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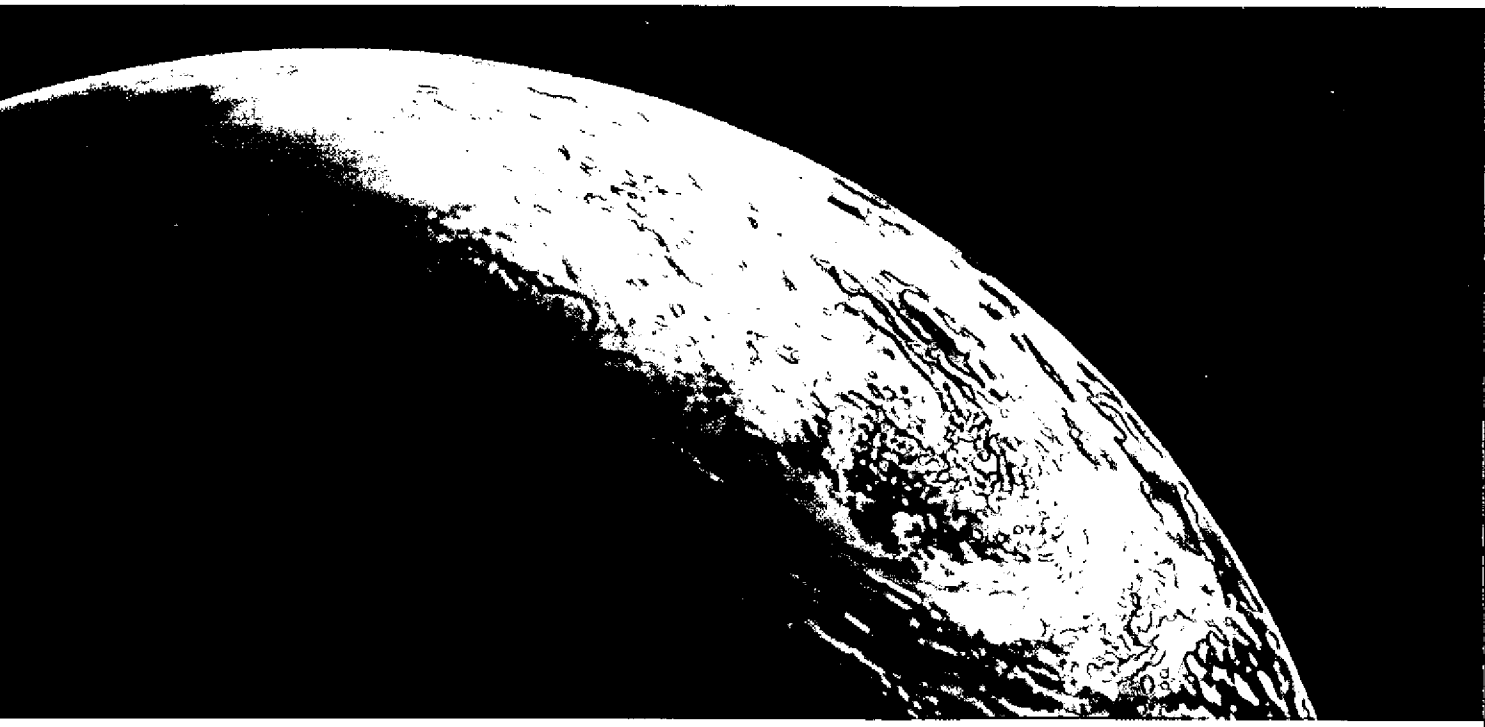

Foreign Direct Investment in South-East Asia: Experience and Future Policy Implications for Developing Countries

Report of UNIDO Expert Group Meeting (EGM) 21-23 March 2005, Bangkok, Thailand

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INDUSTRIAL DEVELOPMENT ORGANIZATION

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Nick J. Freeman, Consultant and EGM Rapporteur; Peter J. Buckley, Professor of International Business; Hafiz Mirza, Professor of International Business;
and Frank L. Bartels, Senior Industrial Development Officer, UNIDO.

Contents

Abbreviations and Acronyms

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
AIA	ASEAN Investment Agreement
AICO	ASEAN Industrial Cooperation scheme
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral Investment treaty
BOI	Thai Board of Investment
BTA	Bilateral trade agreement
DTT	Double taxation treaty
EGM	Expert group meeting
FDI	Foreign direct investment
FPI	Foreign portfolio investment
GVC	Global value chain
ICT	Information communications technology
IP	Investment promotion
IPA	Investment promotion agency
IPR	Intellectual property rights
ITPOs	Investment and Technology Promotion Offices
M&A	Merger and acquisition
MNE	Multinational enterprise
NIEs	Newly industrialised economies
ODA	Overseas development assistance
OECD	Organisation for Economic Co-operation and Development
R&D	Research and development
SDPN	Spatially distributed production networks
SME	Small and medium sized enterprise
UNIDO	United Nations Industrial Development Organization
VIIT	Vertical intra-industry trade
WTO	World Trade Organisation

Preface

This UNIDO report presents the key issues and outcomes from the papers, presentations and deliberations of the UNIDO expert group meeting (EGM) on Foreign Direct Investment in Southeast Asia: Experience and Future Policy Implications for Developing Countries. The EGM, held in March 2005 in Bangkok, Thailand, concerned the primary objective of delineating the factors and variables of foreign direct investment (FDI) to which national industrialisation and investment policies need to be attuned.

The EGM aimed to provide the policy-making community and business leaders in Southeast Asia with a broad view of the fundamental issues, and a deep appreciation of the inter-relationships, pertaining to FDI activity. These relationships determine structural factors in: i) the intermediation role of multinational enterprises (MNEs) in the international economy; ii) the changing characteristics of markets, traded goods and services within world economic activity; and iii) regional vectors of (spatially distributed) manufacturing and services provision.

It is important to state here what the report does, and does not, seek to do. It does not seek to present an exhaustive analysis of the evolution of the regulatory framework of trade rules within which FDI, foreign portfolio investment (FPI) and international contracting occurs. Nor does it comprehensively survey the underlying motivations and rationale for FDI. The report does, however, attempt to articulate current thinking on the nature of the issues which are crucial to FDI policy craft today, as identified by experts, informed researchers, experienced practitioners and pragmatic policy-makers.

The thematic programme of the EGM, which draws on the experience and expertise enunciated above, is presented in Appendix I. A year in preparation, the EGM brought together some of the leading international

thinkers and writers on FDI and matters related to FDI (see Annex 1 for a list of presenters and Annex 2 for a list of participants).

The invited policy-makers and business leaders were affiliated to national institutions for policy and business, namely: boards of investments; investment promotion agencies; economic development agencies; economic and industry ministries of state; state planning departments; national and international chambers of business, commerce and industry.

The EGM, supported by the Thai Board of Investment (BOI), was formally opened by the Secretary-General of BOI, Mr. Satit Sirirangkamanont. Mr. Jean-Marc Deroy, UNIDO's representative in Thailand and Mr. Frank L. Bartels followed with opening statements on behalf of the Director-General of UNIDO, Mr. Carlos Magariños (see Appendices II, III and IV).

Preamble

Within the constantly evolving framework of global investment and trade regulation, structural factors that determine the role played by multinational enterprises (MNEs) in the international economy have been undergoing realignment. This realignment, underway since the 1970s, has been accelerating in its manifestations away from a spatial distribution of production, and towards a redistribution of services traded across international boundaries. Notably, international contracting and supply relationships ('offshore outsourcing') have tended to be concentrated in the East and Southeast Asian economies, with these regions' productive capacity serving much of the global economy.

This ongoing realignment is a function of a combination of technological, information communication, manufacturing, and management advances which cumulatively serve to enable the various stages of production -- and tradable services -- to be increasingly disintegrated, reconfigured and relocated according to: i) the efficiencies of capital and labour on the one hand; and ii) on the other hand, the distribution of total factor productivity growth profiles of different countries (and even specific locations within countries). These stages of production are then re-integrated through MNEs' own co-ordination and governance mechanisms, and international trade. This realignment occurs in a world that can be envisaged "as a grid of potential locations for value-adding activities, connected by flows of information and products" (Buckley and Hashai, 2004, p. 33). The value-adding activities -- which are predominantly controlled, co-ordinated and managed by MNEs -- are increasingly layered (or 'nested') inter-actions of FDI, FPI and international contracting, in manufacturing as well as services.

