership advantages.

Countries that do not belong to a regional grouping may become less attractive as an investment location, unless their markets or economies are large, locationally efficient or technologically more advanced. Locational efficiency and market size, among others, are important factors in ensuring competitiveness and in increasing the net value of investment projects. A regional approach can enhance these factors, where an individual country by itself will have difficulty or limited scope in achieving enhanced locational competitiveness associated with the benefits of agglomeration, full capacity utilisation, and in overcoming the handicap of small markets.

The regional approach to attracting or promoting FDI is likely to gain further momentum for the following reasons:

(i) The changing global industrial landscape will influence the manner in which companies operate within specific industries and within a region, due to industrial clustering and agglomeration of interrelated firms. Industrial clustering may become a formidable approach for industrial development, where complementary production units or firms are agglomerated to support production or supply chain systems in a cluster, with the aim of developing a more efficient and productive industry. If industrial clustering becomes a favourable concept for industrial development, then FDI decisions will be influenced more by industrial cluster arrangements and industry-specific motivations. For industrial clustering to work in a regional context, regional cooperation in terms of attracting investment and conditions for the agglomeration of interrelated industrial activities must exist.

(ii) Regional integration and economic cooperation will help improve the competitiveness of regions and of the constituent countries in attracting FDI. For instance, the increase in FDI flows to the MERCOSUR countries and the experience of NAFTA in terms of increased FDI to Mexico can be attributed, in part, to the positive effects of economic integration involving the countries in these regions. The increase in FDI flows to Eastern European countries in recent years is also partly influenced by the EU enlargement process involving these countries. Regional integration will have at least two categorical effects on locational advantage. One, on the region, due to the combined locational advantage contributed by each individual member countries, which allows a greater utilisation of division of labour, industrial clustering and production specialisation. The other will be in influencing the investment strategies of firms, and in changing investors' perceptions of the investment environment of the region and of the respective member countries. Investment cooperation within an integrated region will enhance

competitive advantage, provide an environment where production capacity can be optimised, generate synergies, and other economic and industrial benefits that an individual country by itself may not be able to offer (and hence be less attractive as a location for FDI).

(iii) A strong private sector base is crucial to expanding entrepreneurial skills and generating private capacity to help sustain higher levels of economic development. By attracting suitable FDI, greater private sector development can be achieved as FDI brings along with it foreign business and management skills, including technology, and ideally results in the spillover effects that are important ingredients for growth and industrial progress. These compelling reasons, among others, motivate countries to attract more and higher quality FDI, and a viable approach is to cooperate to attract such capital flows. In a regional context, by promoting greater private sector development through FDI, including joint venture activities, regional integration can also be expedited through investment processes and the linkage of companies and production activities. A strong private sector base means an increase in the capability of firms to undertake FDI and, in particular, intra-regional investment flows.

(iv) In search of greater competitiveness, companies are increasingly finding ways to reduce cost and divest operations that have less competitive advantage. In adding value to the production chain, increasingly more and more companies are outsourcing certain aspects of the production process to other manufacturers. Regional integration and regional investment cooperation facilitate a smoother flow of outsourcing activities, and they also provide an opportunity for an easier sourcing of parts and components within a region. This helps increase location efficiency, where a country will benefit most by harmonising its locational advantages with those of other countries.

There are basically two categories of regional investment arrangements – binding and non-binding approaches. An example of the former is the ASEAN Investment Area (AIA) arrangement, while the latter is typified by the APEC Non-Binding Investment Principles. These regional investment arrangements help to improve the investment environment, image and regimes of countries belonging to the group, and can stimulate FDI location decisions in favour of the region.

11.3 ASEAN regional cooperation in attracting FDI

The reasons for ASEAN countries to cooperate in promoting FDI are evident, and most are similar to those explained in the previous section. However, the more conspicuous reasons are associated with the need to enhance individual country and regional competitiveness through cooperation in promoting ASEAN as an investment region – a regional model of attracting FDI. Another reason is that because of the region's integration process it is natural to include

investment, given that trading arrangements and other aspects of economic cooperation are already part of the region's integration agenda. Clearly, investment cooperation is a subset of a larger regional integration arrangement, but one that can help strengthen the integration process. FDI and MNEs' regional operation strategies are centred on using combined regional locational advantages and involve a regional division of labour, that can help expedite regional integration through the linking of production units and creating a value chain process across the region. Regional integration and investment cooperation are reinforcing factors, and they complement each other by strengthening one another.

Another key reason that helps to explain the ASEAN investment cooperation is the consideration of some countries to negate certain locational disadvantages, such as small individual markets. Further, the spirit of cooperation to meet external challenges and competition is another important factor. The 'AFTA effect' could have also induced the need for greater investment cooperation. AFTA (the ASEAN Free Trade Area) means that a member country with a restrictive investment regime can still be serviced through trade routes, by producing in one country and exporting to the former. Under such conditions, the economic argument for protecting or restricting investment flows to a certain industry or country becomes weak. If an industry or a country's market can be serviced through a trade route, then there is little point in restricting FDI flows, and this realisation may make countries more receptive to investment cooperation.

The global FDI landscape and international business environment of today has changed considerably from the 1970s and 1980s – marked, as it is, by a rapid global liberalisation process and the growing competition for FDI. Not only has there been an increase in the number of countries competing for FDI, but the style and approach of competition for such international capital flows has also changed. What ASEAN is doing today on regional investment cooperation is adapting to these changes and global challenges through strengthening the regional effort in attracting FDI. In this regard, it is important to trace the development of ASEAN investment cooperation to better appreciate the questions of '*why*' and '*how*' the region has moved to a stronger form of investment cooperation involving the implementation of a number of significant investment agreements and action plans.

11.3.1 Early ASEAN investment cooperation

Early ASEAN investment cooperation, while it was limited, can be traced back to the 1970s. Among the major achievements of early investment cooperation was the conclusion of the 1987 ASEAN Agreement on the Promotion and Protection of Investments. Other investment issues were also discussed and were largely confined to investment cooperation and promotion issues. These included an early attempt to study the harmonisation of fiscal incentives, the organisation of investment seminars in cooperation with a number of ASEAN dialogue partners, and discussion on approaches to promote greater FDI flows from Japan, the then EEC

and the USA, including intra-ASEAN direct investment. Investment cooperation matters, such as training and capacity building, were also considered in these early arrangements. Appendix 11.A provides a list of selected investment issues discussed in the early period of ASEAN investment cooperation (1977–94), under the earlier institutional setting.

The early institutional structure and the types of investment issues discussed in ASEAN would have been insufficient as a basis for the more significant model of regional investment cooperation witnessed today. Early investment matters were only discussed as part of business activities under the Committee on Industry, Minerals and Energy (COIME) and the results of COIME meetings – which included, among others, investment issues – were reported to the ASEAN Economic Ministers (AEMs) for guidance or endorsement. COIME was one of the five now-defunct economic committees that helped the AEMs coordinate ASEAN economic cooperation up to 1992.[3] Investment matters were not discussed in a manner as comprehensive or in depth as they are today. This is because, in part, COIME had other roles and major economic matters to cover, and to report to, the ministers. More importantly, the timing was not right, and the conditions were not suitable for a stronger form of investment cooperation or arrangement to take place.

11.3.2 Present ASEAN investment cooperation

It was only in the mid-1990s that a more significantly structured and considerable form of investment cooperation emerged, in terms of institutional arrangements – especially in terms of the comprehensiveness and depth of issues discussed – which led to the formulation of investment agreements that further strengthened the region's investment cooperation process. Significant ASEAN investment cooperation was actually forged in the high inward FDI growth years to, and within, the region, particularly in the period 1994–96. Investment cooperation during this period helped lay the foundation for stronger subsequent arrangements, such as the decision to establish the AIA and the signing of a number of investment agreements and protocols.[4]

Prior to the signing of the Framework Agreement on the AIA in 1998, the 1995 Action Plan and the various specific activities contained in the 1996–98 Work Programme were actively implemented. In drafting the AIA Framework Agreement, the 1995 Action Plan and the companion work programme were taken into account. Some of the work activities implemented in 1995–97 supported the subsequent decision to establish an AIA and the drafting of the AIA Framework Agreement. Among the 1995–97 investment activities that facilitated strengthening ASEAN investment cooperation were the following.

- (i) The implementation of the 1995 Action Plan and Work Programme on Cooperation and Promotion of FDI and Intra-ASEAN Investment.
- (ii) An investment survey in 1996 on more than 248 MNEs with investment activities in the region. The survey covered issues on MNEs' location choice, investment strategies and perception of ASEAN as an investment region.

(iii) The effort to improve or enhance the 1987 ASEAN Agreement on Promotion and Protection of Investments in 1995. The effort subsequently led to the conclusion and signing of the 1996 Protocol to Amend the 1987 Agreement.
(iv) The outcome of an ‘Experts Seminar on the Promotion of Foreign Direct Investment and Intra-ASEAN Investment in the Context of the ASEAN Investment Area’ in May 1996 and a ‘High-level Roundtable for the Formulation of Strategic Plans on Cooperation and Promotion of FDI in ASEAN’ in February 1996.

There is a greater degree of locational complementation in the region today than in the 1970s and 1980s, because of the enlargement of the membership from the ASEAN-6 to ASEAN-10 (see Box 11.1). The newer member countries are at different stages of economic development, while some of the older members have moved to a more advanced level of economic attainment. This provides an environment of ‘locational complementation’ within the region. Further, under the conditions of rapid economic development, some ASEAN countries are increasingly faced with acute constraints on certain factors of productions (e.g. land and labour) where the other members, including the newer ones, have plenty to offer or complement to support regional industrial development. The decision to establish the AFTA in 1992 has also helped pave the way for a strong form of regional investment cooperation.

Unlike in the 1970s and 1980s, more and more companies in some ASEAN countries have become important regional players and have over the years gathered entrepreneurial and international business experience – including financial capabilities – for undertaking productive activities or expanding their existing operations outside their national boundaries, both within and beyond the region.

Box 11.1 Chronology of the establishment and expansion of ASEAN

1967	The Bangkok Declaration to establish ASEAN was signed by Indonesia, Malaysia, Philippines, Singapore and Thailand.
1984	Brunei Darussalam joined ASEAN.
1995	Vietnam joined ASEAN and acceded to all ASEAN Agreements.
1997	Laos and Myanmar joined ASEAN and acceded to all ASEAN Agreements.
1998	Cambodia became the tenth member of the ASEAN family and acceded to all ASEAN Agreements.
1998	The Framework Agreement on the AIA was signed by all member countries and Cambodia acceded to the Agreement.

In recent years, as maintaining cost competitiveness has become a pressing concern, companies (both indigenous Southeast Asian and foreign multinationals) in higher cost ASEAN countries have been forced to relocate their operations (or parts of their operations) to lower cost (labour abundant) member countries – reflecting the 'flying geese' theory of explaining industrial development and the pattern of FDI flows. As a result of rapid private sector development, some ASEAN countries are now significant sources of FDI for the region and this is a crucial underlying factor that further encourages a stronger form of regional investment cooperation today.

In addition, regional investment cooperation has been regarded as an arrangement that yields significant advantages to individual member countries. Hence, regional investment cooperation has been accepted as a means of adding value, creating synergy and enhancing competitiveness in attracting FDI. More importantly, these regional arrangements have not been seen as a negative sum game from the beginning, but as a process whereby something can be gained by each member. It is believed that the regional model can generate significant complementation of locational factors that can sway FDI decisions in favour of the region and, depending on the types of FDI operations, to a particular location within the grouping. So long as FDI is attracted to the region, more spillover benefits can be retained within the region than would prevail otherwise.

11.3.3 ASEAN investment cooperation institutional structures

In February 1993, some of the ASEAN Heads of Investment Agencies (AHIA) met for the first time in a consultative forum in Jakarta. Prior to the consultative forum, the AHIA had never met in an ASEAN setting to discuss investment matters.[5] However, the first formal meeting of the AHIA was held in November 1995,[6] and a Working Group on Investment Cooperation and Promotion (WGICP) was established to assist the Senior Economic Officials Meeting (SEOM), with the AHIA to handle regional investment matters. Since then, the institutional machinery for investment has evolved considerably, due to the increasing importance attached to investment cooperation in the region. In 1996, the WGICP was dissolved and all regional investment cooperation matters were taken over by a newly created body of higher ranking officials,[7] known as Senior Officials Meeting on Investment (SOM-I).[8] This development gave more prominence and recognition to the importance of investment issues, in the context of a wider regional economic cooperation arrangement.

In December 1995, the ASEAN heads of government agreed to further strengthen regional economic cooperation to include what is now referred to as the AIA. By 1996, the AEMs, at their meeting in Manila, instructed the officials to formulate an agreement for the development of the AIA. A special ad hoc committee was then established to negotiate and draft the agreement.[9] The committee commenced the drafting work in June 1997 and many meetings were held. In October 1998, the Framework Agreement on the AIA was signed, and subsequently ratified, by all the member countries. The last instrument of

ratification was received in June 1999, and the Agreement has been effectively in force since then. However, implementation of some of the provisions or measures of the AIA commenced almost immediately after the signing of the Agreement, rather than after ratification.

In view of strengthened investment cooperation, the region's institutional structures underwent further development. A ministerial level council (known as the AIA Council) was established to oversee and coordinate the implementation of the AIA Agreement. The Council has met four times since its inaugural meeting in October 1998 in Manila. A Coordinating Committee on Investment (CCI) was established to assist the AIA Council. The Committee meets regularly, on average about four to five times a year, to discuss regional investment matters and AIA implementation issues. A Working Group on Foreign Direct Investment Statistics (WGFDIS) has also been established to assist the AIA Council on all aspects of the regional FDI statistical work. The primary focus of the Working Group is to harmonise FDI measurement, data collection and the reporting system in the region, and to submit to the Council a high quality and comparable FDI data set, on an annual basis, to monitor the AIA's development.

By the late 1990s ASEAN had adopted, and is now committed to, a stronger regional approach in promoting and cooperating in attracting FDI. Specific areas of investment cooperation were intensified and strengthened with an increased frequency of meetings, at various levels, that generated significant results. Various other regional investment agreements have been formulated, signed and ratified to further strengthen the regional approach in attracting FDI. The most significant agreement concluded to date is the agreement to establish an AIA involving the ten ASEAN countries. The agreement and the implementation of its provisions is now the cornerstone of ASEAN investment cooperation.

11.4 Areas of ASEAN investment cooperation

11.4.1 ASEAN investment area agreement

The aim of the AIA is to enhance the competitiveness of the region for attracting higher and sustainable levels of direct investment flows into and within ASEAN. This is to be achieved through actively promoting ASEAN as a competitive region for FDI, with greater investment liberalisation, enhanced investment facilitation and promotion arrangements, including undertaking specific measures to support greater transparency and elimination of investment impediments. The other key features of AIA involve the granting of national treatment, a greater opening up of industries for investment, and to jointly promote ASEAN as a competitive destination for FDI (see Box 11.2). All investment matters are being implemented to realise the regional investment arrangement by the agreed timeframe, which was originally agreed at 2010 for ASEAN investors and 2020 for all investors. The timeframe was considerably shortened at subsequent AIA Council meetings from 2010 to 2003 for the manufacturing sector for ASEAN investors and from 2020 to 2010 for all investors.[10]

Box 11.2 Key measures of the ASEAN Investment Area (stipulated in the original framework agreement on the AIA)

(a) Immediately extend national treatment and open up all industries for investments. However, for some exceptions, as specified in the Temporary Exclusion List and the Sensitive List, these will be progressively liberalised to all ASEAN investors by 2010 or earlier and to all investors by 2020 in accordance with the provisions of the Framework Agreement on AIA. At the Fourth AIA Council Meeting the Council agreed that the 2020 timeframe be shortened to 2010, with Cambodia, Laos, Myanmar and Vietnam reducing their timeframe to 2015.
(b) Identify and progressively eliminate restrictive investment measures.
(c) Liberalise rules, regulations and policies relating to investment; rules on licensing conditions; rules relating to access to domestic finance; and rules to facilitate payment, receipts and repatriation of profits by investors.
(d) Complete implementation of all the measures and activities identified in the Schedule 1 of Cooperation and Facilitation Programme under the AIA Agreement by 2010 or earlier.
(e) Complete implementation of all the measures and activities identified in the Schedule II of Promotion and Awareness Programme under the AIA Agreement by 2010 or earlier.
(f) Improve and enhance the measures and activities of the Cooperation and Facilitation, and Promotion and Awareness Programmes to further strengthen the implementation process of the AIA arrangements.
(g) Undertake active and high profile joint investment promotion activities to promote greater awareness of investment opportunities in ASEAN to global and regional investors. This shall include, among others, joint publications of investment and business information as well as databases and statistics.
(h) Promote freer flow of capital, skilled labour, professionals and technology among ASEAN member states.
(i) Work towards establishing a comparable approach of FDI data collection, measurement and reporting among the member states.
(j) Undertake activities to increase transparency of investment regimes of member states.
(k) Identify areas for technical cooperation in: human resource development, research and development, infrastructure development, small and medium sized enterprises and supporting industry development, information and industrial technology development.

Three broad-based programmes form the thrust of the AIA arrangement. These are the Cooperation and Facilitation, Promotion and Awareness, and Liberalisation Programme.[11] These programmes are being implemented through individual and collective action plans on agreed schedules and timetable.

In addition to the elements contained in the regional investment agreements, ASEAN is also implementing various investment cooperation measures enlisted in the Hanoi Plan of Action (HPA) announced by the ASEAN Leaders at their Summit in Hanoi in 1998. The HPA is time bound. All measures contained in the HPA are to be completely implemented by 2004.

ASEAN investment cooperation is now primarily focused on realising a competitive investment region for FDI through the AIA. The provisions in the various investment agreements, the action plans, the implemented measures and the statements of the ASEAN leaders and ministers all underscore this trend. The various agreements, action plans, work programmes and statements that contributed to strengthening ASEAN investment cooperation include the following.

ASEAN investment agreements

(i) The 1987 ASEAN Agreement for the Promotion and Protection of Investments.
(ii) The 1996 Protocol to amend the 1987 Agreement for the Protection of Investments.
(iii) The 1996 Protocol on Dispute Settlement Mechanism.
(iv) The 1998 Framework Agreement on the AIA.
(v) The 2001 Protocol to amend the 1988 Framework Agreement on the AIA.[12]

Investment action plans and work programmes

(i) Plan of Action on Cooperation and Promotion of FDI and intra-ASEAN Investment, 1995.
(ii) 1996–98 Work Programme to Implement the Plan of Action on Cooperation and Promotion of FDI and intra-ASEAN Investment.
(iii) Initial Work Programme on Investment Promotion, Facilitation and Liberalisation, which appears as annexes of the 1998 Framework Agreement on the AIA.
(iv) Hanoi Plan of Action (investment section).

Investment statements

(i) Chairman of ASEAN Summit – Bangkok Press Statement, 1995.
(ii) Joint Press Statement of the Twenty-eighth ASEAN Economic Ministers Meeting, 12 September 1996, Jakarta, Indonesia.
(iii) Joint Press Statement of the Twenty-ninth ASEAN Economic Ministers Meeting, 16 October 1997, Subang Jaya, Malaysia.

(iv) Joint Press Statement of the Thirtieth ASEAN Economic Ministers Meeting, 7–8 October 1998, Makati City, Philippines.
(v) Sixth ASEAN Summit Statement on Bold Measures, Hanoi, 1998.
(vi) Chairman's Press Statement of the Third Informal ASEAN Summit, 27–28 November 1999, Manila, Philippines.
(vii) Chairman's Press Statement of the Fourth ASEAN Informal Summit, 22–25 November 2000, Singapore.
(viii) Joint Press Statement of the First Meeting of the ASEAN Investment Area Council, 5 March 1999, Phuket, Thailand.
(ix) Joint Press Statement of the Second Meeting of the ASEAN Investment Area Council, 29 September 1999, Singapore.
(x) Joint Press Statement of the Third Meeting of the ASEAN Investment Area Council, 4 October 2000, Chiang Mai, Thailand.
(xi) Joint Press Statement of the Fourth Meeting of the ASEAN Investment Area Council, 14 September 2001, Hanoi, Vietnam.

11.5 The contribution of ASEAN investment cooperation to regional competitiveness

In the period 1999–2001, the AIA Agreement and the HPA's investment provisions were actively implemented. During this period, a total of forty-five investment activities were jointly undertaken to enhance the competitiveness and attractiveness of ASEAN as an investment region. Various specific investment activities were implemented to further open up the investment regime and improve the investment environment in the region. Appendix 11.B provides a detailed listing of selected regional investment activities conducted in the later period of ASEAN investment cooperation (1995–2001). Whether ASEAN investment cooperation has contributed to regional competitiveness and generated greater advantages for individual member countries can be best evaluated by highlighting the regional measures that have been collectively achieved so far. A measure that helped increase the competitiveness and attractiveness of the region should also contribute the same for the individual countries. ASEAN investment cooperation, particularly under the AIA process, albeit at an early stage of implementation, has produced a number of significant results. These include, among others, the following specific 'deliverables': investment promotion, investment facilitation and investment liberalisation.

11.5.1 Investment promotion

In the past three years, efforts have been undertaken to promote ASEAN as an investment region and to help promote greater intra-ASEAN investment, particularly to the newer member countries. These efforts include the following activities:

(i) A series of ministerial-level joint outward investment promotion events to Japan, the USA and Europe were conducted in 2000, to promote investment opportunities in ASEAN to potential investors in these target countries.

(ii) A series of joint CLMV[13] investment seminars in ASEAN capitals were launched in 2001. The first of these was organised by the Thai Board of Investment, Board of Trade of Thailand, Thai Chamber of Commerce and the Federation of Thai Industries and conducted in April 2001 in Bangkok. The aim of the series of CLMV investment seminars is to promote investment opportunities in ASEAN's newer members to investors in the other ASEAN countries.

These joint promotion events convey a strong regional image. They present a concerted effort in promoting FDI and sending a powerful message that investors must think, operate and invest regionally in order to maximise the benefits of a large regional market facilitated by the ongoing integration process. The promotion arrangement in 'selling investment opportunities in the region' could bring about a greater impact and appeal to prospective investors and benefits to all the member countries. For instance, by attending one ASEAN joint promotion event, prospective investors can obtain information on all the member countries and on the region. This provides synergy in terms of promotion efforts, including cost-saving advantages to member countries, and a greater inducement and attraction to attending the joint promotion events from the investors' perspective. In addition, the regional approach to promoting investment opportunities in the newer member countries can derive greater benefits and competitiveness for Cambodia, Laos, Myanmar and Vietnam than would be the case otherwise.

11.5.2 Investment facilitation

In taking advantage of the rapid development in communication and digital technology, a significant outreach facility is being constructed to effectively promote the region's investment environment and opportunities to global investors. The facility known as the ASEAN Investment Portal will form a gateway linking ASEAN to the world, by providing a comprehensive coverage of up-to-date business and investment information on the region. The portal is an important facilitation tool and supports the transparency initiative enshrined in the AIA agreement. Another facilitation arrangement that is in operation is the ASEAN Supporting Industry Database (ASID). The database facilitates an easier sourcing of parts and components, and greater investment in supporting industry in the region. The database, developed and maintained by Thailand's Board of Investment, contains detailed information on more than 11,000 parts and components manufacturers in the region.

Recognising the importance of quality FDI statistics in measuring the development of the AIA arrangement, work on harmonising the FDI statistical system in the region was initiated. Regional FDI statistical cooperation work commenced in 1998, and comprehensive and comparable FDI statistics have been published since 1999. A framework for the harmonisation process has been formulated and is being implemented with the commitment of individual

countries to meeting the 'deliverables'. A work programme and road-map guiding specific harmonisation and compilation deliverables have also been adopted. This work programme should help realise a converged FDI data recording, compiling, measuring and reporting system, to accurately monitor the true extent of FDI flows in the region, to support the AIA process. Aside from harmonising the FDI data system, the FDI data compilers and statisticians have also commenced work on improving FDI data quality, such as on collecting data on cross-border mergers and acquisitions. An annual FDI data set has been regularly submitted to the AIA Council in the past two years, which has subsequently been released to the public. In ensuring that the harmonisation work is on track, a series of capacity building workshops and technical assistance activities have been organised for the newer ASEAN member countries, in a bid to bridge the statistical development gap between the newer ASEAN members and the older ones. A series of regional investment publications and editions have also been prepared and made available to the public, to support greater transparency. The titles listed in Box 11.3 are initial efforts to provide information to help investors better understand the development of the region's investment environment, and assist them in making appropriate investment strategies and planning in the region.

