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DETERMINING THE DIRECTIONAL FLOWS OF FOREIGN DIRECT INVESTMENTS IN THE ASEAN REGION: KEY MACROECONOMIC AND "DOING BUSINESS" INDICATORS AFFECTING THE DIRECTION OF ASEAN FDI INFLOWS AND ITS IMPACT ON INTRA- AND EXTRA-ASEAN TRADE

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INTRODUCTION

Job creation, increasing household income, and the improvement of living standards do not only depend on the provision of adequate social services and government infrastructure support, but more so, on the growth and expansion of private sector investments. The creation of new jobs and the expansion of manufacturing productive capacity are roles better performed by the private sector rather than by governments constrained by the amount of resources that they can mobilize through taxation.

Investments, such as the establishment of manufacturing plants, purchase of capital equipment, and increases in inventory raise the productive capacity of the economy and provide employment opportunities for the work force. The growth and development of the manufacturing, utilities, construction, and mining industries can only be achieved for as long as new investments flow into these sectors, alongside with the adoption of appropriate technologies.

However, when domestic investments remain low because of inadequate aggregate savings, poorly functioning financial markets, and the lack of infrastructure support, most developing countries have to rely on foreign direct investments (FDI) to develop domestic industries. Gains from the presence of foreign firms in the domestic economy (i.e., production of goods with higher value added, the transfer of new technologies, etc.) ultimately spill-over to local firms and industries. Countries in the ASEAN region, for instance, have long been attempting to attract more FDI in higher value added manufacturing in order to strengthen their respective export sectors and exploit the opportunities of increased market access provided by bilateral, regional, and multi-lateral trade agreements.

IDEAL CONDITIONS THAT ATTRACT FOREIGN DIRECT INVESTMENTS

The formulation of policies that attract FDI should focus on the creation of a favorable business environment that includes the following:

1. Macroeconomic stability characterized by sustained economic growth, low inflation, low interest rates, and stable exchange rates (Bevan & Estrin, 2008);
2. Large markets provide enormous business opportunities, particularly the chance to maximize the advantages of economies of scale (Sethi, Guisinger, Phelan, & Berg, 2003);
3. Adequate infrastructure support (i.e., transportation, power, etc.), which reduces the cost of doing business (Rehman, Ilyas, Alam, & Akram, 2011);
4. Skilled labor, not only low-cost labor, matching the needs of foreign firms (Borensztein, Gregorio, & Lee, 1998);
5. Liberal investment laws in extractive industries and agriculture and liberal trade policies covering minerals and agricultural products (Borensztein, Gregorio, & Lee, 1998);
6. Host country participation in the formation of bilateral, regional, and multi-lateral trade agreements (Borensztein, Gregorio, & Lee, 1998);
7. Liberal investment policies involving equity ownership, leasing agreements, and the exclusion of industries in the negative list (Aldaba, 2006);
8. Fiscal incentives in the form of tax holidays, tax credits, duty free importation of capital equipment, tax deductible labor training expenses, and accelerated depreciation (Aldaba, 2006);
9. Strong and accountable institutions, which include a judicial system that is effective in settling disputes and enforcing contracts (Vittorio & Ugo, 2008);
10. Good governance through the eradication of graft and corruption improves the efficiency and effectiveness of the provision of public services (Kahai, 2004);
11. Political stability, manifested in the completion of all elected officials' term of office, ensures the full implementation of development programs and the consistent implementation of rules and regulations.

ASEAN FOREIGN DIRECT INVESTMENTS INFLOWS

From 2009 to 2011, ASEAN FDI inflows increased from $46.90 billion to $114.11 billion, growing by a factor of 2.43 times since the occurrence of the United States (US) financial crisis and the global economic slowdown. Prior to 2009, ASEAN FDI placed at $63.69 billion in 2006 grew by 32.12% in 2007 to reach the pre-crisis level of $84.15 billion but decreased to $49.29 billion in 2008 and $46.90 billion in 2009 (ASEAN, 2013).

From 2006 to 2011, Singapore consistently attracted that largest amount of FDI with the biggest recorded in 2011 at $64 billion. In 2010 and 2011, approximately 52.83% and 56.08%, respectively, of the total ASEAN FDI inflows went to Singapore. Indonesia was the second largest recipient of FDI for 2010 and 2011 at $13.77 billion and $19.24 billion, respectively. Malaysia was the third largest recipient of FDI, which grew by 6.5 times from 2009 to 2010 and further expanded by 31% to reach $12 billion in 2011. Thailand was the fourth largest recipient of FDI for the year 2010 and 2011 at $9.11 billion and $7.78 billion, respectively; followed by Vietnam at $8 billion and $7.43 billion, respectively; and the Philippines at $1.3 billion and $1.26 billion, respectively.

Brunei Darussalam, Cambodia, Lao PDR, and Myanmar were ranked 7th, 8th, 9th, and 10th, respectively, in terms of receiving FDI. Brunei Darussalam's inflows continually increased from $330.1 million in 2008 to $1.21 billion in 2011. Cambodia's FDI inflows peaked at $891.7 million in 2011. Lao PDR received its highest inflows in 2010 at $332.6 million, while Myanmar's inflows peaked in 2008 at $975.6 million (ASEAN, 2013).