The emergent pattern of realignment is not simply a result of increasing technological, finance, human capital and other resource differences between industrialised and developing countries. The quality of FDI and industrial policy craft -- and its implementation -- are also determining factors.

The realignment of structural factors in the roles of MNEs, international small and medium sized enterprises (ISMEs) in global manufacturing and services present considerable policy challenges to policy-makers in developing countries. The EGM and this report are intended to deliver assistance in identifying suitable responses and solutions to these challenges.

Introduction
The Changing Face of Foreign Direct Investment

The important role played by foreign direct investment (FDI) in economic growth and development is widely accepted. UNIDO's own analyses of industrial organisation, and the determinants of competitive industrial performance, identify FDI as a key driver of a country's capacity to trade. Not surprisingly, therefore, developing countries' industrial plans commonly seek to attract FDI inflows, and the countries of Southeast Asia have proven to be leading exponents in this regard. On average, South and East Asia attracted 7% of annual global FDI flows in the 1980s and just under 15% in the 1990s. This contrasts markedly with Sub-Saharan Africa, which attracted just 1.2% and 0.8% in the same periods, respectively. While the total global flows of FDI tend to vary each year, up and down, one constant is the asymmetry of FDI distribution, with some regions and countries faring much better than others in attracting and hosting foreign investment projects (see Appendix V).

Another feature of FDI activity is its steadily increasing complexity, thanks in part to technological and communication advances, and the reduction in various regulatory and other barriers to cross-country investment and trade [UNIDO (2005)]. Market liberalisation is one driver of FDI flows, as is financial liberalisation, permitting capital to flow more easily across the globe. This is evidenced by advances in sourcing and outsourcing, and the global integration of production, marketing and servicing networks as inter-connected systems that can be distributed right around the world. All these different activities are pinned together by MNEs through their strategic -- and increasingly dynamic and fluid -- relationships with affiliates, subsidiaries and suppliers. Indeed, over time, we are seeing the production and other business activities of MNEs being increasingly finely 'sliced and diced' into smaller and smaller constituent elements, and then reconfigured, so as to gain competitive advantage from economies of scale and economies of scope [Bartels and Pass (2000)].

Recent years have seen increasing competition between countries to attract and host finite FDI flows. But the challenge for policy-makers is not just about attracting a greater share of FDI inflows, but also harnessing it to optimal effect. International experience provides some lessons on optimal policy designs and instruments (and their implementation). However, the topic remains the subject of continuing and continual research and analyses, not least because FDI activity itself (both in manufacturing and services) is in a state of permanent evolution and change. For example, the steady rise of global value chains and global production networks, briefly depicted above, has become an increasing source of interest. For policy-makers, the key question is: how can a country best position itself to take advantage of this new phenomenon? While policy instruments that proved effective in attracting and harnessing FDI yesterday may prove less effective today (and tomorrow), new instruments may be part of the answer.

It is in this context that a UNIDO expert group meeting (EGM) was conceptualised and conducted; using the experience of Southeast Asia as a lens through which to depict and debate the challenges currently confronting developing countries in successfully attracting and best harnessing FDI inflows. The Southeast Asian region spans a diverse range of countries, at very different stages of economic development and transition, and therefore serves as a useful object of study for most developing countries [Freeman and Bartels (2004)]. This report is intended to serve as a summary of the EGM's presentations and discussions.

Theme 1
FDI and Multinational Enterprises in Southeast Asia: Globalisation's Challenges

Presentation summary

Providing a robust platform on which the topic of FDI in Southeast Asia can be explored, Peter Buckley provided a 'long view' perspective of global and regional FDI activity. He introduced the notion of multinational enterprises (MNEs) as global networks, seeking to "circulate mobile inputs globally, to combine with locationally fixed factors". The primary motives for FDI by MNEs can be categorised as seeking to gain: i) market access; ii) access to immobile inputs, such as raw materials like oil; and iii) access to immobile resources, such as competitive labour inputs and tax rates. The role of MNEs is to circulate mobile inputs across the globe, so as to combine them most effectively (and efficiently) with these immobile factors. This results in the formation, co-ordination and movement of various operations and functions within an MNE, distributed across countries. And can be likened to that of an 'integrated global factory'. See Figure 1, below.

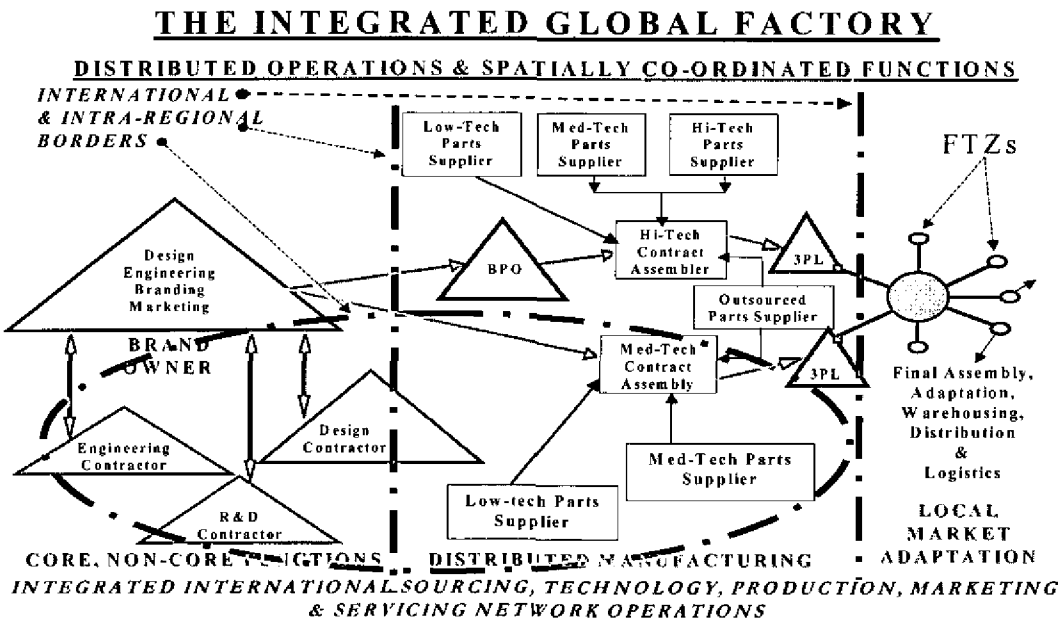

Figure 1: The integrated global factory. Adapted from Buckley (2003); Buckley and Ghauri (2004).

In terms of product classification, and therefore global value (or supply) chains, each MNE may have several global factories, some of which may

overlap according to production process, corporate function and/or subsidiary mandate. But it is important to recognise that MNE networks are becoming increasingly flexible and fluid, and much less static in nature and composition. Further, there is a trend away from hierarchical and vertically integrated MNEs that are wholly controlled from the centre, and towards more looser organisational structures, or extended organisational forms that tend to resemble markets, linked by various forms of contract, and not just by equity ownership. The recent shift towards greater international outsourcing is one example of this trend. The implication for policy-makers is that there are potentially more opportunities to benefit from this change in MNEs' behaviour and structure, and as the various parts of production are 'sliced and diced' into finer and finer elements, the opportunity to become a specialised participant should increase. But, at the same time, we are witnessing greater competition between countries to attract these smaller parcels of investment.

In a stylised way, the 'internationalisation' of companies' operations results in a conflict of different asset markets: i) global (and relatively efficient) capital markets; ii) regional goods and services markets; and iii) nationally segmented labour markets with relatively high transaction costs. While policy-makers potentially have considerable influence over national markets, they have relatively less influence over regional markets, and very limited control over the movements of international markets. Similarly, in seeking to positively influence the actions of MNEs, such as attracting investment (and outsourcing), the potential for policy-makers to stimulate change can be somewhat limited. For example, there are some organisational attributes and operational features of MNEs that are unchanging, such as: i) the competitive aim of maximising profits; ii) the desire to co-ordinate and control operations; and iii) the need to reduce transaction costs by 'internalising' markets. Here there is little that policy-makers can do to effect change. But other MNE characteristics tend to be more transient, and therefore provide some degree of traction for policy-making influence.