In forging greater private sector involvement in the AIA process, the AIA Ministerial Council incepted a forum, in September 2001, in which major business sector organisations have a regular dialogue with the ministers, to exchange views on investment issues. The forum provides an environment for a two-way dialogue and frank exchange of information. Representatives of major business organisations can be updated regularly on the region's investment environment; and the AIA Council is able to obtain feedback on the effectiveness of the region's investment policies, including the perception of investors on the region's investment environment, and on contemporary corporate investment culture and strategy.

The above investment facilitation activity contributes to making investment processes in the region easier. These facilitation activities have helped generate a more efficient investment and business operation environment. As such, they contribute to increasing ASEAN's competitiveness in attracting FDI. Many of the facilitation activities posed a challenge for member countries to initiate or implement at a unilateral level. But through collective efforts they are easier to achieve, because of peer pressure and regional commitment. Executing a regional investment measure may face fewer obstacles from other departments in a country than a similar measure proposed on an individual basis by a certain national department. These regional facilitation activities help each country move forward in developing a more conducive investment environment through a regional scheduled programme, technical assistance and exchange of experiences.

11.5.3 Investment liberalisation

Greater liberalisation arrangements, on a collective and individual basis, have been – and are being – undertaken. These collective liberalisation efforts have widened and deepened the AIA arrangement, encouraged a considerably shortened

Box 11.3 Investment publications on ASEAN

'Given the purpose and credibility of the AIA in attracting greater levels of FDI, it is equally important that this regional investment arrangement is efficiently promoted to investors. … In support of the transparency and awareness exercise, ASEAN should spare no less effort in producing effective and meaningful investment publications or literatures that are made publicly accessible'.

(*ASEAN Investment Report*, 1999: p.14)

Published titles:

1. Directory of Technology Suppliers in ASEAN, 1998.
2. Handbook of Investment Agreements in ASEAN, 1998.
3. Compendium of Investment Policies and Measures in ASEAN Countries, 1998.
4. Investing in ASEAN: 'A Guide for Foreign Investors', 1999.
5. ASEAN Investment Area Publication Series 1: Temporary Exclusion List and Sensitive List – Manufacturing Sector, 1999.
6. Statistics of Foreign Direct Investment in ASEAN, 1999.
7. ASEAN Investment Report 1999: 'Trends and Developments in Foreign Direct Investment'.
8. ASEAN Investment Map, 2000.
9. ASEAN Investment Area Publication Series 2: Temporary Exclusion List and Sensitive List – Agriculture, Forestry, Fishery and Mining Sector, 2000.
10. ASEAN Investment Area Publication Series 3: Individual Action Plan, 2000.
11. Statistics of Foreign Direct Investment in ASEAN: 'Extended Data Set', 2000.
12. ASEAN Investment Report 2000: 'Challenges and Development'.
13. Facts and Figures: Cost of Investing and Doing Business in ASEAN, 2000.
14. Facts and Figures: Cost of Investing and Doing Business in ASEAN – Extended Variables, 2001 Edition.
15. Statistics of Foreign Direct Investment in ASEAN 2001: Enhanced Data Set.
16. ASEAN Investment Area Facilitation Series 1: Industrial Estates, Free Trade Zones, Export Processing Zones, Science and Technology Parks in ASEAN, 2002.
17. Compendium of Investment Policies and Measures in ASEAN: An Update, 2002.

timeframe and significantly expanded the scope of coverage. The specific liberalisation 'deliverables' include the following.

(i) A protocol to improve the AIA arrangement was signed in September 2001 in Vietnam. The Protocol expanded the coverage of the AIA Agreement to include services incidental to the manufacturing, agriculture, forestry, fishery and mining sector. It also includes a provision shortening the timeframe for the phasing out of the manufacturing sector Temporary Exclusion List (TEL) from 2010 to 2003 to ASEAN investors by Brunei, Indonesia, Malaysia, Myanmar, Philippines, Singapore and Thailand. Cambodia, Laos and Vietnam will have to phase out their manufacturing sector TEL no later than 2010.
(ii) The Temporary Exclusion and Sensitive Lists for the opening up of sectors and granting of national treatment for the manufacturing sector have been submitted by all countries and published for transparency purposes.
(iii) The Temporary Exclusion and Sensitive Lists for the opening up of sectors and granting of national treatment for the non-manufacturing sectors (namely, agriculture, forestry, fishery and mining) have been submitted by all countries and published for transparency purposes.
(iv) The individual action plans of member countries in implementing measures that would further improve their investment environment and which supports the AIA process have been submitted and published for transparency purposes.
(v) Work on identifying and removing investment impediments has started. More work in this area are being planned.
(vi) Work on developing and submitting the Temporary Exclusion and Sensitive Lists for the opening up of sectors and granting of national treatment for sectors covered under services incidental to manufacturing, agriculture, forestry, fishery and mining is still ongoing.
(vii) The ending date of 2020 for all investors has been shortened by ten years for Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand, and by five years for the newer member countries.[14]

11.5.4 Other aspects of ASEAN investment cooperation

Another important area of recent ASEAN investment cooperation is in the area of capacity building, training and bridging the development gap. Capacity building and human resource development programmes have played a central role in strengthening the skills and in advancing the knowledge of ASEAN investment officials. Most of the training workshops were conducted using expertise drawn from within the region, and the sharing of experiences between the more advanced ASEAN countries and the newer member countries. A number of international organisations and institutions in some ASEAN dialogue countries have also assisted in conducting some of the capacity building workshops. A total of fifteen regional joint training workshops and seminars, covering various

aspects of investment issues and concerns, have been conducted since 1999. These training events have helped investment officials to jointly 'brainstorm' and discuss investment issues of importance to the region, and in building mutual confidence. Some of the investment training workshops organised for the benefit of the newer member countries' officials and in bridging the development gap are also highlighted in Appendix 11.B.

11.5.5 Investment surveillance

The AIA Ministerial Council has regularly reviewed the investment situation in the region, and developments around the world. In so doing, the annual ASEAN Investment Surveillance Report, which examines the pattern and characteristics of FDI flows into and within ASEAN, including analysis on topical investment issues and on investment strategy, has been prepared. In 1999, the AIA Council agreed that steps should be taken to facilitate a better understanding of the region's investment situation by investors and the public, and this led to the publication of the annual *ASEAN Investment Report* series (with different emphasis and themes each year).

A study on the relevance of incentives in attracting FDI has been conducted. The study provided an important insight, in that it suggests that investment incentives are relevant in promoting FDI flows if used prudently, under appropriate conditions; and they can, similarly, be an effective tool in influencing FDI location choice. The study also highlighted how investment can be affected by existing impediments in the region, and that ASEAN countries should avoid 'incentives-granting competition'.

The measures depicted here have compelled the Southeast Asian countries to collectively liberalise their investment regimes, to make the region a competitive destination for FDI. Countries that are more restrictive, or move slowly in these regional investment liberalisation arrangements, will be less successful in attracting FDI. In this regard, regional cooperation provides an impetus to improving a country's investment environment faster than would be the case otherwise, and contributes to a swifter enhancement of the region's competitiveness.

11.6 The future of ASEAN investment cooperation and development

A few salient features of the AIA Agreement must be stressed. The agreement constitutes an arrangement, not a scheme, to establish an investment area involving ten member countries. It is a binding instrument and all signatories are to implement the respective provisions contained in the agreement, in accordance with a specific time frame and schedules. The AIA is a widely encompassing arrangement in the sense that several specific schemes aiming at promoting or facilitating FDI flows to the region can be incorporated. The AIA agreement or

arrangement is not part of AFTA. The latter promotes a free flow of trade in goods, while the former is designed to promote and facilitate a freer flow of FDI into and within the region, including the lowering of transaction costs for investing in ASEAN. However, the two agreements or arrangements complement each other, and they will help in creating a more competitive environment for attracting FDI.

The future prospects for ASEAN investment cooperation are good because of the realisation of AFTA in 2002, the ongoing active implementation of the AIA agreement, and the overall regional integration momentum. Member countries are committed to realising AIA and in implementing the measures they collectively negotiated and agreed upon. ASEAN investment cooperation is strongly supported by the implementation of agreements, action plans and the accompanying work programmes. These are some of the instruments that will keep the implementation of the AIA agreement in check. Regular meetings are held geared towards reporting on progress in the implementation of the AIA agreement, and in supporting the annual meetings of the AIA Council and the AEM. The annual ASEAN Summit, which includes investment issues for discussion by the leaders, also adds pressure to fulfilling commitments and enhancing investment development. These meetings are in themselves important driving forces in pushing and adding pressure, in ensuring commitment to implementation by the member countries. In addition, the review process under the AIA agreement and of the 'Hanoi Plan of Action' further adds pressure to ensuring the timely delivery of the AIA. In the last three years, a number of new initiatives have also been undertaken, in addition to the measures stipulated in the AIA agreement, to further strengthen ASEAN cooperation in investment.

Given that all ASEAN countries are desirous in attracting more FDI to finance economic development, the AIA arrangement – as a forward looking mechanism – can in the future be used to introduce or incorporate new initiatives or elements to maintain regional competitiveness. There is no reason why further new initiatives cannot be undertaken to strengthen regional investment cooperation, as well as implementing the AIA provisions. Indeed, trends to introduce new initiatives look set to continue. Under any regional investment cooperation arrangement, it is important that all member countries move together, with some flexibility to be accorded to countries at different stages of development. Undoubtedly, those with restrictive investment policies will lose out in attracting more FDI. In tandem with this argument, the AIA provides a self-reinforcing stimulus in encouraging all member countries in the group to arrive at the final destination together, without any being left behind or disadvantaged.

Regional integration cannot be fully achieved if an investment arrangement is not included. As such, investment cooperation arrangements will continue to remain high on the regional integration agenda. Viewed from another perspective, stronger regional integration processes mean greater regional competitiveness – and this implies a stronger regional position for each individual country to attract healthy levels of FDI flows. With growing levels of FDI, intra-regional

investment and business linkages, as well as growing regional production networks by MNEs, the regional integration processes will be further strengthened. Thus, regional integration, FDI flows and MNE activities help reinforce one another.

One major outstanding challenge in ASEAN investment cooperation is the current trend of declining investment flows into the region, both in terms of share and in absolute amounts, since the 1997 financial crisis. While this development may be a transient concern, there is an urgent need for the region to take more concerted measures to further improve the region's competitiveness in an increasingly competitive global investment environment. For these reasons, ASEAN investment cooperation and the commitment of member countries to realising the AIA must be expedited and strengthened. In summary, for the reasons discussed earlier, the AIA – like AFTA – will be realised in accordance with a time frame and schedules agreed among the signatories to the agreement. Several new investment initiatives taken in the past two years have, in fact, helped strengthen further ASEAN investment cooperation, with the AIA arrangement being deepened and widened.

11.6.1 Role of the ASEAN Secretariat

The ASEAN Secretariat is an important component of the investment institutional structure, and has played a significant role in supporting the development of the investment cooperation and AIA process, particularly since 1995. The Secretariat, working closely with the CCI and WGFDIS, has helped prepare concept, research and policy papers; organised various regional seminars; and run training workshops on capacity building to bridge the development gap between the older and newer members. It has also initiated certain measures, under the guidance of CCI and WGFDIS, on the establishment of various investment databases and statistics. It facilitates liberalisation and harmonisation work activities; and produces regional investment publications for transparency purposes and public consumption. The annual *ASEAN Investment Report* is prepared and coordinated by the Secretariat. The Secretariat, being strengthened and professionalised since 1993, will continue to play an active role in supporting the smooth implementation of the AIA agreement, including any new investment initiatives.

11.7 Conclusion

FDI has played an important role in the industrial and economic development of countries and regions. Partly because of this, competition for FDI has increased and become more competitive among countries, and increasingly between regions. The desire to attract more FDI is, in itself, a principal force pushing countries and regions to continuously improve their attractiveness and competitiveness as locations for investment. In an increasingly competitive global FDI environment, countries can often do better by cooperating as groups, rather than

competing, to attract FDI because of synergy, agglomeration benefits and the larger economic agenda supporting regional integration. This is likely to be the trend of future FDI competition or attraction strategies.

In an era of globalisation, MNEs too are being forced to be more competitive, in order to service markets and organise their operations efficiently. Many are organising their production chains through linking production units located in different parts of the world, or within a region, to benefit from reductions in the overall cost of production. In addition, in responding to regional integration processes, many MNEs have adopted regional investment strategies. Some are consolidating their existing operations within a region to establish a stronger foothold, increase efficiency in servicing markets, and maximise competitive advantages which can be generated by an efficient use of combined regional locational advantages. Others may quickly adjust to regional economic integration, by expanding their investment operations, through a greater division of labour within the entire production chain in a region. Thus, a regional approach to attracting FDI is driven not only by the desire of a group of countries to form an investment zone or bloc, but also in response to MNEs' investment strategies that are increasingly regional-network oriented.

ASEAN investment cooperation started in the 1970s, and early investment cooperation was limited. Since the mid-1990s, ASEAN investment cooperation has evolved considerably, with a strong institutional structure, the formulation of various investment agreements and protocols, and with the explicit aim of realising the AIA, encompassing all ten member countries. The timing of this strengthened arrangement for ASEAN investment cooperation was crucial. An arrangement in its present form would have been difficult to forge in the 1970s and 1980s. Most of the then ASEAN countries were not ready, and probably not able to accept such a significant regional investment arrangement and the high levels of commitment involved. Developments in global FDI activity in the 1990s and heightened competition are further factors explaining the timing of enhanced ASEAN investment cooperation. Finally, recent ASEAN investment cooperation was also facilitated by the development of the institutional structure governing investment matters in ASEAN, especially from the mid-1990s.

The core of the present ASEAN investment cooperation is found in the Framework Agreement on the AIA, the schedules attached to the Framework Agreement, the action plan, and the investment section of the 'Hanoi Plan of Action'. New investment matters or directives, not listed in these documents, emanating from the decisions of the AIA Council and AEM meetings, or the ASEAN Summits, are being – or could be – added to further strengthen the regional investment cooperation investment process. The future of ASEAN investment cooperation will continue to be strong and substantial. This is supported by the implementation of the AIA Agreement, the importance of FDI to the region, the institutional structure that has been put in place, and the desire of the region to enhance competitiveness through undertaking concerted liberalisation, facilitation and promotion initiatives, and because of the regional integration process.

Appendix 11.A: Highlights of selected investment issues in early ASEAN investment cooperation (1977–94)

Date	*Selected meetings/events*	*Selected key investment issues*
27–29 June 1977	Fourth Meeting of the ASEAN Economic Ministers, Singapore	As a step to promote greater flow of trade, investments and business activities in the region, Ministers encouraged the conclusion of bilateral agreements on investment guarantees and avoidance of double taxation between ASEAN countries.
7–8 September 1979	Eighth Meeting of the ASEAN Economic Ministers, Manila, Philippines	Ministers endorsed the establishment of an investment promotion visits programme between ASEAN and Australia. They also approved the negotiating brief for the Permanent Agreement for the establishment of the ASEAN Promotion Centre for Trade, Investment and Tourism in Tokyo. The US proposed ASEAN Trade and Investment Centre in the US were considered.
7–10 November 1979	Ninth Meeting of the Committee on Industry, Minerals and Energy (COIME) of the ASEAN Economic Ministers, Manila, Philippines	The Meeting discussed mechanisms and seminars to promote and enhance greater FDI flows from US to ASEAN. COIME also considered the European Economic Commission (EEC) proposal on a Joint Committee for Regional and Inter-Regional Investment Promotion.
26–27 November 1979	ASEAN–Japan Economic Ministers' Meeting, Tokyo	Ministers discussed several issues relating to trade and investment flows between the two sides, including specific approaches in promoting Japanese FDI flows to ASEAN.
16–17 April 1980	Fifth ASEAN–Australia Forum, Jakarta	Agreement was reached on a Trade and Investment Promotion Programme commencing in July 1981. The programme aimed to facilitate the development of ASEAN exports to Australia and to encourage Australian investment in ASEAN.
30 June to 2 July 1980	Eleventh Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Manila, Philippines	A representative from the US Council for Economic Development presented to COIME a case for a full time ASEAN Investment Coordinating Board in the US.
25–27 September 1980	Twelfth Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Denpasar, Bali, Indonesia	The issue on "Harmonisation of Fiscal Incentives for Foreign Investments" was discussed.

(*continued*)

Appendix 11.A (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
29–30 September 1980	First Meeting of the ASEAN Economic Ministers on Industry, Denpasar, Bali, Indonesia	Ministers agreed that a meeting of the Board of Investments (BOI) be convened to discuss areas where member countries can cooperate in providing information on fiscal incentives and to formulate specific mechanism to facilitate intra-ASEAN investments by the private sector.
24–25 October 1980	Tenth Meeting of the ASEAN Economic Ministers, Bangkok, Thailand	Ministers agreed that a meeting of BOI representatives be convened by COIME in Manila. Ministers agreed that the negotiations on the Agreement to establish the ASEAN Promotion Centre on Trade, Investment and Tourism be finalised by the Secretary-General of the ASEAN Secretariat and that necessary steps be taken.
11–12 December 1980	First Meeting of the ASEAN Boards of Investments, Manila, Philippines	The Meeting recommended that an Experts Group Meeting be established to study the mechanics and other aspects of a proposed ASEAN Investment Guarantee Agreement. Other issues discussed included: (i) possible areas where Member Countries can cooperate in providing fiscal incentives for foreign investments; (ii) formulation of specific mechanisms to facilitate intra-ASEAN investments by private sector; (iii) exchange of information among the member countries on their respective long-term industrial plans and programmes with a view to seeking better cooperation in the economic field; and (iv) discussion on efficient transfer of technology from transnational corporations to ASEAN countries.
16–17 October 1981	Consultation of the Experts Group on ASEAN Investment Guarantee Agreement, Manila, Philippines	The following investment issues were involved: (i) Exchange of information on existing foreign investment policies in the member countries;

		(ii) Examination of the mechanics and all other aspects of an ASEAN Investment Guarantee Agreement.
		The Meeting recommended that a negotiating group be established in late 1982 to commence the formulation of an ASEAN Agreement for the promotion and protection of investments.
28–29 January 1982	Fifth Meeting of the ASEAN–Japan Forum, Jakarta	The two sides discussed approaches to promote greater Japanese FDI to ASEAN. Greater use of the ASEAN Centre on Trade, Investment and Tourism in Tokyo and investment promotion seminars was discussed.
11–13 February 1982	Sixteenth Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Bangkok, Thailand	The Meeting adopted the Report of the Consultation of the Experts Group on the ASEAN Investment Guarantee Agreement, held on 16–17 October 1981, Manila, Philippines.
12–14 May 1982	Seventeenth Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers Meeting, Manila, Philippines	COIME agreed to recommend to the ASEAN Economic Ministers (AEMs) to convene a negotiating group to formulate an ASEANInvestment Guarantee Agreement.
13–15 April 1983	Twentieth Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Manila, Philippines	COIME adopted the Interim Technical Secretariat' Memorandum on ASEAN–Japan Industrial Cooperation and the proposed ASEAN Memorandum on ASEAN Japan Cooperation on Private Investment for presentation at the Sixth ASEAN–Japan Forum on 26–28 May 1983 in Tokyo.
10–12 August 1983	Twenty-first Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Manila, Philippines	COIME discussed with Japan on approaches to increase Japanese FDI to ASEAN.
17–19 October 1983	Fifteenth Meeting of the ASEAN Economic Ministers	Ministers endorsed the work of COIME on investment matters. These included investment promotion through ASEAN investment seminars in Europe in April 1984 and in Japan through the ASEAN Memorandum on ASEAN–Japan Cooperation on Private Investment.

(*continued*)

Appendix 11.A (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
1–3 December 1983	Twenty-second Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Metro Manila, Philippines	COIME discussed with the EEC the preparation and modalities for the ASEAN investment seminars in Europe in April 1984. The investment seminars would include presentations by the ASEAN countries on the following: (i) investment opportunities and incentives; (ii) taxation rules/accounting and auditing requirements; (iii) transfer of technology, protection of intellectual property; (iv) forms of investment.
12–14 December 1984	Twenty-fifth Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Manila, Philippines	The following investment issues were considered: (i) Discussed with the EEC to increase European investment in ASEAN. (ii) Recommendation to create a separate investment directorate in the ASEAN Centre in Japan. (iii) Discussed on approaches to promote greater Japanese FDI in ASEAN.
7–8 May 1984	Sixteenth Meeting of the ASEAN Economic Ministers, Jakarta, Indonesia	Ministers agreed to exchange views on improving the investment climate in ASEAN countries, under the ASEAN–Japan dialogue process.
11–13 December 1985	Twenty-seventh Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Kuala Lumpur, Malaysia	A Proposal on the "Survey and Compilation of Investment Data Relating to Transnational Corporations" was submitted to UNDP. The project was to identify companies in the United States that would be interested to invest in the ASEAN region.
6–8 August 1986	Twenty-eighth Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Manila, Philippines	COIME recommended that the second meeting of the ASEAN Boards of Investments be convened to exchange views on ways of improving intra-ASEAN investments as well as increasing the flow of foreign investments into the region.

8–10 June 1987	Working Group on Investment Meeting (twenty-ninth COIME Meeting), Manila, Philippines	The Meeting discussed the following: (i) "Consolidated List of Foreign Investment Incentives of the ASEAN Countries". (ii) *Draft Investment Guarantee Agreement*.
8–10 June 1987	Twenty-ninth Meeting of the Committee on Industry, Minerals and Energy of the ASEAN Economic Ministers, Metro Manila, Philippines	The following event and investment matters took place: (i) Joint Investment Committees (JICs) of Indonesia, Malaysia and Thailand were convened. (ii) The EEC requested the Boards of Investments of the ASEAN countries to simultaneously run seminars and film show during the ASEAN–EEC Agro-Food Industrial Conference to be held in Bangkok from 30 November to 2 December 1987. (iii) The proposed Symposium on Investment and Transfer of Technology under the ASEAN–Japan Cooperation was discussed. (iv) Follow-up discussion on the following were considered: (a) Draft ASEAN Investment Guarantee Agreement; (b) Consolidated List of Investment Incentives of ASEAN member countries.
3–4 July 1987	Issue Committee Meeting No. 2 of the ASEAN Committee on Industry, Minerals and Energy, Bandar Seri Begawan, Brunei Darussalam	Two major investment issues were discussed. They were: (i) *Harmonisation of Investment Incentives* The Committee prepared a consolidated list of investment incentives in the ASEAN region. A proposal was made for the Heads of ASEAN BOIs to meet to look into the possibility of harmonising incentives in ASEAN. (ii) *ASEAN Investment Guarantee Agreement* The Committee agreed that a multilateral ASEAN investment guarantee agreement for the protection and promotion of intra-ASEAN investments could be drawn up among the ASEAN member countries as an initiative for furthering ASEAN industrial cooperation.