INTRA- AND EXTRA-ASEAN TRADE

Total ASEAN trade, placed at $2,388.59 billion in 2011, was comprised of 25% intra-ASEAN trade – at $598.24 billion - and 75% extra-ASEAN trade – at $1,790.35 billion. Singapore accounted for the largest share of both intra- and extra-ASEAN trade at $205.67 billion and $569.48 billion, respectively. Thailand ranked second for both intra- and extra-ASEAN trade at $111.45 billion and $347.45 billion, respectively. Malaysia had the third largest value for intra- and extra-ASEAN trade at $108.14 billion and $307.58 billion, respectively (ASEAN, 2013).

SOURCES OF FOREIGN DIRECT INVESTMENTS INFLOWS

For the year 2011, the largest portion of ASEAN FDI inflows came from its respective regional members. Intra-ASEAN FDI accounted for 23.02% of all inflows to the region. The second largest contributor was the European Union (EU) at 15.98%; Japan was third at 13.16%; China ranked fourth at 5.29%; and the US was fifth at 5.07%. For the years 2009 and 2010, ASEAN was only the second largest contributor to FDI inflows at 13.43% and 15.52%, respectively. The EU topped the list for these years at 17.19% and 18.44%, respectively (ASEAN, 2013).

Japan's contribution to ASEAN FDI decreased from 8.8% in 2008 to 8.08% in 2009 but rose to 11.66% in 2010 and 13.16% in 2011. China and the US's contributions fluctuated during the period. China's contribution to ASEAN FDI inflows peaked at 5.29% in 2011. The share of the US was at its highest in 2010, 13.84%. It dropped to 5.07% in 2011 (ASEAN, 2013).

The value of ASEAN FDI inflows originating from within its members was at $14.32 billion in 2010 and $26.27 billion in 2011; approximately $54.48 billion and $47.72 billion, respectively, came from its dialogue partners (countries outside ASEAN). The EU was largest contributor of inflows outside the ASEAN at $11.72 billion in 2005, $21.90 billion in 2007, $17.01 billion in 2010, and $18.24 billion in 2011; whereas Japan was the region's largest source of investment inflows in 2006 at $10.76 billion. Although a decline in inflows from all dialogue partners was observed in 2006 to 2009, the majority recovered in 2010 and 2011 (ASEAN, 2013).

The presence of bilateral or multilateral agreements governing trade with large market non-ASEAN members (i.e., the US, the EU, etc.) provides opportunities for the growing number of competitive exporters among ASEAN member countries to sell more goods and services within the free trade area.

RESULTS

Panel regression results involving nine ASEAN member countries over a five year period reveal that market size, sustained economic growth, per capita gross domestic product, infrastructure support, and foreign exchange rate are the key macroeconomic variables, which attract intra-ASEAN FDI. Empirical results for extra-ASEAN FDI, on the other hand, reveal that it is only responsive to market size and economic growth.

In addition, the significant "doing business" indicators include: 1) ease of doing business; 2) ease of starting a business; 3) protecting investors; and 4) trading across borders. These explanatory variables generally provided results consistent with the a-priori expectations. As the ranking of each ASEAN member country improves under each of these indicators, FDI goes up.

The doing business indicators are even more significant when used as explanatory variables for intra- and extra-ASEAN trade. Trading across borders and protecting investors provided consistent significant results in explaining movements in both categories of ASEAN trade.

Except for Singapore, the rest of the ASEAN member countries need to continue improving on investment rules, regulations, and policies, which contribute to the ease of doing business in the region in order to attract not only intra-ASEAN FDI but also a larger share of the global FDI inflows. Out of 189 countries, Singapore is ranked number 1 in the ease of doing business and in trading across borders; number 4 in starting a business; number 2 in protecting investors; and number 13 in terms of enforcing contracts.

The other ASEAN member states have rankings that are generally at the bottom half of the list of all countries. Improving the investment climate in the other ASEAN member countries requires implementing rules, regulations, and policies similar to those of Singapore but with significant variations that account for differences in the level of development in specific industrial, agricultural, and service sectors; deficiencies in infrastructure support; limited participation in bilateral trade agreements; and the need to reform institutions that enforce the rule of law, settle disputes, and protect property rights.

Thus, reforms concerning investment rules, regulations, and policies have to be initiated in order to improve the rankings of other ASEAN member countries in the ease of doing business yearly evaluation conducted by the World Bank. Policy adjustments should include: 1) streamlining government procedures in securing permits and clearances to start a business, business registration, and the payment of taxes; 2) easing trade across borders without compromising the security risks involving contraband and technical smuggling; 3) protecting investors' property rights; 4) enforcing contracts; and 5) increasing access to credit.

In addition to these reforms, it will also be important to consider instituting policies that protect the interest of the host country so that the gains from FDI inflows are maximized and the negative outcomes reduced. Policies that safeguard the host country from multinational firms acting as monopolies or collusive oligopolies should include: 1) anti-trust regulations; 2) protection of sovereignty with regard to land ownership and leasing agreements; 3) protection from tax evasion practiced through transfer pricing and the inappropriate granting of fiscal incentives; and 4) environmental protection.

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