These include: i) changes in long-term business strategy and organisation configuration; ii) issues of ownership and financing; iii) the specific locations of all activities (including that of headquarters); and iv) firm specific advantages. And it is here that policy-makers should focus their attention. This can be done at the national level by seeking to:

- Strengthen and build capacity in pertinent institutions;
- Pursue consistent and transparent long-run policies;
- Lower transaction costs.

It is worth noting that these are almost entirely congruent with best practice elements necessary for wider economic development, and can be expected to generate benefits for domestic firms as well as foreign MNEs.

In seeking to identify which potential host countries offer the most attractive enabling environment for investment, MNEs will often use the increasing number of benchmark surveys, rankings and indices that are available, and which seek to evaluate and compare states. These include UNIDO's Competitive Industrial Performance Index, which evaluates the relative degree of productive capacity and industrial complexity (precursors for investors to create manufacturing output and value) and the World Bank's 'Doing Business' survey. The latter survey includes an assessment of: i) how many days it requires to set up a business; ii) the main obstacles to establishing a new firm; iii) the main obstacles to growth for existing companies; and iv) the quality of business regulation and its implementation, etc. Another example is the Opacity Index, which measures small-scale but common investment risks that are typically associated with insufficient transparency in host countries' legal, economic, regulatory and governance structures.

While a number of country-representatives at the EGM quibbled with the means by which these benchmark surveys are constructed, and the biases that are sometimes contained within global indices of this kind, the fact remains that MNEs do use them when appraising where to enact specific FDI projects. As a consequence, making a concerted attempt to move up the

benchmark rankings should be one aim of policy-makers and investment promotion agencies (IPAs). But more importantly, as it is virtually impossible to move up across all rankings simultaneously, it is the judicious selection of nationally relevant variables from among the benchmarks -- and their significance in attracting FDI -- that should be the focus of attention by policy-makers and IPAs. In this sense, the encouragement from Peter Buckley to "look behind the figures", to see what could and should be changed, was welcome.

Commentary and discussion

Brian Caplen noted that roughly three quarters of world trade is now conducted within MNEs (i.e. shipping goods from one part of a transnational firm to another) and their global factory. The challenge for policy-makers is how to insert their country into this global factory, at a time when we are also moving towards a more rules-based approach to trade in goods and services, as a result of World Trade Organization (WTO) and other bodies. East Asia's track record in responding to past challenges is fairly impressive, as evidenced by the far-sighted policies enacted by Singapore to attract FDI in the 1960s and 1970s, when it went against conventional thought. East Asia was also the first region to embrace outsourcing, initially in the textile industry. Looking ahead, the rise of 'virtual companies' poses new challenges for most countries in Southeast Asian countries and beyond, as does the competitive 'pull' exerted by China. Possible responses include diversification and specialisation, along a narrow range of specific comparative advantages, typically stemming from specific technological or innate skill advantages. The increasing value of a "level playing field" for both domestic and foreign investors was also underscored as being important.

One constant is MNEs' need for consistency and transparency in policy-making by host countries, and an aversion to gratuitous bureaucracy and red tape (which are often associated with corruption). For firms involved in production or services at the higher end of the value chain, the general

quality of life in a country can be essential in attracting the necessary talent, and therefore is an important determining factor in locating an investment. The provision and quality of after care service for investors (i.e. assistance provided by the IPA to an MNE, after the initial investment has been made) can also be an important determinant, notably in terms of reinvestment by existing investors. In Thailand, for example, the Board of Investment (BOI) has introduced a trouble-shooting unit, to assist foreign investors with any problems that they may subsequently encounter.

Looking ahead, in-depth analyses of what countries did best in relation to the strategies of regional neighbours resonates with international best practice in pro-FDI policy craft.

Theme 2
FDI and National Experiences

First presentation summary

Since the 1960s, the pace of growth in world trade has outpaced the growth in world output. Similarly, since the early 1980s, the pace of growth in FDI flows has outpaced the growth in world trade. And as a consequence, roughly three quarters of world trade is now conducted within MNEs, as intermediate products are produced and assembled across borders, and even services are increasingly tradable in association with international production. Much of this FDI activity is conducted betwixt the so-called 'Triad' powers of Europe, the US and Japan, as substantial flows of capital pass through the investment corridors that span the Atlantic and Pacific oceans. Much of this 'Triad' investment is not greenfield investment activity (i.e. the establishment of new capacity), but rather cross-border merger and acquisition (M&A) activity. Numerous factors drive M&A activity, which tends to occur in cycles within specific industries. The most recent global M&A boom was in 2000, with some signs that another flurry may begin in 2005.

Across the Southeast Asian region, some of the outstanding common FDI challenges faced by policy-makers included: i) restructuring investment laws; ii) inadequate information from, and limited co-ordination between, relevant state agencies; iii) limited ability to catalyse local entrepreneurship sufficiently, so as to enable local firms to engage more broadly with foreign investors; iv) inadequate 'hard' and 'soft' infrastructure, especially in relation to information and communication technologies; v) managing the host location image; vi) entrenching the higher value operations of MNEs more firmly within specific localities (in the context of intra-regional competition for FDI and outsourcing); vii) inadequate human resource capacity in policy matters; viii) an inability to reduce 'red tape' effectively; and ix) incoherent policy discrimination between foreign and domestic investment. These kinds of fairly common challenges, which could be viewed as regional disadvantages, vary across the region in degrees of intensity and

consequence, as well as in terms of the policy responses being currently pursued to address them.

Some of the policy responses to these challenges included: i) dealing more effectively with FDI arbitration, as a consequence of changes to legislative frameworks; ii) reducing costs of co-ordination; iii) strengthening the institutional mechanisms for engaging foreign investors and local industry; iv) using provisions of regional arrangements more effectively to compensate for national resource constraints; iv) more coherent emphasis on destination image management; v) more effective national inter-agency co-ordination; vi) sharper focus on increasing human resources productivity; and vii) harmonising private company law within a unitary investment framework.

Such responses, some unique and others common across the region, varied in strength and direction, depending on the particular constraints facing each country. Looking forward, a focus on evolving challenges and policy responses requires a strategic view of how to manage and resolve identified challenges. In relation to this, national presentations disclosed the following strategic considerations regarding FDI: i) economic (and socio-political) reform to account for the crucial role of investment; ii) trade normalisation with key trading partners; iii) a shift of focus towards the international contracting (outsourcing) dimension of FDI; iv) increasing the role of regional integration; v) evaluating investment promotion performance across all institutions engaged in attracting and retaining FDI; vi) establishing regional industrial parks as special zones; vii) rapidly reducing the policy difference between investors; and viii) establishing comprehensive investor 'aftercare' service centres for existing investors.

Commentary and discussion

Nick Freeman noted that all the national presentations resonated with a keen focus on investment promotion, and that this was encouraging evidence of the broad awareness of the need to compete for FDI. Noting that the redundancy rate for investment incentives was often very high, the evident

'pipeline' of harmonising legislation to increase policy coherence was clearly a step in the right direction. The fragmented and small national markets within the region called for greater, not less, regionalisation, so that sectors within countries would be better enabled to diversify within the integrated global factory, and thereby seek specialisation within MNEs' production networks. Regional co-operation at the institutional level is essential to permit industrial collaboration (and competition) at the micro-economic level. And in this respect, the conditions for attracting FDI need to be sustainable for FDI to gain traction with increasingly specialised domestic sectors.

The high commonality of challenges implied that gains can be made through co-operation between IPAs across the region, in sharing their responses and pursuing 'regional best practices'. The national distinctiveness in revealed comparative advantages and created assets also point to gains from further regional division of labour, although it was acknowledged that the danger of 'over competition' and a 'race to the bottom' through incentives wars could, and should, be avoided through regionalism.

Second presentation summary

Atchaka Brimble of Thailand's BOI portrayed the changing characteristics of the Thai experience of FDI, highlighting in particular the global and regional asymmetries in FDI flows, and the FDI performance of the country relative to other recipients in the Asia Pacific area. Thailand is currently enjoying renewed interest by investors, with the 'Triad economies' as leading sources of FDI; and Singapore, Malaysia and Taiwan province of China as the predominant regional sources of FDI inflows for Thailand.