(*continued*)

Appendix 11.A (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
9–11 July 1987	Nineteenth Meeting of the ASEAN Economic Ministers, Singapore	Ministers instructed COIME to initiate negotiations among the appropriate government agencies on the Investment Guarantee Agreement with the view to finalising the Agreement in time for the December ASEAN Summit. Ministers supported the successful conclusion of the negotiations on the future of the ASEAN Promotion Centre (APC) on Trade, Investment and Tourism in Tokyo and the signing of the Memorandum of Understanding for the Extension of the APC Agreement between Japan and ASEAN for a period of five years, beginning 25 May 1987. Ministers endorsed the positive improvement to the Centre and hoped that the Centre, under the newly concluded arrangement, would further facilitate the promotion of ASEAN's manufactured export to Japan, and the inflow of Japanese investments and tourists to ASEAN.
23–25 September 1987	Second Meeting of the ASEAN Boards of Investments, Kuala Lumpur, Malaysia	The Meeting considered the Draft ASEAN Investment Guarantee Agreement and agreed to submit the draft for the consideration of the ASEAN Economic Ministers Meeting. The Meeting recommended that COIME consider the issue on "exchange of information on industrial policies and plans". The Meeting also agreed to strengthen contacts between the ASEAN Boards of Investment by encouraging informal dialogues between the Heads of BOIs. The Meeting also discussed the possibility of harmonisation/coordination of investment incentives in ASEAN and noted that there are differences in the investment incentive system of member countries. Other issues discussed included the ASEAN–EEC approach to promoting investment in ASEAN.
22–24 October 1987	Issue Committee Meeting No. 3 of the ASEAN Committee on Industry, Minerals and Energy, Bandar Seri Begawan, Brunei Darussalam	The draft Agreement for the promotion and protection of investments in ASEAN was refined.

9 December 1987	Informal Meeting of the Committee on Industry, Minerals and Energy Preparatory to the Third ASEAN Summit, Manila, Philippines	The draft Agreement for the promotion and protection of investments in ASEAN was considered. The draft was recommended to the ASEAN economic ministers (AEM) for signing at the Third ASEAN Summit.
9–11 August 1988	Thirtieth Meeting of the Committee on Industry, Minerals and Energy Preparatory to the Third ASEAN Summit, Manila, Philippines	The Meeting discussed investment issues that could be raised to the US under the ASEAN–US Dialogue Mechanism, in particular in promoting greater US FDI to the region.
17–19 October 1988	Twentieth Meeting of the ASEAN Economic Ministers, Pattaya, Thailand	Ministers agreed to encourage greater Japanese investment in the production of industrial goods, utilizing indigenous resources and manpower thereby resulting in more transfer of appropriate technology to ASEAN under the ASEAN–Japan dialogue.
30 November to 1 December 1989	Twenty-first Meeting of the ASEAN Economic Ministers, Bandar Seri Begawan, Brunei Darussalam	Ministers discussed issues tabled at the Uruguay Round of Multilateral Trade Negotiations (URMTN), including the issue on “Trade-Related Investment Measures”.
29–30 October 1990	Twenty-second Meeting of the ASEAN Economic Ministers Meeting, Bali, Indonesia	Ministers noted the following investment issues discussed: (i) *ASEAN–Australia* At the Thirteenth ASEAN–Australia Forum (held in Singapore on 15–17 May 1990), officials and private sectors from both sides continue efforts to further identify and exchange information on ways in which trade and investment between ASEAN and Australia could be enhanced. (ii) *ASEAN–Canada* The Canadian Section of the ASEAN–Canada Business Council agreed to undertake activities including seminars and publications on investment opportunities in both ASEAN and Canada to promote investments. (iii) *ASEAN–Japan* At the twelfth Meeting of the ASEAN–Japan Forum (held on 19–20 September 1990 in Tokyo) investment matters were actively discussed.

(*continued*)

Appendix 11.A (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
7–8 October 1991	Twenty-third Meeting of the ASEAN Economic Ministers, Kuala Lumpur, Malaysia	Ministers discussed investment issues under the various ASEAN dialogue mechanisms: (i) *ASEAN–Canada* Ministers noted that the two-way trade and investment flows between ASEAN and Canada was low and efforts have to be taken to enhance the trade and investment relations. (ii) *ASEAN–EC* Ministers stressed the need to explore ways to increase EC investments into ASEAN. (iii) *ASEAN–US* The private sector representatives from both ASEAN and US attended the tenth ASEAN–US Dialogue on 20–22 June 1991 in Washington DC and requested the governments to facilitate greater investment from US into ASEAN and *vice versa*.
8–9 February 1993	First Consultative Meeting for the Promotion for Foreign Direct Investment in ASEAN Countries, Jakarta, Indonesia	The Meeting exchanged views on a number of key investment issues faced by the region. These included the following: (i) "Challenges Facing ASEAN in Attracting FDI in the Light of World Economic Slowdown and Competition"; (ii) "Strategy for attracting FDI in Small and Medium Scale Projects in ASEAN Countries"; (iii) "Financing Aspects in the Promotion of FDI in ASEAN Countries"; (iv) "Infrastructure Aspects in the Promotion of FDI in ASEAN Countries"; (v) "Cooperation Mechanism for the Promotion of FDI in ASEAN Countries".

		A Memorandum of Understanding among Authorities of ASEAN Countries responsible for Investment Promotion was signed to enhance regional investment cooperation.
7–8 October 1993	Twenty-fifth Meeting of the ASEAN Economic Ministers, Singapore	Ministers stressed that the creation of the ASEAN Free Trade Area (AFTA) would enhance ASEAN's attractiveness for investment.
13–14 June 1994	Meeting of the Working Group on the Promotion of Foreign Direct Investment in ASEAN Countries, 13–14 June 1994, Bali, Indonesia	The Meeting discussed the following investment matters: (i) three working committees were formed at the fringes of the Meeting to discuss specific issues: A Working Committee to consider the Promotion of FDI by Small and Medium Enterprises and Technology Transfer and Human Resource Development; A Working Committee to consider the Infrastructure aspect of FDI Promotion and Promotion of FDI in the Financial Services Sector; and a Working Committee to explore a working relationship between ASEAN Investment Authorities and SEOM; and (ii) ASEAN position on investment matters discussed in APEC and WTO-GATT.

Appendix 11.B: Highlights of selected investment issues in later period of ASEAN investment cooperation (1995–2001)

Date	*Selected meetings/events*	*Selected key investment issues*
1–2 August 1995	First Working Group on Investment Cooperation and Promotion Meeting, Jakarta, Indonesia	The Meeting considered the following: (i) ASEAN Plan of Action for the Promotion of Foreign Direct Investment and Intra-ASEAN Investment; (ii) Investment Promotion Project Proposals (High-Level Roundtable on the Promotion of FDI in ASEAN; Joint Investment Promotion Events in ASEAN Capitals and Abroad: A Concept Paper; Training Course/Workshop for ASEAN Investment Officials; Joint Publications on Investment Environment and Opportunities in ASEAN; Biennial Joint Publication of ASEAN Investment Agencies and the ASEAN Secretariat; Database and Directory of an ASEAN-wide List of Potential Joint Venture Partners: A Concept Paper; Industrial and Investment Familiarisation Tours in ASEAN for Prospective Foreign Direct Investors: A Concept Paper). The Meeting also discussed the following: (i) UNDP ASP-5 Project on Comprehensive Review of Foreign Direct Investment (FDI) in ASEAN; (ii) UNDP ASP-5 Seminar on Foreign Direct Investment in ASEAN in the Context of AFTA; (iii) ASEAN Fair 1995 and ASEAN Regional Investment Seminar; and (iv) Regional Investment Promotional Publications.
27–28 November 1995	ASEAN Heads of Investment Agencies (AHIA) Meeting, Bangkok, Thailand	A first Plan of Action on Cooperation and Promotion of FDI and Intra-ASEAN Investment was finalised. AHIA recommended that the Working Group on Investment Cooperation and Promotion (WGICP) study the possibility of improving the 1987 ASEAN Agreement for the Promotion and Protection of Investments.

		AHIA also considered a concept paper on establishing an ASEAN investment zone as a regional approach in attracting FDI.
14–15 December 1995	Fifth ASEAN Summit, Bangkok, Thailand	The Fifth ASEAN Summit endorsed the Plan of Action and agreed that ASEAN shall implement the present Plan of Action, among other investment measures, to help build ASEAN as a competitive and attractive investment region. The Summit also called for the realization of a bold regional initiative on investment, with the view of attracting higher and sustainable levels of FDI flows to the region. This initiative was later known as the ASEAN Investment Area.
8–9 March 1996	Second Working Group on Investment Cooperation and Promotion Meeting, Brunei Darussalam	Measures to support the realization of the regional initiative on investment were first discussed. New provisions to modify the 1987 ASEAN Investment Agreement and the Work Programme for 1996–98 for implementing the ASEAN Plan of Action on Cooperation and Promotion of Foreign Direct Investment and Intra-ASEAN Investment were identified.
9–10 April 1996	Third Working Group on Investment Cooperation and Promotion Meeting, Singapore	The regional initiative on investment and other aspects of regional investment cooperation matters were extensively discussed.
27 April 1996	Third ASEAN Economic Ministers Retreat, Singapore	Ministers agreed that the regional initiative on investment be called the ASEAN Investment Area (AIA).
23–24 May 1996	Experts Seminar on Promotion of Foreign Direct Investment and Intra-ASEAN Investment in the Context of the ASEAN Investment Area, Bangkok, Thailand	The seminar, organised by the ASEAN Secretariat, was hosted by the BOI of Thailand. A number of recommendations were made to further increase ASEAN's competitive edge and attractiveness for FDI.

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
24–25 June 1996	Fourth Working Group on Investment Cooperation and Promotion Meeting, Bali, Indonesia	Various aspects of investment cooperation matters including measures and approaches for realizing AIA were further developed. The Meeting recommended to AHIA that the 1987 ASEAN Agreement for the Promotion and Protection of Investments be updated with the following additional provisions: (i) transparency and predictability; (ii) simplification of investment procedures and approval process; (iii) dispute settlement; and (iv) accession of new members.
5 July 1996	ASEAN Heads of Investment Agencies Meeting, Shah Alam, Malaysia	The Senior Officials Meeting on Investment (SOM-I) was established to assist AHIA in handling increasing investment cooperation matters. Various aspects of regional investment cooperation matters including the AIA were also discussed. The recommendation to update the 1987 ASEAN Investment Agreement was also endorsed. The preliminary results of the ASEAN survey on investment, based on a sample size of 248 foreign and ASEAN investors, was presented.
14–16 August 1996	ASEAN Legal Experts Meeting, Jakarta, Indonesia	The legal text of the draft Protocol to amend the 1987 Investment Agreement was finalised for signing by the Twenty-eighth AEM Meeting in Jakarta in 1996.
5 September 1996	First Senior Officials Meeting on Investment (SOM-I), Jakarta, Indonesia	Preparation for the AHIA Informal Meeting in Jakarta was discussed. The thirty-two programme of activities contained in the Work Programme to implement the Plan of Action covering 1996–98 were reviewed and prioritised.

6 September 1996	Informal Meeting of the ASEAN Heads of Investment Agencies, Jakarta, Indonesia	Recommendations on the measures and approaches for realising AIA were finalised for the consideration of the Twenty-eighth AEM Meeting in Jakarta. The 32 activities in the Work Programme for 1996–98 were also endorsed.
12 September 1996	Twenty-eighth ASEAN Economic Ministers Meeting, Jakarta, Indonesia	The Protocol to amend the ASEAN Agreement for the Promotion and Protection of Investment was approved and signed.
23–25 September 1996	First Annual Training Workshop for ASEAN Investment Policy-making Officials, Manila, Philippines	The First Annual Training Workshop for ASEAN Investment Policy-making Officials was organised by the ASEAN Secretariat and hosted by the BOI of the Philippines. The Workshop focused on the theme "International Investment Scenario and Investment Business Practices" and was participated by thirty officials from the ASEAN Member Countries, Lao PDR and Cambodia.
24–25 February 1997	High-Level Roundtable for the Formulation of Strategic Plans on Cooperation and Promotion of FDI in ASEAN, Kuala Lumpur, Malaysia	A High-Level Roundtable was organised by the ASEAN Secretariat and hosted by the Malaysian Industrial Development Authority and was attended by more than 120 people. The Roundtable identified and delineated appropriate measures and FDI market positioning/product development strategies for enhancing ASEAN's attractiveness in attracting FDI. The Roundtable made two broad categories of recommendations – a set of policy measures that are broad based while another set of measures are specific to the topics of the papers presented. These recommendations together with that of the comprehensive investment survey helped ASEAN formulate a medium- to long-term strategic plan for intensifying investment cooperation and facilitation.
11–12 March 1997	Second Senior Officials Meeting on Investment, Hanoi, Vietnam	Seven priority projects on investment promotion and facilitation were agreed. These were: (i) Conducting a Study on Business Sectors; (ii) Establishing a Comprehensive Investment Information on ASEAN in CD-ROM; (iii) Producing a Promotional Video Presentation on ASEAN's Investment Environment; (iv) Considering the Convening of an ASEAN Investment Conference in 1998; (v) Production and Publication of a Technology Databank Directory; (vi) Linking of ASEAN Member Countries Websites to the ASEAN Homepage; and (vii) Conducting a Study on Possible Industrial Clustering in ASEAN.

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
19–20 May 1997	Technical Meeting to Review the Report of the Comprehensive Survey on Promotion of Foreign Direct Investment into and within ASEAN, Lombok, Indonesia	The Report of the Comprehensive Survey on Promotion of Foreign Direct Investment into and within ASEAN, specific measures and policy recommendations were reviewed.
16–17 June 1997	First Meeting of the Working Committee on Drafting the Framework Agreement on the ASEAN Investment Area (WCAIA), Kuala Lumpur, Malaysia	The first draft Framework Agreement was deliberated. Twenty possible provisions for the Agreement were identified.
1–2 July 1997	Third Senior Officials Meeting on Investment, Manila, Philippines	Discussions on the preparations for the AHIA Meeting and on various investment issues and projects for the consideration of AHIA were deliberated. Twenty projects, earmarked for funding under the ASEAN–UNDP Sixth Cycle Programme, were finalised for submission to the AHIA for approval.
3–4 July 1997	ASEAN Heads of Investment Agencies Meeting, Manila, Philippines	The AHIA agreed to meet, if and when there is a need, to provide guidance and direction to the Working Committee on the Drafting of the Framework Agreement on AIA (WCAIA). The following activities were endorsed: (i) To hold a number of joint investment promotion events in Asia and Europe in 1998 to promote the investment opportunities in the region to global investors. The joint promotion events will be organised in conjunction with the thirtieth ASEAN Anniversary. (ii) To convene a major ASEAN Investment Conference in conjunction with the Thirtieth ASEAN Anniversary. The Conference would involve ministers of ASEAN Member Countries and world corporate leaders. The twenty projects for UNDP funding were also endorsed.

26–27 August 1997	Second Meeting of the Working Committee on Drafting the Framework Agreement on AIA, Singapore	The scope of the framework agreement, the appropriate mechanism to administer the implementation of the framework agreement and the major deliverables of the AIA were discussed.
11–13 October 1997	Third Meeting of the Working Committee on Drafting the Framework Agreement on AIA, Subang Jaya, Malaysia	The following institutional arrangements for the implementation of the AIA Agreement were recommended: (i) that an AIA Council be established and the Secretary-General of ASEAN be a member of the Council; (ii) that the AHIA shall participate in the AIA Council Meetings; and (iii) that the Coordinating Committee on Investment (CCI) shall report to the AIA Council through the Senior Economic Officials Meeting (SEOM).
10–13 November 1997	Second Annual Training Workshop for ASEAN Senior Investment Policy Making Officials, Bangkok, Thailand	The Second Annual Training Workshop was organised by the ASEAN Secretariat and hosted by the BOI Thailand. The workshop helped the investment officials and investment policy makers better informed on the multi-facets and multi-dimensional aspects of the rapidly changing global investment environment and contemporary international business practices. The Workshop also focused on providing the participants with better understanding of international investment issues such as WTO-TRIMS, GATS, and APEC Non-Binding Investment Principles. More than forty-five ASEAN investment officials participated in the workshop.
10 December 1997	Informal Meeting of the ASEAN Heads of Investment Agencies, Bangkok, Thailand	The development of the AIA Agreement was discussed. Other areas of regional investment cooperation and promotion were also discussed.
16–17 December 1997	Fourth Meeting of the Working Committee on the Drafting of the Framework Agreement on AIA, Kuala Lumpur, Malaysia	In drafting the Framework Agreement, the following issues were extensively discussed and negotiated: (i) opening up of all industries; (ii) granting of national treatment; (iii) definition of an ASEAN investor;

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
		(iv) granting of ASEAN MFN; (v) extension of preferential treatment currently accorded to non-ASEAN based on existing/future bilateral investment agreements between them and the non-ASEAN countries, to ASEAN investors; (vi) institutional machinery; (viii) programme and measures.
1–3 March 1998	Fifth Meeting of the Working Committee on Drafting the Framework Agreement on the ASEAN Investment Area, Brunei Darussalam	The draft Framework Agreement was further formulated. The status of the following three investment projects was noted: (i) ASEAN Supporting Industry Database; (ii) Directory of ASEAN Technology Suppliers; and (iii) Compendium of Investment Policies and Measures in ASEAN.
16 June 1998	Joint Investment Promotion Event in Japan	The Tokyo investment promotion event was organised by the ASEAN Promotion Centre and assisted by the ASEAN Secretariat. The Tokyo event was participated by most of the AHIA and representative of the AHIAs, and was attended by over 300 Japanese business people. The event consisted of a seminar and exhibition which were simultaneously held. The ASEAN delegation also had consultation with senior representatives of Keidanren.
24–25 June 1998	Sixth Meeting of the Working Committee on Drafting the Framework Agreement on the ASEAN Investment Area (WCAIA), Jakarta, Indonesia	The draft Framework Agreement was further refined.
14–15 July 1998	First Meeting of the Task Force on the Collection and Reporting of FDI Statistics in ASEAN	The following were discussed: (i) Terms of Reference of the Task Force on the Collection and Reporting of FDI in ASEAN Statistics.

		(ii) FDI Data Collection, Reporting Procedures and System in ASEAN Member Countries. (iii) Framework and Work Programme on FDI Data Collection and Reporting in the Context of the ASEAN Investment Area.
22–23 July 1998	Fourth Senior Officials Meeting on Investment, Singapore	The following issues were discussed: (i) Progress on the drafting of the Framework Agreement on the ASEAN Investment Area. (ii) Implications on the financial crisis on ASEAN's FDI attraction and exchange of information on investment climate in ASEAN. (iii) Investment inputs to the Hanoi Plan of Action. (iv) Implementation of the ASEAN Plan of Action on Co-operation and Promotion of Foreign Direct Investment and Intra-ASEAN Investment. (v) Collection and Reporting of FDI Statistics in ASEAN. (vi) International investment issues.
24 July 1998	Fourth Meeting of the ASEAN Heads of Investment Agencies	AHIA recognised that there is an urgent need to take concerted measures and actions to improve the conduciveness of the regional investment climate in order to assist in the region's economic recovery process. A number of possible approaches for attracting FDI into the region were discussed and the senior investment officials were requested to study the approaches.
17–18 August 1998	Seventh Meeting of the Working Committee on Drafting of the Framework Agreement on the ASEAN Investment Area, Yangon, Myanmar	The draft Framework Agreement was further refined. Preparation for the AIA Council Meetings was discussed.
17–18 August 1998	Fifth Senior Officials Meeting on Investment, Yangon, Myanmar	The first draft of short-term bold measures to improve the ASEAN investment climate was formulated. To obtain inputs for the short-term measures, it was agreed that a Consultation between SOM-I and the private sector in ASEAN be convened.

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
9 September 1998	Eighth Meeting of the Working Committee on Drafting the Framework Agreement on ASEAN Investment Area, Singapore	Final refinement on the draft Framework Agreement on the AIA was made and the drafts Terms of Reference of the AIA Council and of the CCI were further refined for submission to the AEM and the AIA Council. The Meeting recommended that the three investment publications be launched at the Sixth ASEAN Summit in Hanoi in December 1998. They were: (i) ASEAN Supporting Industry Database; (ii) Directory of ASEAN Technology Suppliers; and (iii) Compendium of Investment Policies and Measures in ASEAN.
9–10 September 1998	Sixth Senior Officials Meeting on Investment (SOM-I), Singapore	A joint dialogue session with the private sector group on possible short-term measures to enhance the attractiveness of the region for direct investment flows was convened. Inputs from the private sector were utilised as one of the bases for the formulation of the tentative baseline of bold package of short-term measures for the promotion period covering 1 January 1999 to 31 December 2000.
4–5 October 1998	Joint Meeting of the Senior Officials on Investment and the Working Committee on the Drafting of the Framework Agreement on ASEAN Investment Area (WCAIA), Manila	The draft text Framework Agreement on AIA was finalised for submission to the AEM for consideration and signing. The draft short-term bold measures was further revised to take into account the additional inputs from member countries and private sector. The investment inputs for the draft Hanoi Plan of Action, draft Terms of Reference of the AIA Council, and draft Terms of Reference of the CCI were finalised.
7 October 1998	Thirtieth ASEAN Economic Ministers Meeting, Manila	The Framework Agreement on AIA was signed. The following were also considered and endorsed: (i) the Terms of Reference of the AIA Council; and (ii) the establishment of a task force to develop a comparable approach of FDI data collection and reporting so as to support the AIA process.

		The draft short-term investment measures were considered and the Senior Economic Officials Meeting (SEOM) were requested to convene and finalise the short-term bold measures, including other economic sectors, such as trade, tourism and services.
8 October 1998	Inaugural Meeting of the ASEAN Investment Area Council	The following were discussed: (i) establishment of the CCI; (ii) submission of the initial package of Temporary Exclusion List (TEL) and Sensitive List (SL) for opening up of industries and granting of national treatment.
19 November 1998	Joint Meeting of the Coordinating Committee on Investment and the Senior Officials on Investment, Ho Chi Minh City	The bold measures on investment were further refined and preparations for the presentation of the three investment publications at the ASEAN Summit were discussed.
19–20 November 1998	Special Economic Officials Meeting (SEOM), Ho Chi Minh City	The bold measures on investment were consolidated together with draft proposed bold measures on trade and services.
8–9 December 1998	The Meeting of the ASEAN Senior Economic Officials for the Sixth ASEAN Summit, Hanoi, Vietnam	The Statement of Bold Measures, which included a substantive section on investment, was finalized. The Statement was announced by the Sixth ASEAN Summit in December 1998.
25–26 February 1999	First Meeting of the ASEAN Coordinating Committee on Investment, Manila Philippines	The CCI was established to assist the ASEAN Investment Area (AIA) Council in the implementation of the AIA Agreement. The First CCI Meeting discussed, among others, specific actions to be taken in the implementation of the investment measures contained in the Hanoi Plan of Action and in the AIA Agreement. Discussion also focused on the mechanism, criteria and guidelines for the submission of the TEL and SL for opening-up of industries and granting of national treatment. The Committee also discussed a number of other issues such as accession of Cambodia to the AIA Agreement, work activities for the year and a number of regional investment projects.