The investment promotion (IP) strategy of Thailand was seen to focus on the leading variables of FDI benchmarking studies, through both short- and long-term plans. Coupled with this re-orientation was greater attention to attract higher-value added and technologically-intense FDI, in recognition of the need to shift rapidly away from low- and medium-technology, and towards

high-technology cluster development. A pressing issue emphasised was the speed and management of the change, which was governed by institutional development and constraints therein. A recognition of the role of the knowledge-based economy was factored into upgrading skills and investing in innovation as an essential component of investment promotion.

The presentation described a spatial initiative, whereby the clustering and value-chain components of investment promotion could be fully developed, principally by targeting specific investors in auto, agri-business, information communications technology (ICT), fashion, biomass, and providing services outsourcing.

Commentary and discussion

Frank Bartels noted the widening of the FDI ownership base, which pointed to increasing competitiveness across domestic sectors. This presaged future intensification of backward and forward linkages, albeit only if advancing up the value-chain can be matched by policy craft dedicated to upgrading the skills sought by investors. Also crucially important is the need to create 'locational assets' that will enable exports to diversify, in terms of both product category and destination, away from electronics and the Triad countries respectively, so as to increase specialisation. It was noted that the evolution of Thailand's experience in FDI placed increasing demands on policy analysis and research with respect to the 'drivers' of industrial development.

The customisation of incentives for government prioritised strategic cluster development was noted as vitally necessary, not only for inward FDI, but also outward FDI. This customisation, at least in some countries of the region, is being performed at the provincial level. This raises the thorny issue of the efficacy of investment incentives, and the potential for competing for FDI purely through incentive packages. While available 'best practice' provides guides to IPA organisation and management, the key provision of adapting best practices to meet specific national (and local) conditions is a

major determinant of success. This adaptation requires rigorous analysis, accurate and valid knowledge of local conditions, and continuous surveying of FDI variables – activities that are performed neither regularly nor profoundly across much of the Southeast Asian region.

Theme 3
FDI, Boundaries, Hierarchies and Markets

First presentation summary

Presenting an analytical framework within which FDI policy instruments can be designed, Frank Bartels provided the various policy objectives, instruments and implementation processes available to IPAs. Against the background of sovereign authorities being able "to shape -- or even distort -- the economic environment of the host country, in order to attract and retain higher levels of value-adding FDI", the dimensions of FDI policy objectives were seen in terms of the growth of factors and variables.

These factors and variables may be grouped in terms of: i) investment or business climate benchmarking[1]; ii) Competitive Industrial Performance criteria [UNIDO (2002)]; iii) fiscal items (e.g. direct and indirect taxation); and iv) non-fiscal items (e.g. grants). The major challenge confronting policy-makers is that, in a world increasingly influenced by the World Trade Organisation (WTO) and a rules-based approach to policy matters, plus diminishing barriers to factor mobility, the range of FDI promotion has expanded to include all the factors and variables of: i) FDI determinants and motivations; ii) structural adjustment[2]; iii) business operational environment[3]; iv) enterprise performance[4]; v) ability to do business 'without a hassle'[5]; vi) macro-economic competitiveness[6]; vii) economic freedom[7];

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[1] For example, see A. T. Kearney, 2004, *FDI Confidence Index*, Global Business Policy Council, Volume 7; A.T. Kearney, 2004, *A.T. Kearney's 2004 Offshore Location Attractiveness Index: Making Offshore Decisions*, Chicago; Fraser Institute, *Economic Freedom of the World: 2004 Annual Report*, Vancouver; Heritage Foundation, 2005, *2005 Index of Economic Freedom*; IMD, 2003, *The World Competitiveness Yearbook 2003*, Geneva; Transparency International, *Framework Document: Background Paper to the Corruption Perceptions Index*, Passau; UNDP, 2003, *Human Development Report: Millennium Development Goals: A compact among nations to end human poverty*, New-York; UNIDO, 2002, *Industrial Development Report 2002/2003: Competing through Innovation and Learning*, Vienna: UNIDO; WEF, 2000, *Global Competitiveness Report*, Geneva; World Bank, 2005, *Doing Business in 2005*, Washington D.C.: IBRD/World Bank/OUP.

[2] Resource assets, infrastructure, operating costs, economic performance, governance, taxation, regulatory conditions and framework.

[3] Public services and policy, legal system, corruption, regulatory efficiency, mergers monopolies and competition policy, financial services.

[4] Regulatory capture, influence and lobbying, labour market, rule of law.

[5] Starting a business, hiring and firing workers, access to credit, enforcing contracts, closing a business.

[6] Macro-economic conditions, public institutions, technology.

and viii) general foreign investor confidence[8]. Simultaneously, policy discretion has been diminished by the rules-based approach. In terms of competitive industrial performance, the policy factors (and variables) reflect industrial capacity and complexity[9]. In terms of taxation, the pertinent factors and variables of investment promotion cover direct taxes (such as personal and corporate income taxes) and indirect fiscal measures (such consumption and transaction taxes).

Although the priorities of governments and the objectives of MNEs tend to differ, their interaction is of fundamental importance to economic growth and technological development. Governments are primarily concerned with increasing welfare functions within the national economy, for the benefit of their citizens. MNEs are primarily concerned with maximising the long-term value of the firm, for the benefit of shareholders (who may or may not be citizens in the same country as the FDI project). These respective duties do not always coincide or converge. Indeed, they can be highly co-operative and/or conflicting. The issue of policy craft for FDI is therefore increasingly crucial to the economic well-being of developing countries. Therefore, economic policies intended to attract, promote and enhance inward FDI are essential tools that need to be brought into the armoury of the policy-making community. Further, investment policy should be aligned with a host country's industrial policy, as well as with its wider development goals [UNIDO (2005)].

The governments of developing countries choose policy instruments -- generalised as incentives[10] -- to attract FDI activity, and different dimensions of incentives can be depicted. Firstly, incentives can be either *general* or *specific* (with a discretionary perspective).

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[7] Trade policy, fiscal burden of government, government intervention in economy, monetary policy, FDI and FPI, banking and finance, wages and prices, property rights.

[8] Propensity of firms to undertake FDI in a particular location.

[9] A country's Industrial Capability Profile, comprises: manufacturing value-added (MVA) per capita in conjunction with manufactured exports per capita; and share of medium- and high-technology (MHT) in MVA in conjunction with share of MHT in exports. The first pair of indices indicates industrial capacity and competitiveness, whereas the second pair connotes industrial depth and complexity. See UNIDO 2002/2003 Industrial Development Report, Competitive Industrial Performance Index.

[10] Not to be confused with the special category of fiscal or financial incentives.

A second dimension is that incentives can be either *permanent* or *temporal*. However, pragmatically it is useful of think of policy instruments as windows of opportunity which open and close. A third dimension exists at the geographic level, since investment promotion policies can target FDI either at a *national* level or at a *regional* or *local* level. Locality-specific incentives can be used to promote special regions of a country that are poorer, or in greater need of development. Further, incentives can be used to attract foreign investors to the whole *economy* or only to certain *sectors* or *sub-sectors*, according to the specific needs of the country. This set of policy instruments is often geared to accelerating technology transfer and diffusion, in a bid to increase the Competitive Industrial Performance Index, by raising the relative share of medium- and high-technology intensity of exports and manufacturing value added. In the past, this has often entailed 'negative' or 'positive' lists which either cordoned off, or ring-fenced in, strategic sectors of the economy to foreign investors, and reserved other sectors for national firms only. Finally, at the firm level, incentives can focus either on *all FDI*, or only on *specific investors*. These various dimensions are depicted in Figure 2, below.

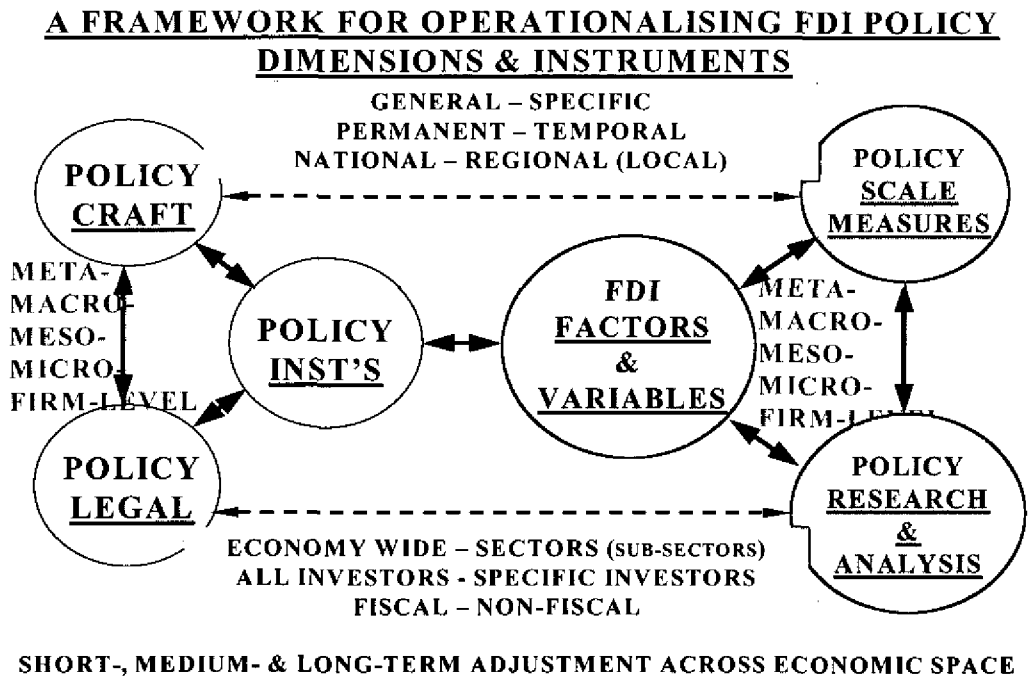


Figure 2: A Framework for 'Operationalising' FDI Policy Dimensions and Instruments

Investment policy craft -- creating policy coherence out of conflicting demands as well as scaling and measuring the necessary factors and variables -- is a challenge. The growing importance of investment and business climate benchmarking as a guide to policy making was acknowledged while indicating econometrically, that every factor or variable (or their combinations) has its own FDI inflow-elasticity and FDI stock-elasticity. IPAs and policy-makers with limited resources should therefore concentrate their policy craft on those FDI factors and variables with the highest FDI-elasticities [Christiansen (2004)][11]. In rank order, these are shown to be: i) growth-competitiveness; ii) economic freedom, combining government intervention, property rights, wages/prices and regulation variables; iii) taxation and regulation; iv) quality of telecommunication services; and v) labour market regulation. This approach lays out the choices available to policy-makers in making viable policy instruments in a systematic manner based on rigorous analysis. Hence from a fourth generation investment promotion perspective, a focus on macro-economic environment stability and technology policies to increase the rate of innovations is welcome.

All these elements and issues in Figure 2 reflect the need for sequencing and switching policy instruments and incentives, both in space and time. In other words, while FDI policy-making is increasingly more complex and diverse, host governments, according to their development needs, have to adapt to the MNEs dynamic activities by sequencing and switching (in a predictable manner) their FDI policy instruments. Moreover, these different policy dimensions also indicate the importance for host governments to create different levels of policies: i) the meta- or supra-national level; ii) the macro- or national level; iii) the meso- or regional and cluster level; iv) the micro- or

[11] For example, the FDI stock elasticities of GDP per capita range from 0.89 to 0.96 implying that a 10% increase in a country's GDP per capita would result in a 10% increase in inward FDI stock. Likewise, the FDI inflow-elasticity of a host country's competitiveness (scaled 1 to 5) at 0.63 implies that an increase of 1 point in the scale would result in an increase of 88% inward FDI ceteris paribus. See Christiansen (2004, pp. 32-37) for other FDI-elasticities (economic freedom, taxation, regulation, infrastructure, human resources).

industrial sector and sub-sector level; and v) the firm level of organisational strategy and competitiveness. The complexity of FDI host policy-making is obvious, but the policy dimensions that are chosen should be in harmony with the country's wider development goals.

Ultimately, it could be argued that all these dimensions distill into one dimension regarding incentives. In fact, incentives can be *fiscal* or *non-fiscal* [UNIDO (2003)], as selectively illustrated in the Table 1 below. As we can see, non-fiscal incentives are constituted by *financial* and *non-financial* incentives.

Table 1: Fiscal and Non-Fiscal Incentives

Fiscal incentives	Non-Fiscal incentives
Tax holidays	Depreciation methods
Tax-free imports	Development Banks' loan policies
Tax exemptions	R&D support
	Environmental standards support
	Labour training support
	Government subsidies

The presentation noted that whereas industrialised countries typically utilise financial incentives, such as grants, developing countries usually use fiscal incentives, such as reductions in the base rate of corporate income tax, tax holidays and import-duty exemptions and drawbacks [Oman (2000)]. Incentives are widely used to attract MNEs and thus create a climate of competition for FDI. Fiscal incentives may be successful in attracting MNEs, but incentives-based competition also creates some problems. Indeed, the first problem of incentives is that they represent an opportunity cost for host governments. Secondly, there can be a significant lack of transparency regarding incentives, which leaves space for corruption and other kinds of rent-seeking behaviour. Finally, given the dimension choices in Figure 2, incentives also provoke market distortions. The major distortions are that incentives tend to favour large corporate investors, at the detriment of small firms, as well as foreign over domestic companies, partly because of their lower risk profile and higher bargaining power. This distortion would tend to disappear (over time) in countries adopting fourth generation investment

policies, as they would treat foreign and domestic firms equally with regard to incentives.

The presentation examined in detail the actual policy instruments for attracting, promoting and accompanying FDI. It is important to bear in mind that the design and the implementation of policies firstly depend on the actual policy instruments. Secondly, they should be converted into law. In fact, it is the country's legal and regulatory system that is the highest authority in attracting, guiding and shaping inward FDI, and it is of crucial importance that all policy tools are translated into consistent national laws or sub-laws. The different policy instruments and regulatory measures are related to; i) admission and project establishment; ii) ownership and control issues; iii) the actual FDI operations; and iv) the main incentives offered to foreign investors.

The advantages and disadvantages of FDI policy instruments arise not in absolute terms but relatively from the way they are calibrated and recalibrated and applied in changing circumstances. For example, regarding ownership, a primary resource driven economy would need high modal neutrality to enable wholly owned subsidiaries (as the likelihood of local firms able to joint venture meaningfully would be low) and have policy instruments that secure property rights. It would be disadvantageous to insist on FDI policy that required MNEs to joint venture with local firms in order to invest in vertically specialised minerals production. Regarding capital depreciation as another example, policies need careful calibration or else intended beneficiaries might not actually alter their capital/labour ratios and capital intensities, in order to upgrade the technological capacity of manufacturing industry.

The discussion on the pros and cons of specific FDI policy instruments actually embodies the debate on whether developing countries should opt for reform in the direction of greater policy liberalisation, or greater policy regulation. Shafaeddin (2000) argues that no country has developed its

industrial base without relying to some extent on infant industry protection. "Both early industrialised and newly industrialised countries applied the same principle, although to varying degrees and in different ways" (p. 2). In a world of different levels of industrialisation, market failures do not enable free international competition to promote effective industrialisation in the least developed countries. Therefore, it appears reasonable that developing countries encourage their infant industry by using the regulation of foreign investment. Nevertheless, regulation should be on a selective, rather than on a universal, basis and the level of protection should not be excessive.

It is also arguable that regulation impedes FDI activity, and thus disfavours developing countries. In fact, these countries often have very high official costs of entry, and MNEs have to follow long procedures before investing. Whereas regulation is meant to achieve socially superior outcomes by countering market failures (such as monopolies and negative externalities), in real terms regulation is very often associated with higher corruption and unofficial economies. Gratuitous regulation can benefit the regulator and not the whole society, and can prevent MNEs from investing. Therefore, extensive regulation can have the opposite effect from its initial purpose, since it is associated with socially inferior outcomes. Thus, as a logical corollary, FDI policies should be liberalised.

However, it is worth mentioning that policies aiming at liberalising FDI are not necessarily the best policies for creating a favourable investment climate, and even less so for attracting or promoting FDI. Moreover, one can note that the liberalisation process should not be seen as a decline of the role of the state, since the measures mentioned above relate to government regulation. In fact, whereas the two first measures imply FDI liberalisation, their overall beneficial impact depends highly on the presence of competent and well-organised market supervision. Thus, one can argue that liberalisation and regulation of FDI are not contradictory, but rather complementary, in order to attract and promote FDI that is beneficial for boosting industrial development.