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
5 March 1999	First Meeting of the ASEAN Investment Area Council, Phuket, Thailand	The Council discussed the implementation of the AIA Agreement, including specific actions to be taken. These included the following: (i) Principles and criteria for the submission of the final TEL and SL for the sectors covered by the Agreement. (ii) Status of ratification of the AIA Agreement. (iii) Inclusion of manufacturing services and services incidental to agriculture, fishery, forestry and mining under the AIA Agreement. (iv) Work programme and other implementation matters pertaining to the AIA Agreement. Ministers agreed that comparable FDI statistics should be achieved and be reported to the Council to support the AIA process.
6–7 March 1999	Second Meeting of the ASEAN Coordinating Committee on Investment, Singapore	The CCI discussed and reviewed the implementation of the investment activities and work programme under the AIA. Specific approaches to support capacity building and facilitate the development of the ASEAN Support Industry Database were discussed. Recognising the importance and usefulness of the work of the Task Force on the Collection and Reporting of FDI Statistics in ASEAN to the AIA process, the Task Force was elevated to the status of a Working Group.
31 May to 2 June 1999	Second Technical Meeting of the Task Force on the Collection and Reporting of FDI Statistics in ASEAN, Kuala Lumpur, Malaysia	A basic set of comparable investment statistics was agreed for submission to the Second AIA Council Meeting in September 1999 in Singapore. A framework for guiding the work on establishing a harmonised FDI data collection and reporting system in ASEAN was finalised. The Framework covers the following key elements: (i) establishing Comparable FDI Data System; (ii) FDI Data Reportage and Presentation; (iii) human Resources Development Programme for ASENA FDI Statisticians;

		(iv) FDI Capacity Building Programme; (v) international Networking and Cooperation Programme; and (vi) preparation of Annual ASEAN Investment Report.
29–30 July 1999	Third Meeting of the ASEAN Coordinating Committee on Investment, Jakarta, Indonesia	The Committee discussed and agreed on a wide range of technical issues, including criteria for drawing up the list of manufacturing services and other aspects of AIA implementation matters.
30 July 1999	Ninth Meeting of the ASEAN Senior Officials on Investment, Jakarta, Indonesia	The senior investment officials discussed arrangements for convening a series of possible Joint Investment Promotion Events in Japan, US and Europe.
6–7 September 1999	Second Technical Workshop on the Collection and Reporting of FDI Statistics in ASEAN, Bali, Indonesia	The workshop brought together ASEAN FDI statisticians from the investment agencies, central banks and central statistical offices of the respective countries to work on a regional basis of improving FDI data quality and various aspects of FDI data harmonisation issues. The following matters were deliberated: (i) Joint IMF/OECD Survey on Implementation of Methodological Standards for FDI Data Collection; (ii) Improving FDI Data Quality: Measurement and Approaches for Collecting Administrative FDI Statistics in ASEAN; (iii) Approaches for Collecting Administrative FDI Statistics in ASEAN; (iv) Development of Foreign Investment Information System; and (v) Overcoming Hurdles and Obstacles on FDI Data Measurement and Collection. The workshop was funded by the Government of Japan.
7–8 September 1999	Third Technical Meeting of the Task Force on the Collection and Reporting of FDI Statistics in ASEAN, Bali, Indonesia	The first set of comparable FDI statistics in ASEAN for presentation to the Second AIA Council Meeting was finalised. The draft Executive Summary of the ASEAN Investment Report 1999 was also prepared. The Task Force further discussed specific approaches to be taken, collectively and individually, to harmonise FDI data collection in the region.

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
27–28 September 1999	Fourth Meeting of the ASEAN Coordinating Committee on Investment (CCI), Singapore	CCI met to finalise various issues, recommendations and documents for the consideration of the Second AIA Council Meeting.
29 September 1999	Second Meeting of the ASEAN Investment Area Council, Singapore	Council noted and agreed on a number of matters. These included, among others: (i) that the Framework Agreement on AIA had been ratified by all member countries; (ii) that the TEL and SL for the manufacturing sector had been submitted by member countries and the lists be released to the public; (iii) that the Interpretative Notes to implement the Framework Agreement on AIA be released to the public; (iv) that the 1999–2003 CCI Work Programme under the AIA Arrangement was endorsed for implementation; (v) that the first set of Individual Action Plans was considered; (vi) convening of the Joint Investment Promotion Events in Japan, US and Europe. Council agreed to expand the scope of the AIA Agreement to cover services incidental to manufacturing, agriculture, forestry, fishery and mining. Council reviewed FDI development in the region and agreed that the ASEAN Investment Report be published on annual basis to help promote better understanding of investment situation in the region and in enhancing transparency.
30 September 1999	Thirty-first ASEAN Economic Ministers Meeting, Singapore	Ministers noted that since the signing of the Framework Agreement on the ASEAN Investment Area, ASEAN member countries have exerted their best efforts to ensure that the region is open for foreign investments and that national treatment is granted with minimal exceptions. ASEAN has started the process of opening up its closed or restricted industries and sectors for investments. The first step was the preparation of a TEL for the manufacturing sector. Items in this list will be fully open to ASEAN Investors by 1 Jan 2003. The Sensitive List for the manufacturing sector has also been prepared. Both lists are now available to the public.

		ASEAN Joint Investment Promotion Missions Ministers noted that the idea of organising a series of joint ASEAN Investment Promotion Missions to the major developed countries to draw investments back to the region was raised by the Singapore Prime Minister Goh Chok Tong during his visit to Brunei in April 1999. Following PM Goh's proposal, the Ministers also noted that Investment officials have developed the idea further based on an understanding that three investment promotion missions will be organised to Japan, Europe and the USA. The main objectives of the events are to market the ASEAN region collectively for FDI.
10–11 April 2000	National Workshop on ASEAN Investment Area, Phnom Penh, Cambodia	Four National Workshops on the AIA process were held in Cambodia, Lao PDR, Myanmar and Vietnam. The workshops were hosted by the respective investment agencies of the four ASEAN countries and organised by the ASEAN Secretariat with the support from the Hanns Seidel Foundation. Each workshop was participated by about forty senior officials from various ministries.The workshops focused on the following topics:
18–19 April 2000	National Workshop on ASEAN Investment Area, Vientainne, Lao PDR	
25–26 April 2000	National Workshop on ASEAN Investment Area, Ha Noi, Vietnam	(i) marketing a Country for FDI (policy Environment, Requirements and (ii) commitments of member countries to implement the AIA Agreement; and (iii) trends and development of FDI in the Global Context, in ASEAN and Promotion Strategies); in the CLMV countries.
5–6 May 2000	National Workshop on ASEAN Investment Area, Yangon, Myanmar	
8 May 2000	Fourth Meeting of the Task Force on the Collection and Reporting of FDI Statistics in ASEAN, Subic Bay, Philippines	The Task Force members met to review the statistical work and agreed to transfer all pending and unimplemented work activities to the Working Group. The Task Force was subsequently dissolved.

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
10–11 May 2000	First Meeting of the Working Group on Foreign Direct Investment Statistics in ASEAN, Subic Bay, Philippines	The following foreign direct investment (FDI) statistical issues were discussed and agreed at the first Working Group meeting: (i) terms of Reference of the Working Group; (ii) submission of necessary data to the ASEAN Secretariat on regular basis; (iii) preparation of ASEAN Investment Report (AIR) 2000; (iv) submission and publication of investment application forms and coding forms; (v) establishing a common, comprehensive, harmonised ASEAN methodology for the collection, analysis and reporting of FDI data; (vi) preparation of wider coverage of "FDI Statistics in ASEAN", edition 2000; (vii) cooperation on improving FDI data measurement, collection and reportage in ASEAN; (viii) workshop for ASEAN FDI statisticians to resolve technical data issues; and (ix) establishment of ASEAN MNEs Database.
15–16 May 2000	ASEAN Joint Investment Mission to New York, United States of America	The second joint investment mission covering three major US cities (i.e. New York, Minneapolis and San Jose) was conducted between 16–19 May 2000. The mission was led by the Minister for Trade and Industry of Singapore.
17–18 May 2000	ASEAN Joint Investment Mission to Minneapolis, United States of America	
19 May 2000	ASEAN Joint Investment Mission to San Jose, United States of America	
21–22 May 2000	ASEAN Joint Investment Mission to London, United Kingdom	The third joint investment mission covering three key European cities (i.e. London, Paris and Munich) was conducted between 22 and 26 May 2000. The mission was led by the Minister of the Prime Minister's Office (in charge of investment) of Thailand. The Secretary-General of ASEAN

23–24 May 2000	ASEAN Joint Investment Mission to Paris, France	and a high-level ASEAN private sector delegation also joined in the European mission and the earlier ones to the USA and Japan.
25–26 May 2000	ASEAN Joint Investment Mission to Munich, Germany	
7–8 August 2000	Eighth Meeting of the ASEAN Coordinating Committee on Investment, Brunei Darussalam	The Committee discussed the development of a protocol to expand and enhance the AIA Agreement, international investment matters, regional investment projects and a joint investment seminar to be held in Tokyo later in the year.
5–7 September 2000	Second ASEAN–China Trade and Investment Seminar, Manila, Philippines	The seminar discussed, among other matters, trade and investment issues and investment situation in ASEAN and China.
11–12 September 2000	Third Technical Workshop on Improving FDI Quality in ASEAN, Bangkok, Thailand	The workshop was organised by the ASEAN Secretariat and Japan Overseas Development Cooperation to resolve technical difficulties in the measurement and collection of FDI data by the ASEAN countries. Among the issues discussed include specific data compilation problems confronted by the member countries, doing estimation and apportionment in FDI data compilation, compilation of mergers and acquisitions data, and interpreting FDI statistics. The workshop was also participated by experts from the IMF and from Japan.
13–14 September 2000	Second Meeting of the Working Group on Foreign Direct Investment Statistics in ASEAN (WGFDIS), Bangkok, Thailand	The ASEAN FDI statisticians met to finalise an extended set of FDI statistics for submission to the Third AIA Council Meeting in Chiang Mai in October 2000. The statisticians also agreed on a road map to guide the work on harmonisation of FDI data system in ASEAN, including specific work activities for the next few years on improving data quality. A number of technical issues were also discussed and specific measures to set the course for future work activities and meetings were agreed.
25–26 September 2000	Ninth Meeting of the ASEAN Coordinating Committee on Investment, Phnom Penh, Cambodia	The Committee met to finalise all work undertaken in the year and to prepare for the Third AIA Council Meeting.

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
4 October 2000	Third Meeting of the ASEAN Investment Area Council, Chiang Mai, Thailand	The Council reviewed the status of the regional investment cooperation and FDI flows in the ASEAN region in the post-crisis period. The Council was pleased with the progress made in the year in relation to the implementation of the AIA Agreement. As a step to further promote ASEAN to global investors and to facilitate investment flows, the Council agreed to launch an ASEAN investment portal. The portal would contain, among others, many aspects of investment information, databases and investment facilitation activities and to act as a gateway linking ASEAN to the world of investors. A business sector-AIA Council dialogue forum is to be launched to facilitate greater private sector involvement in the AIA process. The Council agreed that the following regional publications be launched at the time of the ASEAN Informal Summit in November in Singapore: (i) ASEAN Investment Area Publication Series 2: Temporary Exclusion List and Sensitive List – Agriculture, Fishery, Forestry and Mining Sector; (ii) ASEAN Investment Area Publication Series 3: Individual Action Plan; (iii) Statistics of Foreign Direct Investment in ASEAN: "Extended Data Set", 2000 Edition; (iv) Facts and Figures: Cost of Investment and Doing Business in ASEAN; (v) ASEAN Investment Report 2000: "Challenges and Development"; and (vi) ASEAN Investment Map.
9–10 October 2000	Seminar on Key Issues of Foreign Direct Investment in ASEAN, Kuala Lumpur, Malaysia	The seminar was organised by the ASEAN Secretariat and UNDP to discuss a number of topical issues relating to FDI flows to ASEAN. Among the topics discussed were recent trends and development of FDI in ASEAN, relevance of incentives in attracting FDI, and trends of cross-border mergers and acquisitions in ASEAN.

24 October 2000	Heads of ASEAN Investment Agencies – Japan Chambers of Commerce and Industry (JCCI) Dialogue, Tokyo, Japan	The dialogue involved exchange of views on investment situation in ASEAN between the high-level delegation of ASEAN and the JCCI representatives. The dialogue also discussed investment in the automotive and electrical and electronics industry in ASEAN.
25 October 2000	Joint ASEAN Investment Seminar, Tokyo, Japan	All ASEAN countries participated in the seminar, which was attended by about 300 Japanese business people. The ASEAN countries provided latest investment development, information and the investment climate in the region.
23 November 2000	Informal ASEAN Economic Ministers Meeting of the Fourth ASEAN Informal Summit, Singapore	The six regional investment publications endorsed by the Third AIA Council were launched in conjunction with the Informal Summit.
24 November 2000	Fourth ASEAN Informal Summit, Singapore	Leaders discussed the importance of assisting in the economic development of the CLMV countries by promoting greater intra-ASEAN FDI flows to the newer member countries. Leaders further discussed the importance of the continuous implementation of the AIA Agreement and other regional initiatives. They also discussed the need to accelerate the implementation of AIA and AFTA initiatives.
25 November 2000	ASEAN–Japan Summit, Singapore	Japan's Prime Minister expressed the readiness of Japan to cooperate in promoting trade and investment flow and in economic integration efforts of ASEAN through AFTA and the AIA Agreements.
25 November 2000	ASEAN–China Summit, Singapore	The ASEAN–China Summit discussed the importance of strengthening trade and investment links between ASEAN and China.
25 November 2000	ASEAN–Republic of Korea (ROK) Summit, Singapore	The ASEAN–ROK Summit called for the strengthening of trade and investment ties between ASEAN and ROK.
27–29 March 2001	Fifth ASEAN–ROK Dialogue Meeting, Cebu, Philippinea	The meeting agreed to look into possible mechanisms that would increase FDI inflows between ASEAN and ROK. The Meeting also discussed the need to further enhance ASEAN–ROK investment cooperation.

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
8–9 February 2001	Tenth Meeting of the ASEAN Coordinating Committee on Investments	A number of significant issues were discussed and concluded. They included the following: (i) Protocol to enhance the AIA Agreement. (ii) A concept of an ASEAN Investment Year 2002 campaign with year-long multiprogramme of investment events/seminars, conferences, private sector activities, investment marts, fairs and exhibitions held at regional, sub-regional and national levels. (iii) Format of the First AIA Council–Business Sector Dialogue Forum to be held a day before the Fourth AIA Council Meeting in 2001. (iv) Organisation of CLMV countries investment promotion seminars to help the newer member countries attract greater levels of FDI. Such events will help back-to-back with future CCI meetings.
28–29 March 2001	Third Meeting of the Working Group on Foreign Direct Investment Statistics (WGFDIS), Hanoi, Vietnam	The meeting discussed the following FDI statistical issues: (i) Recent activities undertaken by Member Countries and the ASEAN Secretariat for realising the deliverables endorsed by the Third Meeting of the AIA Council; (ii) Submission of improved FDI data set in 2001 to the AIA Council; (iii) Preparation of ASEAN Investment Report (AIR) 2001; (iv) Capacity building and human resource development programme for ASEAN FDI statisticians; (v) Workshop for ASEAN FDI statisticians to resolve technical data issues; (vi) Data issues on cross-border mergers and acquisitions; and (vii) Development of a database of ASEAN MNEs.
24 April 2001	Workshop on Services Incidental to Manufacturing, Agriculture, Fishery, Forestry and Mining Sectors, Bangkok, Thailand	The workshop provided Member Countries with better understanding on the gray areas between services incidental to manufacturing, agriculture, fishery, forestry, mining sectors and the pure services sectors. The workshop discussed various approaches in which an illustrative list of these sectors could be prepared as a basis to guide Member Countries in drawing up the final list.

25–26 April 2001	Eleventh Meeting of the ASEAN Coordinating Committee on Investments (CCI), Bangkok, Thailand	Among the issues discussed were the following: (i) Preparation of TEL and SL for services incidental to manufacturing, agriculture, fishery, forestry and mining sectors. (ii) Launching of ASEAN Investment Year 2002. (iii) Preparation of the First AIA Council-Business Sector Dialogue Forum. (iv) Preparation of ASEAN Investment Report 2001: *"Foreign Direct Investment and Regional Integration"*.
27 April 2001	Seminar on Investment Opportunities in New ASEAN Member Countries, Bangkok, Thailand	The seminar was organised by several Thai agencies, including the BOI of Thailand to promote investment opportunities in the CLMV countries. About 160 businessmen participated in the seminar.
21–22 May 2001	ASEAN Training Programme on Capacity Building for FDI Statisticians in Cambodia	This series of workshops were sponsored by the Hanns Seidel Foundation (HSF) and organised by the ASEAN Secretariat with the assistance of regional experts from the Malaysian Industrial Development Authority (MIDA), the Bank of Thailand and the Philippines' Central Bank.
24–25 May 2001	ASEAN Training Programme on Capacity Building for FDI Statisticians in Vietnam	Each workshop was attended by a group of 15–20 FDI statisticians and data compilers from the respective national investment agencies, statistical offices and central banks.
4–5 June 2001	ASEAN Training Programme on Capacity Building for FDI Statisticians in Myanmar	The workshops were organised to achieve the following objectives:
7–8 June 2001	ASEAN Training Programme on Capacity Building for FDI Statisticians in Lao PDR	(i) facilitate better understanding of the principles and concepts of FDI data collection and measures needed in improving FDI data quality; (ii) facilitate better understanding of regional cooperation in harmonizing FDI data collection and reporting system in ASEAN; (iii) exchange views and experiences on FDI data compilation, particularly between the older and newer ASEAN member countries; and (iv) identify further technical assistance that may be required to support the work of FDI data compilers and statisticians in the newer ASEAN member countries (need assessment exercise).

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
12–13 July 2001	Twelfth meeting of the ASEAN Coordinating Committee on Investments, Singapore	The Meeting discussed the progress in the implementation of the AIA Agreement and some other investment facilitation initiatives.
6–7 August 2001	Thirteenth Meeting of the ASEAN Coordinating Committee on Investments, Bali, Indonesia	Among the issues discussed and finalised were the following: (i) Additional criteria to classify sectors and activities as services incidental to manufacturing, agriculture, fishery, forestry and mining sectors. (ii) Other implementation matters on AIA Agreement. (iii) Other regional investment cooperation issues.
6–8 August 2001	Workshop on FDI Data Structure and Computerised Database Management Systems, Yangon, Myanmar	The workshop, supported by Japan, was organised by the ASEAN Secretariat. Three participants (from the investment agencies, statistical offices and central banks) from each member country attended the workshop. Experts from Statistics New Zealand, SAS Ltd. and Japan help conducted the workshop. The member countries also exchanged views and experiences along the topics of the workshop. The workshop achieved the following objectives: (i) help the work of ASEAN FDI data compilers and statisticians in harmonising and improving FDI data compilation system; (ii) help ASEAN FDI data compilers and statisticians develop a comprehensive list of FDI data variables and identify systematic approach for coding; (iii) help ASEAN FDI data compilers and statisticians develop a suitable approach for managing and recording the FDI data variables within a computerised system; (iv) enable ASEAN countries generate comprehensive, reliable and timely FDI data set to support the AIA process and facilitate policy design to help achieve the AIA objectives; and (v) enable ASEAN to produce and release better quality FDI statistics on regular basis and promote better understanding of FDI situation in the region.

9–12 August 2001	Fourth Meeting of the Working Group on Foreign Direct Investment Statistics	The meeting discussed the following foreign direct investment (FDI) statistical issues: (i) Status of implementation of the work activities by member countries and the ASEAN Secretariat for realizing the deliverables endorsed by the AIA Council; (ii) Submission of FDI and administrative foreign investment data set to the AIA Council on 14 September 2001 in Hanoi; (iii) Preparation of the ASEAN Investment Report (AIR) 2001: Foreign Direct Investment and Regional Integration and Statistics on FDI in ASEAN: Enhanced Data Set (Edition 2001); (iv) Capacity Building and HRD programme for ASEAN FDI statisticians; (v) Technical cooperation with international organisations and dialogue countries on enhancing regional FDI statistical cooperation and development; (vi) ASEAN MNEs database and development; and (vii) Cross-border mergers and acquisitions in ASEAN.
20–21 August 2001	Second Seminar on Key Issues of Foreign Direct Investment in ASEAN, Kuala Lumpur, Malaysia	The seminar was participated by more than forty-five investment officials from each ASEAN member country, six international and regional experts and the ASEAN Secretariat. The seminar, supported by the Government of Japan, was organised by the ASEAN Secretariat. The following topics were deliberated: (i) recent FDI Flows and technology transfer to ASEAN; (ii) Japanese FDI in ASEAN: historical trends, recent developments and policy; implications; (iii) ASEAN as an investment region: outlook of Japanese investment and operation strategy; (iv) private sector perception of post-crisis investment climate in ASEAN; (v) a practitioner's view on post-crisis investment environment in ASEAN: a competitive analysis; (vi) multilateral investment framework: contribution and challenges to development of host countries.

(*continued*)

Appendix 11.B (Continued)

Date	*Selected meetings/events*	*Selected key investment issues*
		A bilateral consultation between member countries and ASEAN Secretariat on regional investment Issues was also held.
13 September 2001	First AIA Council – Business Sector, Hanoi, Vietnam	The AIA Council conducted two separate consultation fora with business sector organisations from the US and Japan to facilitate greater public–private sector linkage and promote greater FDI flows into the region. The US business delegation was led by the US–ASEAN Business Council. The other US business organisations that participated in the First AIA Council – US Business Sector Forum included representatives from the automotive, logistics and agri-business industry. The Japan business delegation was led by Keidanren. The other Japan business organisations that participated in the First AIA Council – Japan Business Sector Forum included the Japan Automotive Manufacturers Association and the Japan Electronics and Information Technology Association.
14 September 2001	Fourth AIA Council Meeting, Hanoi, Vietnam	Among the issues discussed and concluded by the AIA Ministers included the following: (i) Consideration of an ASEAN investment surveillance report; (ii) Reviewed the implementation of the AIA Agreement; (iii) Shortening of the AIA ending date for all investors; (iv) Conducting an ASEAN competitiveness study; and (v) The Protocol to amend the Framework Agreement on the ASEAN Investment Area was endorsed and signed at the AIA Council Meeting. The Protocol shortened the ending date for the TEL of the manufacturing sector to 2003 instead of 2010 for the original six member countries and Myanmar. Lao PDR, Cambodia and Vietnam will have no later than 1 January 2010 to phase out their TEL for the manufacturing sector. The Protocol expands the coverage of the AIA agreement to include agriculture, fishery, forestry and mining sectors, and services incidental to manufacturing and these sectors.

15 September 2001	Thirty-third Meeting of the ASEAN Economic Ministers, Hanoi, Vietnam	Ministers endorsed the Report and recommendations of the Fourth Meeting of the AIA Council.
5 November 2001	Seventh ASEAN Summit, Bandar Seri Begawan, Brunei Darussalam	Leaders agreed that the realisation of the ASEAN Investment Area should be further accelerated, advancing the end-dates, to enable investors to enjoy benefits earlier. Leaders also agreed that more efforts should be made to remove all remaining impediments and facilitate growth of ASEAN direct investment. Leaders agreed to go beyond the ASEAN Free Trade Area and the ASEAN Investment Area by deepening market liberalisation for both trade and investment.

Notes

1 While it is generally acknowledged that there is a close link between FDI and development, there are also arguments against FDI. For example, in its role in bringing inappropriate technology transfer, and with respect to deteriorating balance of payments in the longer run.
2 Free Trade Agreements (FTAs) are not necessarily confined to the policy framework relating to promotion of trade, as they can also include investment policy arrangements. While most traditional FTAs involved primarily neighbouring countries, recent FTA development indicates that it can be an arrangement involving two or more countries that are not geographical neighbours.
3 The other economic committees were: the Committee on Finance and Banking (COFAB), the Committee on Trade and Tourism (COTT), the Committee on Food, Agriculture and Forestry (COFAF), and the Committee on Transport and Communication (COTAC).
4 As regional investment cooperation strengthens further, as a result of the implementation of the AIA Agreement, a few more protocols are likely to come into being, so as to enhance the Framework Agreement.
5 Some of the AHIAs may have met each other at international fora, but not within an ASEAN type arrangement. In December 1980, the investment boards or agencies of the five founding countries met to discuss specific investment cooperation issues.
6 A few weeks prior to the Bangkok Summit in December 1995, the AHIA considered the concept of an ASEAN investment zone. But it was in the Bangkok Summit that the ASEAN leaders decided and announced the ASEAN free investment area (AFIA). While AFTA is to promote free flow of goods, AFIA – later renamed AIA – is anchored on promoting freer flows of investment, including technology and skilled labour.
7 Mostly at Director-General and Deputy Director-General levels.
8 All the work of the WGICP was assumed by SOM-I.
9 The Committee was known as the ‘Working Committee on the ASEAN Investment Area’.
10 The newer member countries of ASEAN will shorten the timeframe from 2020 to 2015 for all investors. See Joint Press Statement of the Fourth Meeting of the AIA Council, Hanoi, Vietnam, 2001.
11 For details of these programmes see ASEAN, 1998.
12 The protocol improves the 1998 framework agreement, in that it expands the scope of coverage, and puts into effect the shortening of the timeframe from 2010 to 2003 for the manufacturing sector.
13 The term CLMV refers to Cambodia, Laos, Myanmar and Vietnam.
14 See the Joint Press Statement of the Fourth AIA Council Meeting, Hanoi, September 2001.

12 Foreign investment and Southeast Asian economic development

Issues and challenges

Hal Hill

12.1 Introduction

The preceding chapters in this volume examine a diverse set of issues related to foreign direct investment (FDI) into and from Southeast Asia, from an early twenty-first century perspective. These include the diversity of policy regimes and strategies; external competition for FDI, especially from China; trade–FDI connections; the political economy of FDI policy; and the scope for regional cooperation. The purpose of this concluding chapter is to draw out some of these thematic issues, against the broader backdrop of Southeast Asian economic development and the recent FDI literature.

By way of introductory context, it is useful to reflect briefly on what sort of volume this might have been, had it been compiled in the recent past. Specifically, how did the picture look ten, twenty and thirty years ago?

In the early 1970s, FDI policy was very much work in progress (Lindblad, 1998). Most Southeast Asian governments were still grappling with the transition from colonialism to independence. Indonesia was only just beginning to re-engage with the world community. The Indochina war and the possibility of falling dominoes cast a shadow over the region. From the late 1960s, all of the original ASEAN member countries (i.e. Indonesia, Malaysia, the Philippines, Singapore and Thailand) had begun to introduce proactive FDI policies, including the establishment of investment boards offering various fiscal incentives. However, only Singapore offered an unambiguous and coherent welcome.[1] In the other four countries, and particularly the three largest, there was significant nationalist opposition to foreign ownership. Japan's sudden emergence as one of the region's leading sources of foreign investment was regarded with ambivalence. This was manifested dramatically in the form of violent protests on the streets of several Southeast Asian capitals in January 1974, during the ill-fated regional tour of the then Japanese Prime Minister Tanaka. This sentiment also permeated much official policy: foreign firms could enter, but with many – often unworkable – conditions; the commercial regulatory climate was opaque and complex; in response to the trade barriers, multinational enterprises (MNEs) established import-substituting and inefficient 'tariff factories' with predictably disappointing results.

By the early 1980s, a rethink was under way. The 1970s was in important respects a learning experience for policy makers and the business community

alike, and there was dissatisfaction with elements of the strategy. Growth rates in almost all Southeast Asian economies were beginning to slow, for various, mostly interconnected, reasons. Trade liberalisation was in vogue, with the potential to sweep away the old model of FDI into a protected domestic market. The Latin American debt crises were unfolding, deterring foreign investors from the developing world. Moreover, more countries were beginning to compete for FDI, including even China and India. 'New forms' of FDI were emerging, as were new source countries; the latter most importantly included the four Asian newly industrialised economies (NIEs). All these factors contributed to a gradual relaxation of FDI restrictions, and to the search for new approaches to maximize the benefits from the MNE presence.

By the early 1990s, the environment had changed significantly. Booming economic conditions from the late 1980s, now beginning to spread to the Philippines and Indochina, generated both commercial optimism and policy complacence. The world saw Southeast Asia, and East Asia more generally, as the most dynamic region of the global economy. East Asian economic integration was proceeding rapidly, driven by massive economic restructuring in Japan and the NIEs, significant trade liberalisation in the region, and the emergence of the 'global factory' of cross-border vertically integrated manufacturing activities within MNEs, especially in the electronics and auto industries. FDI into Southeast Asia was at record levels. Financial sectors and capital markets were opening up, some times aggressively and with little prudence, resulting in massive short-term capital flows, in magnitude overshadowing FDI flows for several years. Rapidly rising and generally broad-based improvements in living standards ameliorated earlier nationalist sentiment and opposition to foreign ownership. Domestic businesses had become more confident of their capacity to manage the foreign presence, viewing it more as a 'positive sum game' calculus. Consequently, governments also adopted a more relaxed attitude to the foreign presence. China's rapid growth was mostly viewed as complementary to, not in competition with, Southeast Asian economic development. Regional confidence was bolstered by the signing of the ASEAN Free Trade Agreement (AFTA), and the prospect of the Association embracing all ten of the region's nation-states.

In the early twenty-first century, the pendulum has swung yet again, and now more closely resembles the sombre uncertainty of the 1960s. Such a sentiment runs through the contributions to this volume. There is a general consensus that the Asian economic crisis of 1997–98 constitutes a major discontinuity in the region's economic development, especially in its two largest economies, Indonesia and Thailand. In the international business community, Southeast Asia is now clearly overshadowed by China and, possibly, even India. There is concern that officials in Southeast Asia are not sufficiently alert to new policy challenges. These include, for example: a mindset that views FDI primarily as 'green-field' rather than the rapidly increasing post-crisis volumes of mergers and acquisitions (M&As); the rise of the 'new economy' in various guises; and the potential for trans-border cooperation, perhaps with the eventual aim of creating a seamless regional market and business environment.

The organization of this concluding chapter is as follows. Section 12.2 provides a brief overview of some salient trends and issues related to FDI in Southeast Asia. In Section 12.3 we dwell briefly on the special issue of FDI behaviour in periods of economic crisis. The links between trade and FDI are addressed in Section 12.4. Finally, Section 12.5 revisits one of the most commonly debated FDI policy issues, that of fiscal incentives for foreign investors.

12.2 Recent trends and issues

There are mixed trends in FDI flows to and from Southeast Asia since the 1997–98 economic crisis. On the one hand, the region's economic growth momentum has slowed sharply. The political and commercial environment is also characterized by much greater uncertainty, principally in Indonesia and to a lesser extent the Philippines. Although these two countries have traditionally attracted no more than one-third of Southeast Asia's aggregate FDI inflows, the 'contagion of geography' inevitably spills over to its neighbours. It needs to be remembered that these two countries comprise about 60 per cent of Southeast Asia's population. They are also the world's two largest archipelagic nations, with implications for smuggling, piracy, terrorism and other nefarious activities.

Yet crises present both challenges and opportunities. Especially where recovery is swift and durable, as is argued later, economic crisis may well be accompanied by rising FDI. The evidence presented in this volume is that the former effect outweighs the latter for Southeast Asia at present. As Frank Bartels demonstrates in Chapter 5, drawing on UNCTAD's *World Investment Report* database, the region's share of global FDI more than halved between 1993 and 1998 (from 7.3 to 3.3 per cent). Its share of the developing world's total FDI flows also declined, though not as sharply.[2] By contrast, inflows to China, against which Southeast Asian nations now frequently benchmark themselves, continued to be buoyant throughout the period. The region's outward investment share has also declined, the non-Singapore component falling to negligible levels.

Popular comment has arguably magnified the seriousness of these declines, even for Indonesia, the country with the most daunting post-crisis problems. The region's shares were at historically unprecedented levels in the pre-crisis 1990s, and so a more accurate benchmark might be with the 1980s. Moreover, FDI data are notoriously fickle. Balance of payments calculations such as these make no allowance for reinvested earnings, while M&A activities are typically undercounted. It is thought that China's FDI inflows may be overstated by as much as one-third, owing to the 'round-tripping' phenomenon of Chinese funds being coursed through Hong Kong to attract more beneficial foreign investor status. The distinction between 'foreign' and 'domestic' investment is everywhere increasingly blurred.

Nevertheless, it is clear that Southeast Asia faces new challenges in retaining its existing foreign investors and attracting new ones. Several of these challenges are addressed in this volume. Peter Buckley in Chapter 2, for example, worries that some governments may not be aware of, or adapting quickly enough to, the

new international commercial environment which attaches a premium to flexibility. Christopher Dent's analysis in Chapter 3, introducing the notion of 'economic security' and exploring its implications for FDI flows to the region, points in a broadly similar direction.

The old pattern of greenfield FDI, and durable, long-term joint ventures is increasingly being replaced by M&As (especially post-crisis, on which see later) and volatile, opportunistic and short-term relationships. The rise of the 'new economy', even after the collapse of the NASDAQ, presents new challenges. Inert and bureaucratic investment agencies have not changed quickly enough. With the notable exception of Singapore, moreover, these agencies have always struggled with their dual, and potentially conflicting, identities of promoter and regulator of FDI, a point emphasized over a decade ago by Wells and Wint (1991). Nationalist resistance to enforced 'fire-sale' FDI has emerged as a powerful force in the region in the wake of the crisis, even in historically open countries such as Thailand. In turn, such a sentiment has hampered the capacity of investment agencies to promote FDI more vigorously. Perhaps more could have been made of this phenomenon in the volume.

The discussion here refers principally to FDI rather than portfolio and other forms of investment. In the case of portfolio investment, there are in addition a distinct set of policy issues on the reform agenda, particularly the question of capital controls referred to later. There is a general apprehension in the region towards stock markets in the wake of the 1997–98 financial crisis. But, as Nick Freeman in Chapter 10 points out, they are an essential ingredient of financial intermediation and therefore underpin long-term economic development. A well functioning equity market should be able to contribute to raising funds for long-term (non-bank) local corporations, and to play a role in facilitating M&A activity. Moreover, although there are specific policy challenges relating to these flows, many also intersect with a broader FDI and commercial reform agenda. Poor standards of corporate governance, low levels of accountability and transparency, and legal and bureaucratic complexities deter foreign investors, whether they are MNEs, institutional funds managers or direct investors in the stock market.

Nowhere are these new commercial challenges more evident than in the case of China. Here the contributors reflect the range of views evident in broader intellectual, business and policy circles. China's industrial prowess across so many sectors appears so daunting that it prompts Peter Buckley to ask the question 'where is Southeast Asia to find a niche?' Moreover, as Adam Cross and Hui Tan in Chapter 7 argue, the country's accession to the World Trade Organisation is increasing its attractiveness to foreign investors as it joins the international commercial mainstream.

How should the Southeast Asian nations view the rise of China: as a zero or positive sum proposition? There can be no doubting the challenges and, at the micro level, there is much anecdotal evidence of foreign investors either relocating to China, or selecting it over a Southeast Asian alternative. Yet, the big picture is surely a positive sum game. China is now East Asia's principal regional economic dynamo, as Japan and the NIEs were in the recent past. Trade is a two-way

process. China has quickly become a major trading partner for all its southern neighbours and, although its per capita income is still low, it is on the threshold of becoming a sizeable investor. It is active in regional trade diplomacy, too, with its offer – yet to be fully developed – of an ASEAN–China free trade proposal.

Inevitably, the effects within Southeast Asia of the rise of China are uneven. For high-income Singapore, the relationship is clearly a complementary one, and the island state has moved aggressively to build trade and investment ties. Thailand's long history of commerce with China and its dominant Sino-Thai business community have mostly resulted in a relaxed and proactive approach to China. By contrast, lower wage economies such as Indonesia, the Philippines and Vietnam worry about their capacity to compete with China, especially in export-oriented, labour-intensive manufacturing. Even here, however, it would be a mistake to overstate the concerns. Owing to its high-speed development, wages in coastal China are now comparable to those of Indonesia and the Philippines, and higher than in Vietnam. In addition, there is more economic complementarity than a simple comparison of wages and per capita incomes reveals. For example, Indonesia is attractive to China for its rich natural resource base, in which China has already invested. As for the Philippines, it is evolving towards a stronger service sector orientation, given its large numbers of relatively well educated, English-speaking people.

In sum, therefore, and linking back to the earlier argument, China poses immense challenges and opportunities. Forward-looking and proactive governments will benefit significantly from its seemingly inexorable growth. The slow and hesitant reformers will be the losers.

In this context, it is important to bear in mind Southeast Asia's great economic diversity. It is sometimes forgotten that its richest country, Singapore, has a per capita income approximately 100 times that of the poorest. Some countries have always been very open to trade and FDI; Singapore most obviously so, and Malaysia and Thailand also. Others – such as Vietnam, Cambodia and Laos – have only recently reconnected to the global economy after a decade or longer of socialism and international commercial isolation. Myanmar remains something of a pariah international state, and in consequence is largely shunned by all but the most adventurous foreign investors. It therefore makes little sense to think of a single 'Southeast Asian experience' with FDI.

Nick Freeman (Chapter 9) effectively underlines this proposition with a thoughtful discussion of FDI issues in the three transitional economies, most importantly Vietnam. As these countries opened up, there was an initial period of euphoria among foreign investors. By the mid-1990s, however, the mood had cooled significantly. With their very low per capita incomes, these economies are still small, even Vietnam with its 80 million people. Most importantly, the prolonged commercial isolation and prevailing ideology permeating much of the bureaucracy, not to mention the Communist Party, has meant that policy makers frequently have very little understanding of how to manage a foreign commercial presence. They tend to view FDI as primarily a 'green-field' phenomenon, and they generally underestimate the importance of a consistent and predictable

policy environment. Moreover, many of the general problems associated with the business environment are daunting and not quickly remedied: red tape, corruption, insecure property rights, an ill-defined legal environment, poor physical infrastructure, limited financial development, and a reluctance to reform the huge, inefficient and privileged state-owned enterprise sector, to list just the most obvious ones. Finally, there is a danger of overcompensating foreign investors for these acknowledged deficiencies, of offering excessively generous (and unsustainable) fiscal incentives, while neglecting – and in some cases still actively harassing – the domestic private sector.

12.3 FDI and the 1997–98 economic crisis

An understanding of the behaviour of, and policy options for, international capital flows is crucial to crisis resolution. It is therefore instructive to examine the Southeast Asian experience during 1997–98. Sudden capital flight is a central feature of modern economic crises. Crisis economies typically switch quickly from current account deficits to surpluses. On the current account, expenditure switching and absorption effects reduce imports and promote exports. The other side of the coin is that increased economic and political uncertainty in effect means that the rest of the world is no longer willing to finance a crisis economy's current account deficit.

There is also a debate about whether, during a crisis, the behaviour of different forms of capital diverge. In particular, the argument goes, portfolio and mobile capital are more likely to exit a country and short-term debts to be called in. By contrast, it is alleged that FDI flows are typically much less volatile. An alternative view is that these various forms of capital quickly 'transmute' and therefore the distinction is not significant.

The analytical connection between FDI, crisis and recovery starts with the collapse in aggregate demand during a crisis: consumer confidence and therefore expenditure wanes; the capacity for governments to run fiscal deficits is often constrained; domestic investment falls owing to financial fragility and weak domestic demand. Exports are therefore the critical component in the immediate recovery period. Crucial to the latter are MNEs. Given their global market networks and know-how, deeper pockets, and stronger connections to global capital markets, they have the capacity to translate large increases in potential competitiveness (arising from the depreciated currency) into export growth, in turn facilitating economic recovery.

Moreover, post-crisis FDI may well increase, along the lines postulated in Krugman's 'fire-sale FDI' thesis (Lipsey, 2001). Asset prices are now cheaper, owing to depreciated exchange rates, demand contractions and financial collapse. Policy regimes are typically liberalised as part of the government's recovery package. Athukorala (2003) demonstrates that this is precisely what happened in most of the five East Asian crisis-affected countries during 1997–98. In aggregate, there was massive capital flight, principally portfolio investment and short-term debt. However, FDI actually rose modestly.

Of course, much depends on the host country environment. The general presumption is that governments are forced to liberalise the FDI policy environment, hence facilitating increased inflows. But economic crises are frequently accompanied – indeed caused – by political turbulence. Thus, the extent to which FDI can play a role in the recovery process depends substantially on how congenial is the domestic commercial environment. While FDI held up, or even increased, in most of the crisis-affected economies in 1998 and 1999, Indonesia emerged as the region's outlier, with consistently negative flows. As Thee Kian Wie (2003) argues, in the post-Soeharto era the abrupt changes in the political and institutional rules of the game, and the absence of regime credibility in economic management, continue to deter most investors. Even here, however, as Lindblad's (2003) case studies illuminate, there was no wholesale exodus of MNEs from Indonesia. In challenging circumstances, foreign firms adopted various survival strategies. In addition to switching to exports, there were opportunities to buy cheapened assets, to initiate debt–equity swaps, and to introduce product modifications.

The 1997–98 crisis also served as a reminder that restrictions on short-term capital flows are compatible with an open FDI regime, at least in the short-medium term. This is the major conclusion of the controversial Malaysian policy experiment introduced in September 1998.[3] Nevertheless, it is important to note Malaysia's special circumstances: its very open economy, its good quality bureaucracy, and the fact that it has never had a balance of payments crisis. Moreover, the controls were introduced in the context of a sudden and dramatic political crisis – the sacking and gaoling of the Deputy Prime Minister – indicating the government's resolve to implement the controls.

These issues are not extensively discussed in this volume, but the limited discussion pertaining to it is broadly consistent with the analysis here. In response to the crisis, as several authors observe, much of the FDI began to take the form of M&As, especially fire-sale purchase of distressed and much cheapened assets. As Frank Bartels in Chapter 8 notes, M&As are an important but poorly documented part of the region's FDI picture. Data are very weak for Southeast Asia, but he cites figures suggesting that, for the period 1995–98, they accounted for the following shares of total FDI: 41 per cent in Indonesia, 53 per cent in Malaysia, 13 per cent in Singapore, and 39 per cent in Thailand. These activities almost certainly increased immediately after the crisis, as exchange rates and stock markets collapsed.

Bartels speculates, plausibly, that M&A activity in Southeast Asia may have peaked. The most attractive assets may have already been purchased and asset prices have generally begun to recover. There is nationalist resistance to these fire-sale deals, even in Thailand, a country with a traditionally relaxed attitude to the foreign business presence. Policy regimes were perforce very liberal at the height of the crisis, but have begun to tighten as economic recovery has proceeded. Corporate reform has also progressed slowly, thus acting as a continuing deterrence to potential foreign buyers. That is, the latter have difficulty conducting due diligence tests, they do not have a high level of trust of financial statements, and they fear the unpredictable policy environment, including the

possibility of public protests and employee militancy, even in cases of friendly takeovers.

12.4 Trade and FDI

The relationship between trade and FDI is of central importance. Trade and FDI regimes jointly determine the nature of foreign investors and the benefits for the host economy. MNEs are playing an ever more prominent role in the global economy, with crucial implications for countries pursuing an export-oriented development strategy. As a corollary, the notion of industry policy has changed significantly. In this section, we briefly address these issues, drawing where relevant on contributions to this volume.

FDI is now typically: (a) more export-oriented than it was a decade or more ago, (b) less likely to be attracted by the old 'tariff factory' model of production for a protected domestic market, and (c) accounting for an increasing share of host economy exports. Two factors have been driving these trends. The first is the global trend towards lower trade barriers, particularly in manufacturing, and more recently in services. This trend towards liberalisation has been accompanied by a more open posture towards FDI in practically all countries. To varying degrees, therefore, a simultaneous reform of both trade and FDI regimes has occurred, resulting in a fundamental shift in the orientation of MNEs from producing for a protected local market to 'export platforms' and internationally integrated production networks. In other words, there has been a pronounced shift from 'rent-seeking FDI' to 'efficiency-seeking FDI'. A second factor driving this change has been the technological revolutions in transport costs and production technologies. The rise of the 'global factory' has been made possible by much reduced international transport costs and by disaggregated, trans-border production processes, particularly in MNE-intensive industries such as electronics and automobiles.

The link between FDI and exports is therefore critical. It is now much more difficult for latecomer industrialisers to achieve high rates of export growth without MNE participation. The earlier literature on this subject, in which Nayyar (1978) was the dominant study, argued that MNE involvement in export expansion from the NIEs was mostly low by international standards. While this generally remains the case, it is important to note that in both Korea and Taiwan, the MNE share in exports did increase significantly from about the mid-1970s to mid-1980s, as compared to the figures reported by Nayyar for the late 1960s.

In any case, however, and contrary to Nayyar's arguments, there is clear evidence that the strong export performance of developing countries since the 1970s has been closely associated with MNE involvement. By linking individual country data on MNEs' shares in exports with general export data, Nayyar estimated the share of MNEs in total manufactured exports from developing countries to be not more than 15 per cent *c.*1974. Moreover, he found that the share had not registered any significant increase since 1966. By contrast, a similar calculation, based on unpublished estimates prepared by Professor Chandra Athukorala of the Australian National University, suggests that MNEs accounted for 24 per cent of total manufactured exports from developing countries *c.*1980. This figure had

increased to 36 per cent *c.*1990. When Korea, Taiwan and Hong Kong are excluded from the calculations, the latter estimate increases to 45 per cent. Given the massive increase in manufactured exports from China (from $3.4 billion to $129.1 billion between 1990 and 1996), and the increased share of MNEs in this export expansion (from 17 to 48 per cent between these two years), this figure would have surpassed 50 per cent by the turn of the century.

As economies have opened up, the old policy levers of protection and regulation have therefore become increasingly redundant. The emphasis now is on promotion and efficiency. This includes, *inter alia*, more effective industrial extension, domestic R&D and other support schemes, improved physical infrastructure, legal reform and higher quality education. Of course, the importance of these factors will vary among countries, depending on their stage of development and institutional histories and capacities. Within this open economy context, a much discussed issue concerns the challenge of how to 'leverage' the MNE presence, as a means of maximizing the benefits for the domestic economy. In this respect, Singapore is a leader in the Asia Pacific region. Its policy regime has displayed an ability to adjust the policy settings as the economy has shifted quickly from its labour-intensive industrialisation phase to one which is increasingly technology intensive. Its government anticipated the shift out of low-wage activities, and developed several programs to upgrade local capacities. In the case of the Hard Drive Industry, which it pioneered in Southeast Asia, it set up the Magnetic Technology Center, later renamed the Data Storage Institute (see McKendrick *et al.*, 2000).

This was a successful example of efficient industry policy. In addition to its excellent infrastructure, critical for highly trade-intensive industries, the government introduced a Local Industry Upgrading Program, as a means of tapping into MNEs' expertise. Technical skills were upgraded continuously through good quality technical, vocational and tertiary education. As the country began to lose comparative advantage in labour-intensive sectors, the government worked with MNEs to induce them to stay and upgrade, while shedding uncompetitive segments. On-the-job training was facilitated by the Skills Development Fund, funded in part by a levy on foreign workers. The Economic Development Board introduced schemes to fund MNEs' local R&D activities. The Board was highly attentive to these firms' requirements, and was also willing to target specific MNEs it considered would be useful for future industrial growth.

There is a view that, as a tiny, heavily managed city-state, Singapore's experience is not internationally replicable. However, while Singapore's geography, history and political economy are unique, there is no reason why other countries cannot learn from its success. To do so, at least five features would appear to deserve emphasis:

- First, its economy is completely open, and so firms are immediately subjected to some sort of market discipline and test.
- Second, as part of the package to induce MNEs, it offers the world's best physical infrastructure, and an entirely predictable and business-friendly investment climate.

- Third, the government has demonstrated an unrivalled capacity to walk away from mistakes. A highly open economy reveals these mistakes quickly, and Singapore's meritocratic government is not hostage to the usual set of vested interests, which constrain governments from adopting first-best solutions.
- Fourth, the government has revealed a willingness to open its labour market to an extent practically unparalleled among modern nation-states. At least 25 per cent of its workforce is foreign, and a much higher percentage born overseas. With its high salary structure, it is able to recruit in the most cost-efficient labour markets regionally and internationally.
- Finally, Singapore has a seemingly completely incorruptible civil service. Its public sector remuneration is one of the highest in the world, and it is insulated from political pressures. Thus, a selective industrial policy is more likely to be successful there than in practically any other country in the world.

The more that follower countries depart from these features, the less likely this model is likely to be replicable. Indeed, Singapore's neighbours have adopted a more ambivalent and less hard-headed attitude towards FDI, and arguably have not extracted the same benefits from it.

Several contributors to this volume touch on various trade–FDI connections in Southeast Asia. On regional economic cooperation and intra-ASEAN investment flows, the general sentiment is that Southeast Asia ought to be a natural economic zone in which investment activities freely spill across national boundaries as dictated by comparative and competitive advantage factors. Except in special circumstances, most notably the Singapore-based SIJORI economic triangle, this is not occurring. That is, there are cross-border investments, but they are generally treated as 'foreign' in much the same way as are projects emanating from beyond the region. Peter Buckley speculates that regional governments are not sufficiently cognizant of the dynamic evolution of firm clusters, which globally are becoming 'increasingly dispersed and virtual'. Axèle Giroud in Chapter 6 worries that commercial networks in the region are primarily driven by extra-regional MNEs, and that host governments are not being proactive in developing capacities and opportunities.