It appears that the advantages and disadvantages of FDI policy instruments are not absolute. Rather, successful policy instruments are a matter of matching a country's FDI policies to the specific circumstances of its economy, stage of development, location, resources, regional agreements and international competition, in accordance with the priorities set by the government. For effective FDI promotion, a country should be both co-operative and competitive with its neighbouring partners. In fact, regional-integration agreements constitute a powerful means to attract FDI, especially when the national governments co-operate in order to have coherent and co-ordinated policies. However, IPAs should also be aware of the policy instruments adopted by competitor countries in order to successfully attract MNEs to invest in their country.

Finally, the role of IPAs has become increasingly more complicated. In fact, IPAs have to adopt a much more active and dynamic attitude towards FDI. Of crucial importance is that IPAs co-operate with other levels of government in order to design and implement coherent FDI polices, which should also be reflected in the legal framework. By complementing some FDI liberalisation with coherent regulation and customised policy instruments, IPAs in the developing countries should be able to capture and promote the kinds of FDI activity that can assist them to speed up their industrial development.

Commentary and discussion

Hafiz Mirza noted that, although FDI policy craft was nowadays required within a 'WTO determined environment', rapid changes in the world economy were delivering new sources of foreign investment. Therefore, apparent constraints expressed by representatives of regional IPAs could be overcome by IPAs "making their own histories" through more rigorous policy analyses, and by moving away from narrowingly focused inducements, towards a more general incentivisation of economic activity as a whole. Southeast Asia had demonstrated a consistent track-record of generating distinctive solutions to the problems of: the diverging interests between the State and MNEs;

socialising public goods and private returns; and the role of the interventionist state and incentives to the private sector.

The discussion exposed the pressing need for the region to build on its successes in attracting FDI by increasing the managerial skills of policy-makers. The requirement for greater transparency in legal frameworks, so as to permit consistent interpretation across sovereign territory, was emphasised as being a key determinant of success in investor aftercare services provided by IPAs. Trade-policy linkages were underscored with respect to strategies to attract efficiency-seeking FDI (i.e. export-oriented FDI). A persistent dilemma highlighted was balancing the interests of 'insiders' wanting 'protection' from further competition, and the need for increasing resource allocation efficiency by allowing greater competition.

On the one hand, some countries in the region are reaping the benefits of rapidly moving towards fourth generation investment policies, by reducing the legislative differences between domestic and foreign companies and creating IPAs for domestic industry. On the other hand, some countries are grappling with the impact of the electoral cycle on the business cycle which tended, in some cases, to thwart the transition of policy advice into law.

Finally, the regional division of labour -- a function of differentiated stages of development -- implies an intensification of regional co-operation at the level of inter-ministerial co-ordination, in setting the stage for negotiating major FDI projects into the region. This is despite the temptation (and dangers) of a *zero-sum competitive game*. *Such regional integration initiatives* as ASEAN+3, AFTA and AIA provide opportunities for such co-ordination.

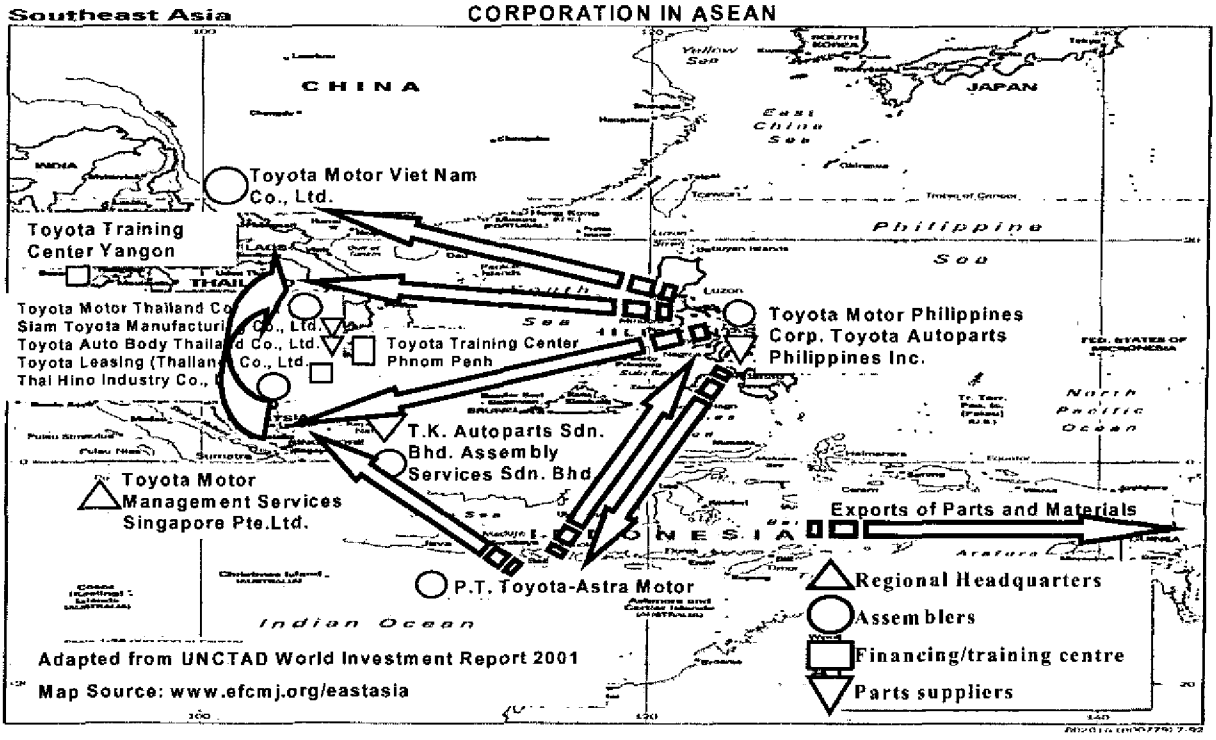
Second presentation summary

Axèle Giroud illustrated that the shift towards spatial distribution of production, across countries and regions, poses new challenges for policy-makers and IPAs. What are the characteristics of these spatially distributed production networks (SDPNs), and what are the implications for countries

seeking to attract FDI? Examining the profile of SDPNs in Southeast Asia provides some useful insights into the FDI dynamics of global value chains (GVCs).

Companies from Japan have led the SDPNs trend within East and Southeast Asia, with networks that have utilised the complementarities that exist between the economies of the whole East Asian region, including that of labour. This degree of complementarity and interdependence within Southeast Asia has been steadily increasing, supported in part by such regional policies as AFTA, AIA and AICO. These in turn have encouraged the development of regional production networks, although it should be recognised that it has been companies themselves that have largely taken the lead, with policy-makers tending to follow. There are numerous examples from the electronics and electrical equipment industry, computers, and also the automotive industry (e.g. Nissan, Mitsubishi and Toyota).

FUNCTIONAL INTEGRATION AND SPDNs: AN EXAMPLE FROM TOYOTA MOTOR CORPORATION IN ASEAN



Typically, but not exclusively, Singapore is often chosen by MNEs as the location for their regional headquarters in Southeast Asia. The picture above provides the indicative example of Toyota.

The SDPNs in the product categories mentioned above demonstrate the leading role of industrial Japan as a co-ordinator of GVCs, and the associated backward and forward linkages. This co-ordination by Japanese MNEs manifests itself as increasing vertical intra-industry trade (VIIT) in intermediate exports and imports. A crucially important aspect of SDPNs is the diffusion of technological advances across the GVCs – hence the importance of policy instruments that target specific sectors and sub-sectors. This calls for sophisticated analysis of value chains and VIIT by policy-makers.

This opens up vistas for regional capacity-building and regional industrial policy. As a consequence, the total value of intra-ASEAN imports has increased from US$38.7bn in 1993 to US$72.2bn in 2002; driven in part by the creation of regional production networks and the cross-border sourcing of parts and components by MNEs with SDPNs that straddle Southeast Asia. Similarly, in terms of cumulative FDI inflows in Southeast Asia, between 1995 and 2003, 13% was sourced from fellow ASEAN member countries (i.e. intra-regional FDI flows), compared with 7% from the other Asian NIEs, 13% from Japan, 16% from the US and 34% from Europe.