The challenge here is what governments may usefully do in the post-crisis drive for reform and recovery. Kee Hwee Wee and Hafiz Mirza in Chapter 11 support an activist approach, noting in an optimistic tone that ASEAN has 'long supported regional cooperation in promoting FDI'. They correctly point to the largely ineffectual promotional efforts in the 1970s and 1980s. But they view the ASEAN Investment Area (AIA) initiative, which got underway formally in 1996, as a positive development.

Geography obviously matters in formulating investment strategies. As the events of 1997–98 illustrated graphically, the world does tend to regard Southeast Asia as some sort of integrated economic entity. For example, Thailand's economic difficulties in 1997 quickly spread to its neighbours, even though the merchandise trade flows between Thailand and its neighbours are quite limited. However well managed Singapore may be, its longer-term economic fortunes are

inevitably tied to the region. While there is much scope for coordinated investment promotion activities, Southeast Asian governments thus far appear unwilling to go much further. They do not yet offer 'national treatment' for investors from neighbouring countries and, as Frank Bartels in Chapter 5 notes, there has not been any serious attempt to harmonise their legal and regulatory environments. Moreover, he argues, Singapore, far and away the dominant regional investor, 'seems more likely to divest selectively its FDI stock away from [its neighbours]'.

Singapore's recent and highly activist approach to extra-regional free trade agreements (FTAs), much to the chagrin of its neighbours, will exacerbate such a trend. It might be argued that AFTA and regional economic cooperation would have the opposite effect, consistent with the general presumption that intra-regional FDI flows rise in the wake of concerted regional integration initiatives. However, Amale Scally and Jayasinghe Wickramanayake in Chapter 4 do not detect AFTA having any such impact in Southeast Asia. It could be that it is too early for these effects to be evident in their study, as their data end at 1997, just as AFTA was gathering momentum, and as the AIA came into force. But a more likely explanation is that AFTA is, sensibly in this author's view, a case of 'open regionalism', in which trade concessions have invariably been 'multilateralised' to all its trading partners. Moreover, as noted, the AIA is unlikely to have much effect, certainly in the short-medium term future. Indeed, a striking feature of the post-crisis period has been the renewed dominance of the region's historically dominant investors, the US and Europe, especially in the wake of Japan's prolonged and ongoing economic malaise.

12.5 Fiscal incentives

In the search for post-liberalisation policy instruments to attract FDI, there has also been a temptation to adopt a range of ineffective 'quick fixes'. One of these has been a renewed resort to fiscal incentives, principally tax holidays and various performance-related tax measures. Conceptually, these share much in common with the old tariff factory model, in that they introduce a short-term distortion to attract MNEs. As the leading analysis of the Southeast Asian economies thirty years ago argued, governments '… should try to attract private foreign investment by making their resources (both natural and human) more attractive rather than by making their markets more attractive by tariffs and tax concessions' (Myint, 1972: 90).

Fiscal incentives are symptomatic of a more general deficiency in the investment environment in several Southeast Asian economies, especially those in transition from a socialist to market economy. This is the 'dual economy syndrome', in which certain ownership groups, industries or even firms receive privileged treatment at the expense of others. In the former socialist economies, it takes the form of highly dispersed protection rates across industries, special facilities for the inefficient state enterprise sector, and preferential treatment for foreign firms over domestic private operations (Freeman, Chapter 9). Small- and medium-sized

enterprises owned by non-party interests continue to be regarded with suspicion by much of the bureaucracy. In the open Malaysian economy, firms with *bumiputra* (indigenous) ownership still receive much government largesse, even though affirmative action programs have been officially de-emphasized. In the Philippines, a major division is introduced by the Philippine Economic Zone Authority (PEZA). PEZA-supported firms receive fiscal incentives, have access to better quality infrastructure, are in proximity to international transport facilities, and are exempt from much onerous red tape. It is therefore not surprising that they have performed best in this partially reformed environment (Hill, 2003). Paradoxically, Singapore worries about the dearth of domestic entrepreneurship, while vigorously attracting FDI and offering public sector salaries, which are among the highest in the world.

Returning to the specifics of fiscal incentives, they are a risky and generally costly means of attracting MNEs. They are invariably ‘second-best’, when a first-best approach would be to address at source the unattractive features of the host economic environment. Foreign firms are attracted to commercially profitable and politically stable environments. Surveys of MNEs invariably record these features as the major determinant of their locational decisions when investing abroad. The empirical evidence also supports such a finding. Hong Kong has traditionally eschewed fiscal incentives in favour of a uniformly low tax regime. Indonesia introduced sweeping tax reductions and simplifications in 1984, including the abolition of most incentives, but FDI inflows actually increased strongly in the wake of the mid 1980s reforms (Hill, 1988).

In the absence of regime credibility, foreign investors implicitly discount the value of these incentives because they doubt their fiscal sustainability. A recent study of Caribbean nations’ proliferating fiscal incentives to attract FDI, especially in IT sectors, underlined this point: ‘If anything, the plethora of incentives for different categories of investors in industrial parks may raise uncertainty regarding the stability of concessions and the government’s long-term plans. Simple, transparent, and less distortionary incentives give clear signals for long-term investment’ (Berezin *et al*., 2002: 32).

Finally, fiscal incentives are corruption-prone and may be employed as a de facto instrument of industry policy by agencies without the analytical capacity to devise and implement such programmes. Here also the Indonesian experience before 1984 and post-1998 is instructive. There may be a case for distortions of these kinds in special circumstances. Export processing zones are a second-best instrument of trade liberalisation, but if general reform is judged politically impossible, the zones may be the only means of achieving gradual liberalisation. Similarly, investment incentives may be a useful signalling device in cases where governments are, seeking to press their reform credentials in international business circles. In both cases, the key is to ensure that these are time-bound, transitional approaches. To prevent vested interests proliferating around these initiatives, they should desirably contain clearly defined and non-negotiable sunset clauses.

Notes

1 In the words of the country's principal economic architect, Dr Goh Keng Swee, Singapore '… had no xenophobic hangover from colonialism'. Quoted in Huff, 1994: 36.
2 It should be noted, of course, that 1998 was a low point for FDI to the region, and that flows to several countries began to pick up subsequently, until 2001 when the combined effects of the global recession and over-supply in the world electronics industry again resulted in declining inflows.
3 See Athukorala (2001) for a detailed examination.

Bibliography

Abeysinghe, T. and Forbes, K. (2001) 'Trade linkages and output-multiplier effects: a structural VAR approach with a focus on Asia', *NBER Working Paper* No. 8600, Cambridge, MA: National Bureau of Economic Research.

Abonyi, G. (2000) 'Linking Asia together', *The Asian Wall Street Journal*, 5 December, (editorial page).

Agami, A.M. (2002) 'The role that foreign acquisitions of Asian companies played in the recovery of Asian financial crisis', *Multinational Business Review*, 10(1): 11–20.

Akamatsu, K. (1962) 'A historical pattern of economic growth in developing countries', *The Developing Economies*, 1: 7–13.

Almor, T. and Hirsch S. (1995) 'Outsiders' response to Europe 1992: theoretical considerations and empirical evidence', *Journal of International Business Studies*, Second Quarter: 223–237.

Alting von Geusau, F. and Pelkmans, J. (1982) 'National economic security: perceptions, threats and policies', Tilburg: John F. Kennedy Institute.

Amelung, T. (1992) 'Regionalization of trade in the Asia-Pacific: a statistical approach', *ASEAN Economic Bulletin*, 9(2): 133–148.

Andersen, P.S. and Hainaut, P. (1998) *Foreign Direct Investment and Employment in the Industrial Countries*, BIS Working Paper 61, Basle: Bank for International Settlements, Monetary and Economic Department.

Antonelli, C. (1999) 'The evolution of the industrial organization of the production of knowledge', *Cambridge Journal of Economics*, 23(2): 243–260.

Appelbaum, S.H., Gandell, J., Yortis, H., Proper, S. and Jobin, F. (2000) 'Anatomy of a merger: behavior of organizational factors and processes through the pre–During–Post-Stages' (Part 1), *Management Decision*, 38(9): 649–661; and (Part 2), 38(10): 674–684.

Ariff, M. (1994) 'Open regionalism a la ASEAN', *Journal of Asian Economics*, 5(1): 99–117.

Aristotelous, K. and Fountas, S. (1996) 'An empirical analysis of inward foreign direct investment flows in the EU with emphasis on the Market Enlargement Hypothesis', *Journal of Common Market Studies*, 34(4): 571–583.

Arndt, H. (1996) 'AFTA and after', in J. Tan (ed.), *AFTA in the Changing International Economy*. Singapore: Institute of South East Asian Studies.

Arndt, S.W. (2001) 'Production networks in an economically integrated region', *ASEAN Economic Bulletin*, 18(1): 24–34.

ASEAN–China Expert Group on Economic Cooperation (ACEGEC) (2001), 'Forging closer ASEAN–China economic relations in the twenty-first century', (October).

Association of Southeast Asian Nations (ASEAN) (1998) *Handbook of Investment Agreements in ASEAN*, Jakarta: ASEAN Secretariat.

Association of Southeast Asian Nations (1999) *ASEAN Investment Report 1999: Trends and Developments in Foreign Direct Investment*, Jakarta: ASEAN Secretariat.

——(2000a) *ASEAN Annual Report*, Jakarta: ASEAN Secretariat.

——(2000b) ASEAN Investment Report 2000: Challenges and Development, Jakarta: ASEAN Secretariat.

——(2000c) *Statistics of Foreign Direct Investment in ASEAN (Extended Data Set)*, Jakarta: ASEAN Secretariat.

——(2001) *ASEAN Investment Report 2001: Foreign Direct Investment and Regional Integration*, Jakarta: ASEAN Secretariat.

——(2002) *Statistics of Foreign Direct Investment in ASEAN: Comprehensive Data Set*, Jakarta: ASEAN Secretariat.

Athukorala, P.C. (1998) *Trade Policy Issues in Asian Development*, London: Routledge.

——(2001) *Crisis and Recovery in Malaysia: The Role of Capital Controls*, Cheltenham: Edward Elgar.

——(2003) 'FDI in crisis and recovery: lessons from the 1997–98 Asian crisis', *Australian Economic History Review*, 43(2): 197–213.

Athukorala, P.C. and Hill, H. (2002) 'Host country impact of FDI in East Asia', in B. Bora (ed.), *Foreign Direct Investment: Research Issues*, London: Routledge.

Athukorala, P.C. and Menon, J. (1996) 'Foreign direct investment in ASEAN: can AFTA make a difference?', in J. Tan (ed.), *AFTA in the Changing International Economy*. Singapore: Institute of South East Asian Studies.

Aylward, A. and Glen J. (1999) 'Primary securities markets: cross country findings', Washington, DC: IFC Discussion Paper No. 39 (June).

Balassa, B. (1961) *The Theory of Economic Integration*, London: Allen & Unwin.

——(1967) 'Trade creation and trade diversion in the European Common Market', *The Economic Journal*, 77: 1–21.

Balasubramanyam, V.N. and Greenaway, D. (1992) 'Economic integration and foreign direct investment: Japanese investment in the EC', *Journal of Common Market Studies*, 30: 175–193.

——(1993) 'East Asian foreign direct investment in the EC', in V.N. Balasubramanyam and D. Sapsford (eds), *The Economics of International Investment*. Brookfield: Edward Elgar.

Bandera, V.N. and White, J.T. (1968) 'US direct investments and domestic markets in Europe', *Economics International*, 21: 117–133.

Banerjee, A., Dolado, J., Hendry, D.F. and Smith, G. (1986) 'Exploring equilibrium relationships in econometrics through static models: some Monte Carlo evidence', *Oxford Bulletin of Economics and Statistics*, 48: 253–277.

Banerjee, A., Dolado, J. and Mestre, R. (1998) 'Error-correction mechanism tests for cointegration in a single equation framework', *Journal of Time Series Analysis*, 19(3): 267–283.

Bank of Thailand (1999) *Annual Economic Report* 1998, Bangkok: Bank of Thailand.

Bartels, F.L. (2000) 'International competition and global co-operation', *Journal of Euromarketing*, 9(2): 85–97.

Bartels, F.L. and Freeman, N.J. (2000) 'Multinational firms and FDI in Southeast Asia: post crisis changes in the manufacturing sector', *ASEAN Economic Bulletin*, 17(3): 324–341.

Bartels, F.L. and McGovern, I. (1998) 'Growth centres and industrial policy: towards a workable framework for transitional economies', paper presented at the China International Business Symposium, Shanghai (May).

——(2002) 'Organizational configuration and corporate governance in Southeast Asia: a framework for analysis', paper presented at the Annual Conference of the Academy of International Business, Puerto Rico, June–July 2002.

Bartels, F.L. and Mirza, H. (1999) 'Multinational corporations foreign direct investment in Asia's emerging markets: before and after the crisis – any changes?', *Management International Review*, 39(4): 13–26.

Bartels, F.L. and Pass, C.L. (2000) *International Business: A Competitiveness Approach*, Singapore: Prentice Hall.

Bartlett, C.A. and Ghoshal, S. (1987) 'Managing across borders: new strategic requirements', *Sloan Management Review*, Summer: 6–17.

——(1989) *Managing Across Borders: The Transnational Solution*, Boston: Hutchinson Business Books.

Bederlos, R., Capanelli, G. and Fukao, K. (2001) 'Backward vertical linkages of foreign manufacturing affiliates: evidence from Japanese multinationals', *World Development*, 29(1): 189–208.

Bellak, C. (1996) 'Foreign direct investment from small states and integration: micro- and macroeconomic evidence from Austria', in S. Hirsch and T. Almor (eds), *Outsiders' Response to European Integration*. Series A: Copenhagen Studies in Economics and Management, No.7. Copenhagen: Handelshøjoskolens, Copenhagen Business School Press.

Berezin, P., Salehizadeh, A. and Santana, E. (2002) 'The challenge of diversification in the Caribbean', IMF Working Paper, WP/02/196, Washington, DC: International Monetary Fund.

Berger, P.L. and Hsiao, H.H.M. (eds) (1988) *In Search for an East Asian Development Model*, New Brunswick: Transaction Books.

Bergsman, J. (1999) 'Advice on taxation and tax incentives for foreign direct investment'. Mimeo, <http://www.fias.net/documents/Seminar19990527.doc>.

Best, M.H. (1990) *The New Competition: Institutions of Industrial Restructuring*, Oxford: Polity Press.

Beyer, J. (2002) 'Please invest in our country – how successful were the tax incentives for foreign investment in transition countries?', *Communist and Post-Communist Studies*, 35: 191–211.

Birkinshaw, J. and Hood, N. (1998) 'Multinational subsidiary evolution: capability and charter changes in foreign-owned subsidiary companies', *Academy of Management Review*, 23(4): 773–795.

Bloom, D.E. and Noor, W. (1995) 'Is an integrated regional labor market emerging in East and Southeast Asia?', Cambridge, MA: National Bureau of Economic Research (NBER) Working Paper, No. 5174.

Booth, A. (1991) 'The economic development of Southeast Asia, 1870–1985', *Australian Economic History Review*, XXXI(1): 20–52.

Borrus, M., Ernst, D. and Haggard, S. (2000a) 'Cross-border production networks and the industrial integration of the Asia-Pacific region', in M. Borrus, D. Ernst, and S. Haggard (eds), *International Production Networks in Asia: Rivalry or Riches?*, London and New York: Routledge.

——(2000b) *International Production Networks in Asia: Rivalry or Riches*?, London and New York: Routledge.

Broadman, H.G. and Sun, X. (1997) 'The distribution of foreign direct investment in China', Policy Research Working Paper number 1720, China and Mongolia Department, Washington, DC: World Bank.

Brooks, R. and Catao, L. (2000) 'The new economy and global stock returns', IMF Working Paper WP/00/216, Washington, DC: International Monetary Fund.

Buckley, P.J. (1988) 'The limits of expansion: testing the internalisation theory of the multinational enterprise', *Journal of International Business Studies*, XIX(2): 181–193.

Buckley, P.J. (2002) 'Is the international business research agenda running out of steam?', *Journal of International Business Studies*, 33(2): 365–373.

Buckley, P.J. and Casson, M. (1981) 'The optimal timing of a foreign direct investment', *Economic Journal*, 91: 75–87.

——(1988) 'A theory of co-operation in international business', in F.J. Contractor and P. Lorange (eds), *Co-operative Strategies in International Business*. Lexington, MA: Lexington Books.

——(1996) 'An economic model of international joint venture strategy', *Journal of International Business Studies*, 27(5): 849–876.

——(1998) 'Models of multinational enterprise', *Journal of International Business Studies*, 29(1): 29–44.

Buckley, P.J. and Mirza, H. (1988) 'The strategy of Pacific Asian multinationals', *The Pacific Review*, Oxford University Press, 1(1): 50–62.

Buckley, P.J., Pass, C.L. and Prescott, K. (1988) 'Measures of international competitiveness: a critical survey', *Journal of Marketing Management*, 4(2): 175–200

Business World (1999) 'Resuscitating Asia', August.

Callis, H. (1942) *Foreign Capital in Southeast Asia*. New York: Institute of Pacific Relations (reprint by Arno Press, 1976).

Campos, N.F. and Kinoshita, Y. (2002) 'Foreign direct investment as technology transferred: some panel evidence from the transition economies', William Davidson Working Paper No. 438.

Cantwell, J. (ed.) (1995) 'Multinational enterprises and innovatory activities: towards a new evolutionary approach', in Molero, J. (ed.) *Technological Innovation, Multinational Corporations and New International Competitiveness*, Chur: Harwood Academic Publishers.

Casson, M. (1994) 'Why are firms hierarchical?', *International Journal of the Economics of Business*, 1(1): 3–40.

—— (1995) *Organization of International Business*, Aldershot: Edward Elgar.

Casson, M., Pearce, R.D. and Singh, S. (1991) 'A review of recent trends' in M. Casson (ed.) *Global Research Strategy and International Competitiveness*. Oxford: Blackwell.

Chang, G.G. (2001) *The Coming Collapse of China*, London: Century Random House.

Chen, P.S.J. (1983) *Singapore Development Policies and Trends*, Singapore: Oxford University Press.

Cheong, Y.-R. (2000) 'The impact of China's entrance to the WTO on neighbouring East Asian economies', *China Economic Review*, 11: 419–422.

Chi, T. and McGuire, D.J. (1996) 'Collaborative ventures and value of learning: integrating the transaction cost and strategic option perspectives on the choice of market entry modes', *Journal of International Business Studies*, 27(2): 285–307.

Chia, S.Y. (1986) 'Direct foreign investment and industrialisation process in Singapore', in C.Y. Lim and P. Lloyd (eds), *Singapore: Resource and Growth*, Oxford: Oxford University Press.

——(1999) 'Trade, foreign direct investment and economic development of Southeast Asia', *The Pacific Review*, 12(2): 249–270.

Chin, C.B.N. (2000) 'The state of the state in globalisation: social order and economic restructuring in Malaysia', *Third World Quarterly*, 21(6): 1035–1057.

Chow, G.C. (1960) 'Tests of equality between sets of coefficients in two linear regressions', *Econometrica*, 28: 591–605.

Claessens, S. (1995) 'The emergence of equity investment in developing countries: overview', *The World Bank Economic Review*, 9(1): 1–17.

Claessens, S., Djankov, S., Fan, J. and Lang, L.H.P. (1998) *Ownership Structure and Corporate Performance in East Asia*. Washington, DC: World Bank.

Claessens, S., Djankov, S. and Klingebiel, D. (2000) 'Stock markets in transition economies', Financial Sector Discussion Paper No. 5 (September), Washington, DC: World Bank.

Claessens, S., Djankov, S. and Lang, L.H.P. (1999) 'Who controls East Asian corporations – and the implications for legal reform', Public Policy for the Private Sector, Note No. 195, Washington, DC: World Bank.

Claessens, S., Klingebiel, D. and Schmukler, S.L. (2002a) 'Explaining the migration of stocks from exchanges in emerging economies to international centres', United Nations University, World Institute for Development Economics Research, Discussion Paper 2002/94 (October).

Claessens, S., Klingebiel, D. and Schmukler, S.L. (2002b) 'The future of stock exchanges in emerging economies: evolution and prospects', The Wharton Financial Institutions Center Working Paper 02–03.

Culem, C. (1988) 'The locational determinants of direct investment among industrialised countries', *European Economic Review*, 32: 885–904.

D'Arge, R. (1969) 'Note on Customs Unions and direct foreign investment', *Economic Journal*, 79: 324–333.

Dent, C.M. (2002) *The Foreign Economic Policies of Singapore, South Korea and Taiwan*, Cheltenham: Edward Elgar.

——(2003a) 'Transnational capital, the state and foreign economic policy: Singapore, South Korea and Taiwan', *Review of International Political Economy*, 10(2): 246–277.

——(2003b) 'Networking the region? The emergence and impact of Asia-Pacific bilateral free trade agreements', *The Pacific Review*, 16(1): 1–28.

Dicken, P. (1998) *Global Shift: Transforming the World Economy*, London: Paul Chapman.

Dixon, C. (1991) *South East Asia in the World Economy*, Cambridge: Cambridge University Press.

Dobson, W. and Chia, S.Y. (1997) *Multinationals and East Asian Integration*, Singapore: Institute of Southeast Asian Studies.

Doz, Y. and Prahalad, C.K. (1984) 'Patterns of strategic control within multinational corporations', *Journal of International Business Studies*, (15): 55–72.

Dunning, J.H. (1973) 'The determinants of international production', *Oxford Economic Papers*, 25: 289–336.

——(1977) 'Trade, location of economic activity and the multinational enterprise: a search for an eclectic approach', in B. Ohlin, P.O. Hesselborn and P.J. Wiskman (eds), *The International Allocation of Economic Activity*. London: Macmillan.

——(1979) 'Explaining changing patterns of international production: in defense of the eclectic theory', *Oxford Bulletin of Economics and Statistics*, 41: 269–295.

——(1980) 'Toward an eclectic theory of international production: some empirical tests', *Journal of International Business Studies*, 11(1): 9–25.

——(1988) 'The eclectic paradigm of international production: a restatement and some possible extensions', *Journal of International Business Studies*, Spring: 1–31.

——(1993) *Multinational Enterprises and the Global Economy*. Wokingham: Addison-Wesley.

——(1997) 'The European internal market programme and inbound foreign direct investment: Part II', *Journal of Common Market Studies*, 35(2): 189–223.

——(1998) 'Location and the multinational enterprise: a neglected factor?', *Journal of International Business Studies*, 29(1): 45–66.

Dunning, J.H. (2000a) 'The eclectic paradigm as an envelope for economics and business theories of MNEs activity', *International Business Review*, 9(2): 163–190.

——(ed.) (2000b) *Regions, Globalization and the Knowledge-based Economy*, Oxford: Oxford University Press.

——(2001) *Global Capitalism at Bay?*, London: Routledge.

Dunning, J. and Dilyard, J. (1999) 'Towards a general paradigm of foreign direct and foreign portfolio investment', *Transnational Corporations*, 8(1): 7–52.

Dyer, J.H. (1996) 'How Chrysler created an American Keiretsu', *Harvard Business Review*, 74: 42–56.

Economist Intelligence Unit (EIU) (2001) 'Forecasting foreign direct investment', *World Investment Prospects*, London: Economist Intelligence Unit (February).

Eden, L. and Lenway, S. (2001) 'Multinationals: the Janus face of globalization', *Journal of International Business Studies*, 32(3): 383–400.

Eglin, R. (2000) 'Challenges and implications of China joining the WTO: what WTO accession means', Geneva: World Trade Organisation Secretariat (June).

Enright, M.J. (2000) 'Regional clusters and multinational enterprises: independence, dependence, or interdependence?', *International Studies of Management and Organization*, 30(2): 114–138.

Ernst, D. (2000) 'Evolutionary aspects; the Asian production networks of Japanese electronics firms', in M. Borrus, D. Ernst, D. and S. Haggard (eds), *International Production Networks in Asia: Rivalry or Riches?*. London and New York: Routledge.

Ernst, D. and Ravenhill, J. (2000) 'Convergence and diversity: how globalization reshapes Asian production networks', in M. Borrus, D. Ernst, and S. Haggard (eds), *International Production Networks in Asia: Rivalry or Riches?*. London and New York: Routledge.

Field, M. and Hanna, D. (1999) 'The development of Asian equity markets', in G. de Brouwer and W. Pupphavesa (eds), *Asia Pacific Financial Deregulation*, London: Routledge.

Fong, C.O. (1990) 'Multinational corporations in ASEAN: technology transfer and linkages with host countries', in S.L. Ying (ed.), *Foreign Direct Investment in ASEAN*, Kuala Lumpur: Malaysian Economic Federation.

Forsyth, D. (1972) *U.S. Investment in Scotland*, New York: Praeger.

FOURIN (1993) *Asean Jidoosha Buhin Sangyo 1993* (ASEAN Autoparts Industry 1993).

Freeman, N.J. (2000) 'A profile of merger and acquisition activity in Singapore since 1997', mimeo, Singapore: Institute of Southeast Asian Studies.

——(2001a) 'The rise and fall of foreign investment in Laos, 1988–2000', *Post-Communist Economies*, 13(1): 101–120.

——(2001b) 'Understanding the decline in foreign investor sentiment towards Vietnam during the 1990s', *Asia Pacific Business Review*, 8(1): 1–18.

——(2003) 'Pragmatism in the face of adversity: enterprise reform in Laos', *Journal of Communist Studies and Transition Politics*, 9(1): 35–48.

Freeman, N.J. and Bartels, F.L. (2000) 'Portfolio investment in Southeast Asia's stock markets: a survey of institutional investor perceptions', *The Asia Pacific Journal of Economics and Business*, 4(1): 28–58.

Freeman, N.J. and Hew, D. (2002) 'Rethinking the East Asian development model', *ASEAN Economic Bulletin*, 19(1): 1–5.

Freeman, N.J. and Nestor, C. (forthcoming) 'FDI in Vietnam: fuzzy figures and sentiment swings', in D. McCargo (ed.), *Re-thinking Vietnam*. London: Routledge.

Fukao, F., Ishido, H. and Ito, K. (2002) 'Vertical intra investment in East Asia', paper presented originally at the 15th Annual Trade Conference, New Development in International Trade, Tokyo (December).

Fukuyama, F. (1996) *Trust – The Social Virtues and the Creation of Prosperity*. Harmondsworth: Penguin.

Galán, J.I. and González-Benito, J. (2001) 'Determinant factors of foreign direct investment: some empirical evidence', *European Business Review*, 13(5): 269–278.

Gelos, R.G. and Wei, S.-J. (2002) 'Transparency and international investor behaviour', Cambridge, MA: National Bureau of Economic Research Working Paper 9260.

Giroud, A. (2003) *Transnational Corporations, Technology and Economic Development: Backward Linkages and Knowledge Transfer in South East Asia*. Cheltenham: Edward Elgar.

Godement, F. (1999) *The Downsizing of Asia*. London: Routledge.

Graham, E.M. and Wada, E. (2001) 'Foreign direct investment in China: effects on growth and economic importance', in P. Drysdale (ed.), *Achieving High Growth: Experience of Transitional Economies in East Asia*. Oxford: Oxford University Press.

Grubel, H.G. and Lloyd, P.J. (1975) *Intra-Industry Trade*. London: Macmillan.

Gupta, O. and Roos, G. (2001) 'Mergers and acquisitions through an intellectual perspective', *Journal of Intellectual Capital*, 2(3): 297–309.

Hedlund, G. (1993) 'Assumptions of hierarchy and heterarchy: an application to the multinational corporation', in S. Ghoshal and E. Westney (eds), *Organization Theory and the Multinational Corporation*. London: Macmillan.

Heinrich, J. and Konan, D.E. (2001) 'Prospects for FDI in AFTA', *ASEAN Economic Bulletin*, 18(2): 141–160.

Hendry, D.F. and Ericsson, N.S. (1991) 'An econometric analysis of the UK money demand in monetary trends in the United States and the United Kingdom', *American Economic Review*, 81: 8–38.

Heng, T.M. (2001), 'National report: Singapore', in ACEGEC (ASEAN–China Expert Group on Economic Cooperation), *Forging Closer ASEAN–China Economic Relations in the Twenty-First Century* (October).

Hernández, L., Mellado, P., Valdés, R. (2001) 'Determinants of private capital flows in the 1970s and 1990s. Is there evidence of Contagion?', IMF Working Paper WP/01/64, Washington, DC: International Monetary Fund.

Hill, H. (1988) *Foreign Investment and Industrialization in Indonesia*. Singapore: Oxford University Press.

——(2003), 'Industry', in A.M. Balisacan and H. Hill (eds), *The Philippine Economy, Development, Policies, and Challenges*. New York: Oxford University Press.

Hill, H. and Athukorala, P. (1998) 'Foreign investment in East Asia: a survey', *Asian-Pacific Economic Literature*, 12(2): 23–50.

Hiley, M. (1999) 'Industrial restructuring in ASEAN and the role of Japanese foreign direct investment', *European Business Review*, 99(2): 80–90.

Hinshaw, R. (1964) *The European Community and American Trade*. New York: Praeger.

Hirsch, S. and Almor T. (eds) (1996) *Outsiders' Response to European Integration*. Series A: Copenhagen Studies in Economics and Management, No.7. Copenhagen: Handelshøjoskolens, Copenhagen Business School Press.

Hirst, P. and Thompson, G. (1999) Globalization in question: the international economy and the possibilities of governance, 2nd edition. Cambridge: Polity Press.

Hobday, M. (1995) *Innovation in East Asia: The Challenge to Japan*. Cheltenham: Edward Elgar.

——(1996) 'Innovation in South-East Asia: lessons for Europe?', *Management Decision*, 34(9): 71–81.

Hood, N. and Young, S. (2000) The globalization of multinational enterprise activity and economic development, Basingstoke: Macmillan.

Howell, L.D. and Xie, D. (1996) 'Asia at risk: the impact of methodology in forecasting', *Management Decision*, 34(9): 6–16.

Huang, C. (1989) 'The state and foreign investment: the cases of Taiwan and Singapore', *Comparative Political Studies*, 22(1): 93–121.

Huang, G. (1997) Determinants of United States–Japanese foreign direct investment: a comparison across countries and industries. New York: Garland Publishers.

Huff, W.G. (1994) The economic growth of Singapore: trade and development in the twentieth century, Cambridge: Cambridge University Press.

Ianchovichina, E. and Martin, W. (2001) 'Trade liberalisation in China's accession to the World Trade Organization', Washington, DC: World Bank (June).

Ianchovichina, E., Martin, W. and Fukase, E. (2000) 'Assessing the implications of merchandise trade liberalisation in China's accession to WTO', Washington, DC: World Bank (June).

Iboshi, P.I. and Plummer, M.G. (1994) 'Direct foreign investment and development in ASEAN', Honolulu: East–West Center Working Papers, No. 3.

IMD (1999) *World Competitiveness Yearbook 1999*. Lausanne: IMD.

Institute of International Finance (IIF) (2002) 'Capital flows to emerging market economies', various issues, Washington, DC: Institute of International Finance Inc.

International Monetary Fund (1997) *International Financial Statistics*. CD-ROM.

——(1999) *International Capital Markets 1999*, Washington, DC: International Monetary Fund (September).

——(2002) *Global Financial Stability Report*, Washington, DC: International Monetary Fund (June).

——(2003) *Global Financial Stability Report*, Washington, DC: International Monetary Fund (March).

——*International Financial Statistics*. Various print issues, Washington, DC: International Monetary Fund.

——*Direction of Trade Statistics*. Various print issues, Washington, DC: International Monetary Fund.

Isogai T. and Shibanuma S. (2000) 'East Asia's intra- and inter-regional economic relations: data analysis on trade, direct investments and currency transactions', International Department Working Paper Series 00-E-4, Bank of Japan.

Japan Bank for International Cooperation (JBIC) (2001) *JBIC Review No.5*, Tokyo: Japanese Bank for International Cooperation.

Johanson, J. and Vahlne, J.E. (1977) 'The internationalization process of the firm – a model of knowledge development and increasing market commitments', *Journal of International Business Studies*, 8(1): 23–32.

Jomo K.S. (ed.) (2001) *Southeast Asia's Industrialization: Industrial Policy, Capabilities and Sustainability*, Basingstoke: Palgrave.

Jun, Y. (2001) 'An emerging regional manufacturing network in Southeast Asia: the case of Samsung', in S. El Kahal (ed.), *Business in Asia Pacific: Text and Cases*. Oxford: Oxford University Press.

Katayama, H. (1999) 'Design of a global car production–Logistics System for a Future ASEAN–China Region', *International Journal of Operations and Production Management*, 19(5/6): 582–601.

Kimura, F. (2001) 'Fragmentation, internalization, and inter-firm linkages: evidence from the data of Japanese manufacturing firms', in L.K. Cheng and H. Kiezkowsky (eds), *Global Production and Trade in East Asia*. Norwell: Kluwer Academic Publishers.

Kogut, B. (1991) 'Joint ventures and the option to expand and acquire', *Management Science*, 37(1): 19–33.

Kojima, K. (1978) Direct foreign investment: a Japanese model of multinational business operations, London: Croom Helm.

——(1996) *Trade, Investment and Pacific Integration*, Tokyo: Bunshindo.

Kojima, K. (2000) 'The "flying geese" model of Asian economic development: origin, theoretical extensions, and regional policy implications', *Journal of Asian Economics*, 11(4): 375–401.

Konstadakopulos, D. (2002) 'The challenge of technological development for ASEAN: intraregional and international co-operation', *ASEAN Economic Bulletin*, 19(1): 100–110.

Kotter, J. (1996) *Leading Change*. Cambridge, MA: Harvard Business School Press.

Krause, L. (1968) *European Economic Integration and the United States*, Washington, DC: The Brookings Institution.

Krugman, P. (1994) 'The myth of Asia's miracle', *Foreign Affairs*, 73(6): 62–93.

Kwan, C.H. (1994) *Economic Interdependence in the Asia-Pacific Region: Toward a Yen Bloc*, London: Routledge.

Lall, S. (2000) 'FDI and development: research issues in the emerging context', paper presented at the Asian Development Forum, Singapore, June.

Lee, W.K.M. (1997) 'Foreign investment, industrial restructuring and dependent development in Singapore', *Journal of Contemporary Asia*, 27(1): 58–70.

Leftwich, R.B. (1973) 'Foreign direct investments in the United States, 1962–1971', *Survey of Current Business*, 53(2): 29–40.

Legewie, J. (1999) 'Manufacturing strategies for Southeast Asia after the crisis: European, US and Japanese Firms', *Business Strategy Review*, 10(4): 55–64.

Legewie, J. and Meyer-Ohle, H. (2000) *Corporate Strategies for Southeast Asia after the Crisis*, Basingstoke, New York: Palgrave.

Lemoine, L. (2000) 'FDI and the opening up of China's economy', Centre D'Etedes Prospectives et D' Information Internationales (CEPII), Working Paper No. 00-11 (June).

Lim, L. and Pang, E.F. (1991) *Foreign Direct Investment and Industrialisation in Malaysia, Singapore, Taiwan and Thailand*, Paris: OECD.

Lindblad, J.T. (1998) *Foreign Investment in Southeast Asia in the Twentieth Century*. Basingstoke: Macmillan.

——(2003) 'Business responses to crisis in Indonesia: the 1930s and the 1990s', *Australian Economic History Review*, 43(2): 169–182.

Ling, S.L.M and Yong, Y.S. (1997) 'Malaysia: electronics, autos, and the trade–investment nexus', in W. Dobson and S.Y. Chia (eds.), *Multinationals and East Asian Integration*, Singapore: Institute of South East Asian Studies.

Lipsey, R.E. (2000) 'Interpreting developed countries' foreign direct investment', NBER Working Paper No. 7810, Cambridge, MA: National Bureau of Economic Research.

——(2001) 'Foreign direct investors in three financial crises', NBER Working Paper No. 8084, Cambridge, MA: National Bureau of Economic Research.

Lubbe, A. (1997) 'National economic security', *Polish Quarterly of International Affairs*, 6(4): 59–76.

Lunn, J. (1980) 'Determinants of US direct investment in the EEC: further evidence', *European Economic Review*, 10: 376–383.

——(1983) 'Determinants of US direct investment in the EEC: revisited again', *European Economic Review*, 21: 391–393.

Luo, Y. (2000), Multinational corporations in China: benefiting from structural transformation, Copenhagen: Copenhagen Business School Press.

McKendrick, D.G., Doner, R.F. and Haggard S. (2000) *From Silicon Valley to Singapore: Location and Competitive Advantage in the Hard Disk Drive Industry*, Stanford: Stanford University Press.

McKibbin, W. and Sachs, J. (1991) Global Linkages: Macroeconomic Independence and Cooperation in the World Economy, Washington, DC: Brookings Institution.
Mallet, V. (1999) *The Trouble with Tigers: The Rise and Fall of Southeast Asia*, London: Harper Collins Business.
Markusen, J.R. and Maskus, K.E. (2001) 'A unified approach to intra-industry trade and direct foreign investment', NBER Working Paper 8332, Cambridge, MA: National Bureau of Economic Research.
Marshall, A. (1919) *Industry and Trade*. London: Macmillan.
Martin, R. (1999) 'The new 'geographical' turn in economics: some critical reflections', *Cambridge Journal of Economics*, 23(1): 65–91.
Mehra, Y.P. (1991) 'An error-correction model of the US M2 demand', *Federal Bank of Richmond Economic Review*, 77(3): 3–12.
Menon, J. (1998) 'The expansion of AFTA: widening and deepening', unpublished, Melbourne: Centre of Policy Studies and the Impact Project, Monash University.
Metwalli, A.M. and Tang, R.Y.W. (2002) 'Southeast Asia: the next M&A hotspot?', *The Journal of Corporate Accounting and Finance*, 13(2): 39–47.
Michalet, C.-A. (1997) 'Strategies of multinationals and competition for foreign direct investment: the opening of Central and Eastern Europe', Washington, DC: Foreign Investment Advisory Service, Occasional Paper 10.
Mirza, H. (2000) 'The globalization of business and East Asian developing-country multinationals', in N. Hood and S. Young (eds), *The Globalization of Multinational Enterprise Activity and Economic Development*, Basingstoke: Macmillan.
Mirza, H., Bartels, F.L., Hiley, M. and Giroud, A. (1997), 'The promotion of foreign direct investment into and within ASEAN: towards the establishment of an ASEAN investment area', Asia-Pacific Business and Development Research Unit, University of Bradford.
Mody, A. and Neglishi, S. (2001) 'Cross-border mergers and acquisitions in East Asia: trends and implications', *Finance & Development*, 38(1): 6–9.
Moran, T.H. (1998) *Foreign Direct Investment and Development: The New Policy Agenda for Developing Countries and Economies in Transition*, Washington, DC: Institute for International Economics.
Morisset, J. and Neso, O.L. (2002) 'Administrative barriers to foreign investment in developing countries', World Bank Policy Research Working Paper WPS 2848, Washington, DC: World Bank.
Mowery, D.C., Oxley, J.E. and Silverman, B.S. (1996) 'Strategic alliances and interfirm knowledge transfer', *Strategic Management Journal*, 17: 77–91.
Multilateral Investment Guarantee Agency (MIGA) (2002) *Foreign Direct Investment Survey*, Washington, DC: World Bank.
Murray, M.J. (1980) *The Development of Capitalism in Colonial Indochina (1870–1940)*, Berkeley: University of California Press.
Muthaly, S., Ratnatunga, J., and Schroder, W. (1999) 'Venturing overseas', *British Food Journal*, 101(2): 108–131.
Myint, H. (1972) Southeast Asia's economy: development policies in the 1970s. Harmondsworth: Penguin.
Narine, S. (1999) 'ASEAN into the twenty-first century: problems and prospects', *The Pacific Review*, 12(3): 357–380.
Narula, R. (1996) *Multinational Investment and Economic Structure: Globalization and Competitiveness*. London: Routledge.
Naughton, T. (1999) 'The role of stock markets in the Asia-Pacific region', *Asian-Pacific Economic Literature*, (13)1: 22–35.

Nayyar, D. (1978), ‘Transnational corporations and manufactured exports from poor countries’, *Economic Journal*, 88: 59–84.

Nolan, P. (2001) *China and the Global Business Revolution*, Basingstoke: Palgrave.

Norlund, I. (1991) ‘The French empire, the colonial state in Vietnam, and economic policy 1885–1940’, *Australian Economic History Review*, XXXI(1): 72–89.

Ohmae, K. (1990) *The Borderless World*. London: Collins.

Oman, C. (2000) *Policy Competition for Foreign Direct Investment: A Study of Competition among Governments to Attract FDI*, Paris: OECD Development Centre.

Organisation for Economic Cooperation and Development (OECD) (1999) *Foreign Direct Investment and Recovery in Southeast Asia*. Paris: Organisation for Economic Cooperation and Development.

——(2000) ‘Main determinants and impacts of foreign direct investment on China’s economy’, Directorate for Financial, Fiscal and Enterprise Affairs, Working Papers on International Investment (4 April).

——(2002) *China in the World Economy*, Paris: Organisation for Economic Cooperation and Development.

Oxelheim, L. and Gärtner, R. (1996), ‘The response of small outsiders countries to the EC 1992 program: some stylised facts’, in S. Hirsch and T. Almor (eds), *Outsiders’ Response to European Integration*. Series A: Copenhagen Studies in Economics and Management, No.7. Copenhagen: Handelshøjoskolens, Copenhagen Business School Press.

Ozawa, T. (1991) ‘Japan in a new phase of multinationalism and industrial upgrading: functional integration of trade, growth and FDI’, *Journal of World Trade*, 25(1): 43–61.

Palanca, E.H. (2001) ‘China’s economic growth: implications to the ASEAN (an integrative report)’, Philippine APEC Study Centre Network (PASCN), Discussion Paper No. 2001-01.

Pangestu, M. (1990) ‘ASEAN co-operation towards foreign investment’, in S.L. Ying (ed.), *Foreign Direct Investment in ASEAN*. Kuala Lumpur: Malaysian Economic Federation.

Petri, P.A. (1994) ‘The regional clustering of foreign direct investment and trade’, *Transnational Corporations*, 3(3): 1–24.

Porter, M.E. (1990) *The Competitive Advantage of Nations*. New York: Free Press.

Qian, J.L., Lam, K. and Wang, D. (2000) ‘Breaking into China: strategic considerations for multinational corporations’, *Long Range Planning*, 33: 673–687.

Ramstetter, E.D. (1997) ‘Thailand: international trade, multinational firms and regional integration’, in W. Dobson and S.Y. Chia (eds), *Multinationals and East Asian Integration*, Singapore: Institute of South East Asian Studies.

Rana, P.B. (1990) ‘Shifting comparative advantage among Asian and Pacific countries’, *The International Trade Journal*, 4(3): 243–258.

Rasiah, R. (2001) ‘Market, government and Malaysia’s new economic policy’, *Cambridge Journal of Economics*, 25(1): 57–78.

Reynolds, L. (1993) ‘The future of international economic policy, *Management Review*, 82(3): 30–33.

Richter, F.-J. (1999) *Business Networks in Asia: Promises, Doubts and Perspectives*, Westport: Quorum.

Robequain, C. (1944) *The Economic Development of French Indo-China*, Oxford: Oxford University Press (AMS Press reprint, 1974).

Robson, P. (1980) *The Economics of International Integration*, London: Allen & Unwin.

Rosen, D.H. (1999) *Behind the Open Door: Foreign Enterprises in the Chinese Marketplace*, Washington, DC: Institute for International Economics.

Rugman, A.M, D’Cruz, J.R. and Verbeke, A. (1995) ‘Internalisation and de-internalisation: will business networks replace multinationals?’ in G. Boyd (ed.), *Competitive and*

Cooperative Macromanagement: The Challenge of Structural Interdependence. Aldershot: Edward Elgar.

Ryan, L. (2000) 'The "Asian Economic Miracle" unmasked', *International Journal of Social Economics*, 27(7): 802–815.

Sauvant, K.P. (2001) 'Recent FDI trends, implications for developing countries and policy challenges', OECD Global Forum on International Investment, Mexico City, 26–27 November 2001.

Scally, A. (1999) 'Regional integration and FDI: a survey of the determinants of FDI in ASEAN and of the importance of AFTA', paper presented at the 1999 Annual Conference of the Academy of International Business South-East Region, 8–10 July 1999, Melbourne, Australia.

Scaperlanda, A.E. (1967) 'The EEC and US foreign investment: some empirical evidence', *Economic Journal*, 77: 22–26.

——(1968) 'The EEC and United States Foreign Investment: some empirical evidence – a reply', *Economic Journal*, 78: 720–723.

Scaperlanda, A.E. and Balough, R.S. (1983), 'Determinants of US direct investment in the EEC', *European Economic Review*, 21: 381–390.

Scaperlanda, A.E. and Mauer, L.J. (1969) 'The determinants of US direct investment in the EEC', *American Economic Review*, 59: 558–568.

Scherrer, P.S. and Bolick, C. (1999) 'Fire sale in Asia: a buyer's market', *The Real Estate Finance Journal*, 14(3): 55–58.

Schmitz, A. (1970), 'The impact of trade blocs on foreign direct investment', *The Economic Journal*, 80: 724–731.

Schmitz, A. and Bieri, J. (1972) 'EEC tariffs and US direct investment', *European Economic Review*, 3: 259–270.

Simonin, B.L. (1999) 'Ambiguity and the process of knowledge transfer in strategic alliances', *Strategic Management Journal*, 20: 595–623.

Smarzynska, B.K. (2002) 'The composition of foreign direct investment and protection of intellectual property rights: evidence from transition economies', Washington, DC: World Bank Policy Research Working Paper WPS 2786.

Smith, R. (1968) *Vietnam and the West*. London: Heinemann.

Soon, T.W. and Stoever, W.A. (1996) 'Foreign investment and economic development in Singapore: a policy-oriented approach', *Journal of Developing Areas*, 30(3): 317–340.

South China Morning Post (2001), 'WTO 2001: China's trade triumph', Special Report, 12th November.

State Statistical Bureau (China) (1999) *China Statistical Yearbook 1999*, Beijing: China Statistical Publishing House.

Stone, M.R. (2000) 'The corporate sector dynamics of systemic financial crises', Working Paper WP/00.114, Washington, DC: International Monetary Fund.

Stopford, J. and Strange, S. (1991) *Rival States, Rival Firms: Competition for World Market Shares*. Cambridge: Cambridge University Press.

Stremlau, J. (1994) 'Clinton's dollar diplomacy', *Foreign Policy*, 97: 18–35.

Stuart-Fox, M. (1995) 'The French in Laos, 1887–1945', *Modern Asian Studies*, 29(1): 111–139.

Tan, R. (1999) *Foreign Direct Investment Flows To and From China*, Philippine APEC Study Centre Network (PASCN), Discussion paper no. 99–21.

Tertrais, H. (2001) 'The failure of industrialization policies in Vietnam in the decolonization and war context (1930–1960s)', paper presented at the EUROSEAS Conference, London, August.

Thee, K.W. (2003) 'The Indonesian economic crisis and the long road to recovery', *Australian Economic History Review*, 43(2): 183–196.

Thompson, V. (1937) *French Indo-China*, London: Macmillan. (Re-print by Octagon Books, New York, 1968.)

Thomsen, S. (1999) *South East Asia: The Role of Foreign Direct Investment Policies in Development*, OECD Directorate for Financial, Fiscal and Enterprise Affairs, Working Papers on International Investment, 1999/1.

Trigeorgis, L. (1996) *Real Options: Managerial Flexibility and Strategy in Resource Allocation*, Cambridge, MA: MIT Press.

United Nations Centre on Transnational Corporations (UNCTC) (1992) *The Determinants of Foreign Direct Investment: A Survey of the Evidence*. New York: United Nations.

United Nations Conference on Trade and Development (UNCTAD) (1996) *Incentives and Foreign Direct Investment*, New York: United Nations.

——(1991) *World Investment Report 1991: The Triad in Foreign Direct Investment*, New York and Geneva: United Nations.