Why should the development of regional production networks be encouraged? They can bring with them a number of positive attributes, including: i) an increase in firms' efficiency and performance levels, largely through the reduction of costs; ii) a strengthening of the region's position within specific industries; iii) and an enhancement of the visibility and

attractiveness of the region to investors; and ultimately iv) making a contribution to the consolidation of a robust regional economy.

Southeast Asia's success in this regard is highly dependent on individual countries making the commitment to develop endogenous industries and creating a favourable investment environment. ASEAN member countries need to collaborate in moving towards greater integration, so as to reap the full benefits of SDPNs. This includes moving towards a model of regional industrial policy, and providing support at the firm level to all companies, whether they perceive the region as a market, or a production base. There is also a need to increase activity in the field of more innovative FDI, through the development of human resources and skills. Tellingly, there is relatively little fundamental research and development FDI activity undertaken by MNEs operating in Southeast Asia.

Commentary and discussion

There is a trend towards what one might call "network capitalism", noted Hafiz Mirza, bringing with it new sources of foreign investment activity, and different ways that individual companies enact investment. For example, the typical way that a British company goes about enacting an FDI project tends to be quite different from the approach adopted by most German firms. There is a need to think beyond simply national FDI policies, and look at regional strategies, clusters and partnering. Such new developments as the ASEAN-China and ASEAN-Japan agreements are signs of this trend developing, and are in some ways a response to the increasingly fine 'slicing and dicing' of production stages, through regional networks and partnerships.

However, many developing countries find themselves confronted with a difficult dilemma. On the one hand, commitments made as part of WTO membership, and other agreements, tend to call for open markets and a level playing field for both domestic and foreign investors. This is broadly supported by consumers, which object to protective practices that often result in higher prices for goods and services, and the need for a country to

generate tax revenues to fund various budgetary needs. On the other hand, some large foreign investors put pressure on IPAs to provide fiscal incentives and assurances on protection. In the case of East Timor, for example, policy-makers had initially intended to have just one law pertaining to investment, both domestic and foreign. But it was eventually decided to pursue separate investment laws for local and overseas investors, administered by two different investment agencies, as a result of pressure from the local business lobby. Ironically, there is little difference between the two laws, other than some of the eligibility criteria for receiving tax credits as incentives. Conversely, Laos and Vietnam are moving towards the enactment of a single investment law, for foreign and domestic investors alike.

Finally, in developing regional policies to attract SDPNs, the role of governments in supporting clusters of partnership exchanges, vendor lists and supplier networks is vital. As is a positive perception of regional distribution services capacity and logistics capabilities, to enable regionally distributed production. One persistent issue was the China dimension to FDI in Southeast Asia, which is discussed next.

Theme 4
FDI and the China Dimension

First presentation summary

Adam Cross presented China's substantial and sustained economic growth, which, since its 'open door' policy initiative, has helped attract considerable FDI activity since the early 1990s, as has its relatively recent entry into the WTO, gradual market liberalisation, and its deepening integration with the world economy. China is now the world's seventh largest exporter, its eighth largest importer, and since 2003, holds the world's fourth largest stock of FDI (after the US, UK and Germany).

There has been much concern within Southeast Asia as to whether export competition from China and China's substantial and rising FDI inflows are diverting foreign investment (particularly from Japan and US) away from the region, or whether they could have an FDI creation effect for Southeast Asia. Having once been perceived as the stellar performer in attracting FDI, Southeast Asia is having to adjust to the prospect of a potent and proximate rival for the attention of MNEs. If FDI flows are finite, and given the recent decline in global FDI flows from its just over US$ 1,400 billion peak in 2000, then attracting foreign investment is a zero-sum game, and China's rise can only be at the expense of its neighbours. This is the first concern for many in Southeast Asia. The second is that China is single-handedly forcing a change in established GVCs.

There are a number of weaknesses in the 'China diversion' hypothesis. First, given the relative size of China's economy, its FDI inflows (as measured by per capita GDP and by sector distribution) are not quite so remarkable, albeit still fairly commendable. Secondly, a substantial proportion of the aggregate FDI inflow figures contain quasi-FDI and 'round tripping' activity (i.e. domestic investment capital routed through external channels, so as to qualify for privileges awarded to foreign investors), whereby domestic investment is incorrectly depicted as foreign investment. It should also be noted that transaction costs, as well as a number of obstacles and risks, are

cumulatively serving to constrain FDI activity in China. These include a lack of information and planning certainty for investors, stemming from: i) inadequate IPR protection; ii) a rapidly mutating policy framework; iii) various regulatory hurdles; and iv) limited market transparency. Rising input prices also pose a problem, such as the cost of various professional services, the relatively high prices for electricity and raw materials, and the inefficiencies still evident in logistics and bureaucracy. Fierce competition is also creating excess production capacity in some fields, and distribution bottlenecks are raising the costs of supply chain management. [Any future revaluations of the Yuan would increase price pressures further.]

Some observers would dispute the zero-sum approach to FDI activity, particularly given WTO obligations to increase market access, and argue instead that FDI growth in China will yield opportunities for Southeast Asia. China will see an increase in demand for raw materials, resources and services in sectors where some Southeast Asian countries have a comparative advantage and/or complementarities. Thanks in large part to the 'integrated global factory' trend of MNEs, and the 'slicing and dicing' of production activity across national borders, the appropriate policies could position Southeast Asian countries well to reap some of the rewards emanating from a rapidly expanding China. These policies include: i) absorbing new technologies, and raising indigenous technology and innovation capacities; and ii) identifying lucrative niches within global production networks. Versatility of technology is key, as is augmenting the local human capital stock.

More specifically, Southeast Asian countries need to combat the challenge posed by China -- on a national level -- by: i) further reducing business and transaction costs; ii) providing high quality support services for MNEs; iii) improving transport and communication infrastructure, including that with China itself; iv) providing training to re-skill workers displaced by the shift of some production to China; and v) by promoting entrepreneurship and revitalising competitiveness. On a regional level, there is utility in facilitating

greater regional collaboration, thereby seeking to replace deteriorating national location advantages with superior regional advantages. Deeper economic integration in Southeast Asia should include: i) co-ordination and harmonisation of FDI regulations and attraction measures; ii) reducing tariff and non-tariff barriers to intra-regional trade; and iii) increasing opportunities for intra-industry specialisation. Such efforts should also prevent unilateral policies that can prompt a 'race to the bottom' in terms of national FDI attraction strategies.

Commentary and discussion

There is a need, Peter Buckley pointed out, for Southeast Asia to differentiate itself from China when seeking to attract FDI inflows. Notwithstanding China's recent track record in attracting considerable foreign investment, the changing nature of FDI and current problems suggest that China is unlikely to enjoy a monopoly on FDI inflows in East Asia, particularly as MNEs typically seek to diversify their operations across multiple locations, so as to mitigate various risks. As the "world's workshop", the concern that China will ultimately end up making everything, is common. But this prospect is unlikely to actually transpire, and countries can proactively pursue policies and strategies that will permit them to harness FDI creation stemming from the rise of China's economy. That said, some countries in Southeast Asia are probably better placed to achieve this than others, at least in terms of the profile of present capabilities. Singapore, Malaysia and Thailand may be better positioned, for example, than Indonesia or Vietnam.

It is clear that the types of FDI also need to be differentiated, notably in terms of MNEs' motivations. The efficiency-seeking FDI, with its export orientation that characterised flows to Southeast Asia is shifting to China, with Hong Kong and Taiwanese investors leading the way. As a consequence, Southeast Asia is exporting intermediate inputs to China as Japanese MNEs in particular deepen their VIIT across China and Southeast Asia. The regional dimension of FDI was repeatedly emphasised as being of crucial importance to IPAs, as market-seeking FDI increasingly looks to

Southeast Asia as an integrated market and workable manifestation of AFTA. This regionalism calls for greater and more rapid harmonisation and co-ordination of policy instruments (especially those directly related to incentives) as a function of the diversity and different stages of industrial development across the region. The wider regional issues, related to the 'ASEAN+3' initiative, and which concern policy harmonisation between ASEAN and China, encapsulate strategic FDI and trade policy with respect to both China's inflows and outflows of FDI.