——(1992) *World Investment Report 1992: Transnational Corporations as Engines of Growth*, New York and Geneva: United Nations, 1992.

——(1993a) *Explaining and Forecasting Regional Flows of Foreign Direct Investment*. New York and Geneva: United Nations.

——(1993b) *World Investment Report 1993: Transnational Corporations and Integrated International Production*, New York and Geneva: United Nations.

——(1994) *World Investment Report 1994: Transnational Corporations, Employment and Workplace*. New York and Geneva: United Nations, 1994.

——(1995) *World Investment Report 1995: Transnational Corporations and Competitiveness*. New York and Geneva: United Nations, 1995.

——(1996) *World Investment Report 1996: Investment, Trade and International Policy Arrangements*, New York and Geneva: United Nations.

——(1997) *World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy*, New York and Geneva: United Nations.

——(1998) *World Investment Report 1998: Trends and Determinant*, New York and Geneva: United Nations.

——(1999) *World Investment Report 1999: Foreign Direct Investment and the Challenge of Development*, New York and Geneva: United Nations.

——(2000) *World Investment Report 2000: Cross-Border Mergers and Acquisitions and Development*, New York and Geneva: United Nations.

——(2001) *World Investment Report 2001: Promoting Linkages*, New York and Geneva: United Nations.

——(2002a) *The Least Developed Countries Report 2002*, New York and Geneva: United Nations.

——(2002b) *World Investment Report 2002: Transnational Corporations and Export Competitiveness*, New York and Geneva: United Nations.

——(2002c) 'FDI downturn in 2001 touches almost all regions', press release, 21 January.

——(2002d) 'China: WTO accession and growing FDI flows', press information note, 11 December.

——(2002e) *FDI in Least Developed Countries at a Glance: 2002*, New York and Geneva: United Nations.

——(2003) 'Spotlight on ASEAN', Note No. 5, 10 February.

Urata, S. (2001) 'Emergence of an FDI–Trade nexus and economic growth in East Asia', in J.E. Stiglitz and S. Yusuf (eds), *Rethinking the East Asian Miracle*, Oxford: Oxford University Press.

Van Hoesel, R. (1999) New multinational enterprises from Korea and Taiwan: beyond export-led growth. London: Routledge.

Venzin, M., Krogh, G. and Roos J. (1998) 'Future research into knowledge management', in G. Krogh, J. Roos and D. Kleine (eds), *Knowing in Firms*, London: Sage Publications.

Vernon, R. (1966) 'International investment and international trade in the product cycle', *Quarterly Journal of Economics*, 2 (80): 190–207.

Wade, R. (1990) Governing the market: economic theory and the role of government in East Asian industrialization, Princeton, NJ: Princeton University Press.

Wallis, K.F. (1968) 'The EEC and United States foreign investment: some empirical evidence re-examined', *Economic Journal*, 78: 717–719.

Walmsley, T.L. and Hertel, T.W. (2001) 'China's accession to the WTO: timing is everything', paper presented at the Third Annual Conference on Global Economic Modelling, Melbourne, Australia.

Weber, K. and Davis, G.F. (2000) 'The global spread of stock exchanges 1980–1998', William Davidson Institute Working Paper 341 (October).

Wei, Y. and Liu, X (2001) Foreign direct investment in China: determinants and impact. Cheltenham: Edward Elgar.

Wells, L.T. Jr and Wint A.G. (1991) 'The public–private choice: the case of marketing a country to investors', *World Development*, 19(7): 749–761.

Westhead, J. (1999) 'The space race', *Corporate Location*, September: 30–31.

Wong, P.-K. (1997) 'Creation of a regional hub for flexible production: the case of the hard disk drive industry in Singapore', *Industry and Innovation*, 4(2): 183–206.

——(2000) 'Riding the waves: technological change, competing US–Japan production networks, and the growth of Singapore's electronics industry', in M. Borrus, D. Ernst and S. Haggard (eds), *International Production Networks in Asia: Rivalry or Riches?*, London and New York: Routledge.

Woo-Cumings, M. (ed.) (1999) *The Developmental State*, Ithaca: Cornell University Press.

World Bank (1993) *The East Asian Miracle: Economic Growth and Public Policy*. Oxford: Oxford University Press.

——(2002) *Foreign Direct Investment Survey*, January, www.ipanet.net/fdisurvey

——(2003a) *Innovative East Asia: The Future of Growth*. Washington, DC: World Bank.

——(2003b) *Global Economic Prospects and the Developing Countries 2003*, Washington, DC: World Bank.

World Trade Organisation (2001) *International Trade Statistics 2001*, Geneva: World Trade Organisation.

Yasheng H. (2000) 'China's foreign investment paradox', *The Asian Wall Street Journal*, 27 September.

——(2001) 'The benefits of FDI in a transitional economy: the case of China', paper presented at the OECD Global Forum on International Investment, Mexico City, November.

Yean, T.S. (1998) 'Competition and cooperation for foreign direct investment: an ASEAN perspective', *Asia-Pacific Development Journal*, 5(1): 9–36.

Yeung, H.W.-C. (1998) *Transnational Corporations and Business Networks: Hong Kong Firms in the ASEAN Region*, London: Routledge.

Young, S. (2000) 'The multinational corporation: the managerial challenges of globalization and localization', in J. Legewie and H. Meyer-Ohle (eds), *Corporate Strategies for Southeast Asia after the Crisis*. Chippenham: Palgrave.

Youngsoo, K. (2000) 'Technological capabilities and the Samsung electronics network', in M. Borrus, D. Ernst and S. Haggard (eds), *International Production Networks in Asia: Rivalry or Riches?*, London and New York: Routledge.

Yu, T.F.L. (2000) ‘A new perspective on the role of the government in economic development’, *International Journal of South Economics*, 27: 994–1012.

Yusuf, S. (2002) ‘Remodelling East Asian development’, *ASEAN Economic Bulletin*, 19(1): 6–26.

Zhan, J.X. (1995) ‘Transnationalization and outward investment: the case of Chinese firms’, *Transnational Corporations*, 4(3): 67–100.

Zhan, J. and Ozawa, T. (2001) *Business Restructuring in Asia: Cross-Border M&As in the Crisis Period*, Copenhagen: Copenhagen Business School Press.

Zhara, S.A., George, G. and Garvis, D.M. (1999) ‘Networks and entrepreneurship in Southeast Asia: the role of social capital and membership commitment’, in F.-J. Richter (ed.) *Business Networks in Asia: Promises, Doubts and Perspectives*, Westport: Quorum.

Index

The constituent and proximate Southeast Asian countries have not been included as entries in this index, as this would have been extremely repetitive. Countries lying outside Southeast Asia, however, have been included in the index.

Abeysinghe, T. 88
Abonyi, G. 2
affiliates 111, 113–14, 116–19
AFTA *see* ASEAN Free Trade Area
Agami, A.M. 164
AIA *see* ASEAN Investment Area
AIA Framework Agreement 208
Air New Zealand 163
Akamatsu, K. 86, 89
alliance security 46–7
Almor, T. 49–50, 57
Amelung, T. 50
American Depository Receipts (ADR) 195
Andersen, P.S. 59
Ansett 163
Antonelli C. 84
AOL Time Warner 39
APEC Non-Binding Investment Principles 204
Appelbaum, S.H. 167
Ariff, M. 49
Aristotelous, K. 50, 56
Arndt, H. 63, 109
ASEAN Agreement on the Promotion and Protection of Investments 205, 207
ASEAN Free Trade Area (AFTA) 7, 9, 13, 39, 49–79, 62, 109, 176, 196, 205, 256, 265
ASEAN Heads of Investment Agencies (AHIA) 208
ASEAN Investment Area (AIA) 7, 13, 16, 50, 86, 100, 109, 164, 176, 204, 206, 220, 264
ASEAN Investment Report 155
ASEAN Secretariat 12, 104, 219
Asian development model 130
Asian financial crisis 8, 11–12, 30, 47, 50–1, 61, 91, 93, 96, 101, 105, 125, 132, 144, 155, 157–9, 163–4, 173–4, 183, 190, 198, 256
asset allocation 192–4
Athukorala, P.C. 33, 49–51, 56–7, 260, 262
Australia 9, 49–50, 63

Balassa, B. 56–7
Balasubramanyam, V.N. 50, 57
Balough, R.S. 50, 56
Bandera, V.N. 57
Banerjee, A. 58
Bangkok Declaration 1967 62, 207
Banque de l'Indochine 172
Bartlett, C.A. 23, 25, 27
Bederlos, R. 121
Bellak, C. 50
Berezin, P. 266
Berger, P.L. 158
Bergsman, J. 181
Best, M.H. 19
Beyer, J. 116, 182
Bilateral Trade Agreements (BTA) 176
Birkinshaw, J. 84
Bloom, D.E. 87
Boeing 39
Bolick, C. 162
Borrus, M. 112, 121
Broadman, H.G. 149
Brooks, R. 193
Brunei 91, 97
bubble economy 40

build–operate–transfer (BOT) 177
Bukara SingTel 163
bumiputra 43, 266

Cable & Wireless 163
Callis, H. 172
Caltex 116, 118
Cantwell, J. 20
capacity building 216
capital flight 260
capital-intensive manufacturing 7, 134, 143, 149–52
Caribbean equity markets 196
Casson, M. 20–2, 31
Catao, L. 193
catching up product cycle theory 106
CEPT *see* Common Effective Preference Tariff
Chang, G.G. 139
Chen, P.S.J. 41
Cheong, Y.-R. 140
Chi, T. 21
Chia, S.Y. 32, 40–1, 43, 108, 114, 121
Chin, C.B.N. 43
China 7, 9, 10, 12–13, 30, 45, 50, 53, 55, 88, 94, 106, 131, 139, 171, 183–4, 255–6, 258–9; WTO accession: impact on Southeast Asian FDI 125–54
China–ASEAN free trade agreement initiative 46
Cisco Systems 112
civil society activism 42, 47
Claessens, S. 85, 189, 194
Cold War 189
collaborative (alliance) ventures 156
colonialism 255, 171
Committee on Industry, Minerals and Energy (COIME) 206
Common Effective Preference Tariff (CEPT) 49, 61, 89
communitarians 28
componentisation 2
contagion 87
contract manufacturers 28
Coordinating Committee on Investment 209
corporate bond markets 190
corporate communities 190–1, 194–5
corporate culture 28–9
corporate governance 7, 166–7, 192, 194–5, 197, 210, 213–14, 216, 258, 261
corporate sector 199
corporate tax rates 181
corruption 182, 264
cross-border investments 264
cross-border mergers and acquisitions 8, 10–11, 13, 155–69, 188, 195
cross-border production networks (CPNs) 10, 104–24, 256
cross-border sourcing 109, 120–2
cross-share holdings 156
Culem, C. 50
cultural differences 19, 156
currency controls 182
currency depreciation 33, 164
cyclical trends 12

D'Arge, R. 50
Davis, G.F. 189
debt–equity swaps 261
defence treaties 21
de-layering 21
Dell 112
Denso 118, 121
deregulation *see* liberalisation
developmental statism 41
Diebold 112
Digital Microwave 112
disintermediation 16–18, 29
divestment (state sector) 182
division of labour 9, 104, 109–11, 152, 162, 205, 220
Dixon, C. 43
Dobson, W. 108, 114, 121
Doz, Y. 25
dual economy syndrome 265
due diligence 162, 166, 261
Dunning, J.H. 45–6, 59–60, 83–4, 125

Eastern Europe 202
eclectic paradigm (OLI paradigm) 59, 83
ecological damage 33, 45
e-commerce 15, 17–18, 25–6, 29–31
Economic Development Board (Singapore) 34, 118
economic security 8–9, 32–48, 258
Eden, L. 82, 99
effect arguments: magnetic, neutral, benign 126
emerging markets 174, 183, 189
employee militancy 262
Enright, M.J. 112
entrepreneurship 27, 29
equity: private 188; rights 171; stakes 188
equity markets *see* stock markets
Ericsson, N.S. 58
Ernst, D. 105–6, 110, 116, 119
Euronext 196

European Union 55, 60, 105
export-orientated industrialisation 33, 134
export platform 140–1, 149
export processing zones 266
Exxon-Mobil 39

FDI history (Indochina sub-region) 170–3
FDI policy in China: developmental periods 128–9
firesale 43, 162, 166, 260–1
fiscal incentives 12, 181, 205, 265–6
flexibility 20, 26–8
flying geese paradigm 86–7, 89, 98 106–7, 208
Fong, C.O. 38
Forbes 88
foreign direct investment (FDI) flows: global 3, 257, 260; intra-regional 4, 9–10, 256
foreign economic policy 33–48
Foreign Portfolio Investment (FPI) 81, 188–200
Forsyth, D. 59
Fortress AFTA 57
Fortress ASEAN 61
Fortress Europe 49, 56
Fountas, S. 50, 56
Fourin 90
Fukao, F. 2
Fukuyama, F. 28

Galan, J.I. 83
Gartner, R. 50, 56
General Agreement on Tariffs and Trade (GATT) 125
Ghoshal, S. 23, 25, 27
Giroud, A. 12–22, 114, 117
Global Depository Receipts (GDR) 195
globalisation 8–9, 15, 23–5, 31–4, 42–4, 47, 81, 105, 108, 125, 138, 179, 193, 198, 201, 220, 256, 262
Globe Telecom 163
Gonzales-Benito, J. 83
Graham, E.M. 129–30, 135, 148
Greater Mekong Sub-region (GMS) Programme 38, 177
Greenaway, D. 50, 56–7
greenfield 8, 11, 30–2, 86, 135, 142, 155, 158, 167, 180, 188, 256, 258–9
Grubel, H.G. 87
Gupta, O. 156

Hainaut, P. 59
Hanoi Plan of Action 211, 218, 220
harmonisation of FDI statistical system 213–14
headquarters–subsidiary relationships 81
Heckscher–Ohlin–Samuelson paradigm 87
Hedlund, G. 27
Hendry, D.F. 58
Heng, T.M. 141
Hernandez, L. 87
Hertel 142
Hew 107
Hewlett-Packard 116
high touch goods 18
Hiley, M. 89
Hino 118
Hirsch, S. 49–50, 57
Hirst, P. 81
Hobday, M. 91, 94, 108
Hood, N. 84, 105
Howell, L.D. 86
Hsiao 158
Huang, G. 41, 59
hub and spoke model 8, 24–5, 29–30, 180
human resource development 216

Ianchovichina, E. 142
Iboshi, P.I. 179
import-substitution industrialisation 33
import-substitution investments 107
Index-tracking 192–3
India 256
Indonesia–Malaysia–Singapore Growth Triangle (IMSGT) 38, 44–5
industrial clustering 203
industrial organisation 80–9
infomediaries 18
Integrated International Networks (IINs) 2, 81
integrated production systems 113
integration: de facto 53–4; de jure 53–4; horizontal 15; vertical 15–16
inter-firm relationships 120–2, 176
intermediation 7, 166; *see also* disintermediation, re-intermediation
internalisation theory 19, 84
International Joint Ventures (IJVs) *see* joint ventures
interventionism 164
intra-firm trade 117–18
intra-regional foreign direct investment 80–102
investment action plans (ASEAN) 211
investment agreements (ASEAN) 211
investment climate 144, 148–9, 151
investment cooperation 12, 201–54

investment facilitation 212–13
investment portfolios 11, 173–4, 190–2, 194, 258
investment promotion 212–13
investments: efficiency-seeking 56; market-seeking 56
investment statements (ASEAN) 211–12
investment subsidies 33
investment surveillance 217
investor protection 193
investor sentiment 170, 173–5, 203

Japan 10, 50, 81, 88–9, 94, 105–6, 108, 111, 114, 119, 121–2, 131, 135, 255, 258, 265
Japan–Singapore Economic Partnership Agreement (JSEPA) 46
Johanson, J. 93
Joint International Business Associations (JIBAs) 84
joint ventures 16, 19–24, 29–30, 136, 176, 188, 204
Jomo, K.S. 178

Katayama, H. 91
keiretsu 113–14, 121
Kimura, F. 2
Kittistaporn, K. 80
knowledge-intensive sectors 143
Koizumi, Prime Minister 46
Kojima, K. 89, 106
Konstadakapulos, D. 107
Kotter, J. 28
Krause, L. 57
Krugman, P. 260
Kwan, C.H. 106

labour-intensive manufacturing 134, 140, 149, 151–2, 181
Lam Research 112
land use rights 176
Latin America 55, 202, 255
Lee, W.K.M. 41
Leftwich, R.B. 50
Legewie, J. 110, 116–17, 119, 121, 122
Lemoine, L. 127, 129–32, 134–5, 138
Lenway, S. 82, 99
liberalisation 1, 10–11, 20, 34, 40–2, 86, 100, 109, 132, 135–9, 156, 159, 163–7, 170, 176, 179, 182, 192, 201–2, 205, 209–10, 212, 214, 217, 255, 262, 266
Lim, L. 41
Lindblad, J.T. 172, 261
Ling, S.L.M. 41
linkages: horizontal and vertical 120
Lipsey, R.E. 260
Liu 126–7, 129–30
Lloyd, P.J. 87
Local Industry Upgrading Program 263
locational complementation 207
location-specific advantages 7, 83, 110, 118, 123, 126, 140, 151, 202–3, 205
low cost production sites 84
low touch goods 18
low wage economies 259
Lubbe, A. 35
Lunn, J. 50
Luo, Y. 139

McGovern, I. 85, 162
McGuire, D.G. 21
McKendrick, D.G. 263
McKibbin, W. 81
Mahathir, Prime Minister 33, 44
Malaysian Exchange of Securities Dealing and Automated Quotation (MESDAQ) 192
manufacturing orientations 134
market access security 38–9
Market for Alternative Investment (MAI) 192
market contestability 100
market enlargement hypothesis 57
market growth hypothesis 57, 60, 62
market-seeking investments 63
market size hypothesis 57, 60–1
Markusen, J.R. 87
Marshall, A. 19
Martin, R. 142
Maskuls, K. 87
mass customisation 26
Matsushita 110
maturity mismatch 190
Mauer 50, 56–7
Mehra, Y.P. 58
Menon, J. 49, 50–1, 56–8, 62–3
MERCUSOR 55, 203
mergers and acquisitions (M&As) 256–8, 261; *see also* cross-border M&As
Mergers, Monopolies and Competition (MMC) 166
Mexico 28, 202
Meyer-Ohle, H. 121, 122
Mitsubishi 114
modal neutrality 100, 155, 167
Mody, A. 157
Moore, M. 125, 136
Motorola 116

Mowery 156
Multimedia Super Corridor (MSC) 42
Multinational Enterprises (MNEs) 37–8, 81, 179, 188, 191, 255–6, 260, 262
Murray, M.J. 171–3
Myint, H. 265

NAFTA 203
Narine, J. 39
Narula, R. 54, 105
NASDAQ 258
nationalist resistance 43, 89, 258, 261
Naughton, T. 189
Nayyar, D. 262
Negishi, S. 157
neo-colonialism 44
New Industrialised Economies (NIEs) 106
New Zealand 9, 49, 63
Nissan 114
Nolan, P. 137–8
Noor, W. 87
Norlund, I. 172

obstacles to business: litany of complaint 139–40, 144
Octel 112
Ohmae, K. 25
open door policy 126, 130
Oracle 39
outsourcing 28
outward investment 107, 257
outward-oriented strategy 33
ownership structures 81
Oxelheim, L. 50, 56
Ozawa, T. 86, 106, 158, 166

Palanca, E.H. 140
Pang, E.F. 41
Philippine Economic Zone Authority (PEZA) 266
Philips 116
Plaza Accord 34
Plummer, M.G. 179
policy coherence 100
Porter, M.E. 19, 167
portfolio investment *see* investment
positive sum game 256, 258
Prahalad, C.K. 25
procurement systems 120–1, 137
product life cycle model 106
promotion 202, 210
protectionism 57, 158
Protocol to Amend the 1987 Agreement 207

QAF Ltd 159
Qian, J.L. 134

Ramstetter, E.D. 42
Rana, P.B. 106
Ravenhill, J. 105, 119
regional competitiveness 201
regional cooperation 201–2
regional equity market 196
regional integration 196, 202–3, 218
regional investment strategies 218, 220
regional political economy 80, 89–91
regional production networks 203
regulatory regimes 5, 7, 139, 148, 151, 159, 162, 166, 182, 195, 197, 255
re-intermediation 16–18
research and development 7, 19–20, 28, 30, 119, 143, 263
restrictive investment measure 210
Reynolds, L. 35
Robequain, C. 171–2
Robson, P. 57
Roos, J. 156
Rosen, D.H. 39
round-tripping 2
Rugman, A.M. 19
Ryan, L. 89, 94

Sachs, J. 81
Samsung 115, 117
Sauvant, K.P. 90
Scally, A. 59–60
Scaperlanda, A.E. 50, 56–7
Scherrer, P.S. 162
Schmitz, A. 50
Schumpeter 42, 167
Seagate 110
sectoral distribution 95
sectoral diversification 193
security: economic typologies 36–48
Senior Officials meeting on Investment 208
Sensitive List 216
SGX (Singapore) 189, 196
shareholder protection 197
Shimawatra, Thaksin, Prime Minister 43
shock period 127, 136–40
Siemens 116
SIJORI economic triangle 264
Silicon Graphics 112
Simonin, B.L. 156
Singapore Power Ltd 159
Skills Development Fund 263

Societe Financiere Francaise et Coloniale 172
socio-economic paradigm security 42–4
Soon, T.W. 41
Soviet bloc 21
spatial distribution 2, 9
Special Administrative Region (SAR) 132
Special Export Zones 127
Specially Designated Industrial Areas (SDIAs) 85–6
stock markets 11–12, 165, 177, 188–200, 258
Stoever, W.A. 41
Stone, M.R. 85
Stopford, J. 41
Strange, S. 41
strategic alliances 201
Stremlau, J. 35
Stuart-Fox, M. 172
subcontracting 16
sub-regional growth zones 202
Sun 149
sunset clauses 266
supply security 37–8

Tanaka, Prime Minister 255
tariff discrimination 49, 50–1, 56–60, 62–3, 100, 107, 109, 127, 137, 141–2, 172, 180, 255
tax haven 141
techno-industrial capability security 40–2
technological convergence 20
technology-intensive manufacturing 134, 140, 149–50
Telebit 112
Temporary Exclusion List 216
Thee, K.W. 261
Thompson, G. 81, 172
Thomsen, S. 127, 140
Time Engineering 163
Toyota 113–14, 118
trade-offs: global 18; local 18
trans-border community security 44–6
transitional economies 11, 107, 170–87, 259
Transnational Corporations (TNCs) 105, 113–14, 193
transparency *see* corporate governance
triad countries 10, 81, 84, 86, 88, 100, 131–2, 135–6, 140, 149, 153, 155–7, 162, 165
Trigeorgis, L. 20

United States 50, 88–9, 105–6, 131, 135
Urata, S. 38

Vahlne, J.E. 91
Van Hoesel, R. 108
venture capital 188, 192, 199
Venzin, M. 156
Vernon, R. 106
vertical intra-industry trade 2, 115
Virgin Atlantic 163
Virt-x 196
volatility 26–31

Wada 129–30, 135, 148
Wade, R. 86, 158
Wallis, K.F. 50
Walmsley, T.L. 142
Weber, K. 189
Wei, Y. 126–7, 129–30
weightings *see* asset allocation
Western Digital 115, 117
Western Europe 135, 177, 183
Westhead, J. 86
White, J.T. 57
Wong, P.-K. 110
Woo-Cummings, M. 41
Working Group on Foreign Direct Investment Statistics (WGFDIS) 209
Working Group on Investment Cooperation and Promotion (WGICP) 208
World Bank/MIGA 85
World Trade Organisation 125

Xie, D. 86

Yamaha 119
Yasheng, H. 179
Yean, T.S. 144
Yeung, H.-W.-C. 113
Yong, Y.S. 41
Young, S. 84, 105
Youngsoo, K. 114
Yu, T.F.L. 86
Yusuf, S. 106

Zhan, J. 86, 158, 166
Zhara, S.A. 113