Second presentation summary

The complex dynamics of competition and/or complementarity in ASEAN–China FDI relations were highlighted by Hafiz Mirza, noting that at national and corporate levels pertinent questions -- such as which economies are competing and which are complementary -- need asking. Answers, in relation to policy objectives and policy instruments, would define the effectiveness of investment policies.

It is crucial for investment policy to recognise that competition for FDI is intra-regional, whereas complementarity in FDI is inter- (and intra-) MNEs. This reality, which reflects the integrated global factory concept, carries profound implications for policy craft. Whereas the 'footprint' of MNEs across Asia is a function of the international location and relocation of production; the integrated global factory is defined by the corporate management of GVCs. Also, whereas FDI to Asia is inter-regional (e.g. EU to Asia); ASEAN FDI is characterised by a high degree of intra-ASEAN focus. Reflecting the dynamics of SDPNs enunciated in an earlier presentation, MNEs are pursuing new 'deverticalised' global strategies which emphasise flexible manufacturing services and regional manufacturing platforms. Enabled by ICT, this pattern is exemplified by relocations of Japanese manufacturing FDI with shifts from relatively high cost locations to localities with competitive productivity adjusted cost of labour.

The increasing significance of outsourcing (of both production and services) associated with FDI, and as a substitute for FDI, implies that the emergence of 'campuses of manufacturing' (evolving from industrial parks) needs to be factored into investment promotion policies. Cluster development in relation to knowledge-based institutions would be a significant determinant of attracting FDI. In addition, FDI targeting policies need to account for specific 'types' of FDI outsourcing by leading MNEs.

Commentary and discussion

Peter Buckley noted that national competition and corporate complementarities in FDI posed challenges for policy craft. Policies need to address whether MNEs strategies are evolving globally or regionally. In general, analysis points to MNEs strategies in EU, North America as regional, in contrast to those in Asia as global (exports from Asia to the rest of the world). Campuses of manufacturing could be viewed as new growth poles, which could attract outsourcing manufacturing services providers.

As a consequence, regional policy coherence is of vital importance in reducing the policy temptations of competing for FDI through incentive wars. Contemporaneously, ASEAN 'could do better' in terms of perceptions of the quality of governance in the region. Additionally, the perceived low capacity levels of IPAs were a matter for urgent attention among policy-makers. The difficulties posed by bilateral trade agreements (BTAs), bilateral investment treaties (BITs), double taxation treaties (DTTs) with regional trade agreements (RTAs) was recognised as requiring increased policy resources, with the caveat that BTAs can often skew resource allocations.

Theme 5
FDI and Capital in Southeast Asia

First presentation summary

The presentation by Nick Freeman took the perspective of Southeast Asia's transitional countries, which together are seeking to establish robust and sustainable market-oriented economies. This includes eradicating poverty, partly through job creation, and starting to catch up with the industrial development trajectories seen in the region's more advanced economies, such as Malaysia and Thailand. The transitional economies have all sought to attract FDI, partly as a way of 'importing' a ready-made private sector, and seeking to stimulate the development of an indigenous private sector, through linkages with foreign investment projects.

In this context, it is important to emphasis that the distinction between foreign investment and domestic investment is becoming less apparent. This in turn impacts on investment promotion policy and regulation. Since the 1980s the world has seen the rise of 'emerging markets' as a mainstream asset class in which both direct and portfolio investors seek to gain exposure. In the period between 1980 and 1998, no less than 43 countries opened stock markets. Stock markets can play an important conduit role in funnelling capital from wealthy industrialised countries to developing economies, and thereby assist indigenous firms in accessing long-term funding. Further, stock markets support privatisation efforts, and can support FDI activity in various ways (including: M&A deals, gradual market entry, market exit, valuation, deal structuring, and so on).

Ideally therefore, all companies (both domestic and foreign) should have potential access to a stock market, particularly given the trend away from relatively closed and vertical MNEs structures that are under-pinned by cross equity holdings, and towards more 'arm's length' structures. As a consequence, MNEs are less willing to play the role of an internal capital market, through leveraging their balance sheet, and the onus is shifting to local firms (affiliates, suppliers, sub-contractors, service providers, etc.) to

raise their own finance like any other input. Firms' success will therefore depend in part on finding cheap and reliable sources of funding, which in turn requires liquid and efficient financial markets. For those smaller economies in Southeast Asia that cannot justify the fixed costs of operating their own capital and stock markets, there would be utility in establishing links with those in neighbouring countries.

One source of foreign investment that is relatively new to Southeast Asia is private equity, as a hybrid cross-over between FDI and portfolio investment. In 2004 alone, US$2.8bn was raised for private equity in Asia (excluding Japan), and US$6bn was invested across over 180 deals. Often focusing on specific business sectors, private equity investors increasingly work in areas that host country governments wish to see development, including: technology, life sciences, infrastructure projects, and even mezzanine funding for expanding SMEs. But crucially, private equity investors tend to be scarce unless there is a stock market present that allows them to exist from their investee companies. Recent years have seen members of the donor community also get directly involved in private equity investment funds, as investors and providers of technical assistance.

Previous presentations discussed the importance of developing countries and their corporate sectors 'plugging into' the 'integrated global factory'. For most countries, the bulk of the corporate community is made up of SMEs which need technical and other assistance to scale up their operations and develop their competencies and capabilities to a level that would allow them to become part of the global factory. In this context, SME sector development policy and enterprise investment and technology upgrading programmes should be part of FDI policy, and vice versa. Indeed, FDI policy should not only be an integrated part of a country's industrial (and financial) policy framework. This in turn necessitates that a high level of inter-agency communication and collaboration exists between pertinent government bodies. FDI promotion can no longer be the sole preserve of an IPA and/or a single ministry mandated to oversee investment activity.

Finally, there is also a need for ingenuity and flexibility in a country's policy craft towards FDI, which not only creates a conducive and equitable enabling business environment, but also sparks the imagination and stimulates the creative juices of investors, both foreign and local, large and small.

Commentary and discussion

The utility of stock markets as a way of improving corporate governance practices should also be recognised. Frank Bartels indicated that with specific regard to improving corporate disclosure levels, this can help developing countries to increase tax revenues by widening the corporate tax base and improving enforcement and collection. The considerable remittances that nationals residing overseas now send back have become the focus of greater attention of late. Some studies suggest that over US$90bn in annual global remittance flows to developing countries exceed annual Official Development Assistance (ODA) flows of around US$70bn. However, most countries have not been particularly active or successful in designing institutions and financial instruments that could direct a proportion of these flows into investment in productive assets, thus helping the domestic industrial sector to grow.

Developing financial instruments of an appropriate level of sophistication, and viable transaction costs, can only be effectively developed in an environment of corporate governance regulation which is not stifling of innovation but, at the same time, is capable of identifying and prosecuting against malfeasance. This implies policy attention to issues of transparency, judicial independence and, again, inter-agency co-ordination to prevent businesses being able to exploit regulatory inconsistencies.

The importance of remittances finding quality yields in differentiated asset classes, in order to avoid 'asset bubbles', was highlighted as one of the set of issues requiring attention. The usually low risk appetite of domestic investors was also recognised, as was the need to broaden the policy advocacy roles of IPAs into awareness-building among industry associations.

Notwithstanding the dynamics of risk and risk appetite in emerging markets, the importance of disclosure, due diligence and corporate governance was highlighted. This points to the need for laws that ensure that markets work properly, and that property rights and ownership rights are respected and enforced. While there is no shortage of domestic savings in Southeast Asia, there is a marked absence of financial instruments which can intermediate those savings into real investment in productive assets. Policy craft for FDI therefore requires not only attention in attracting foreign investors, but also attracting domestic investors into asset classes that link FDI, FPI and the domestic corporate sector.

Second presentation summary

Ikue Toshinaga, UNIDO Investment and Technology Promotion Office (UNIDO ITPO Tokyo), provided an in-depth exposition of Japan's role as a source of global outward FDI, especially to Southeast Asia. Interestingly, some 90% of Japanese firms have intentions to enact FDI activity in China over the next three years – a factor that Southeast Asian policy-makers have to seriously consider. Especially with respect to the investors' 'wish list' of: stability across political, economic and market environments; transparent government policies; efficiently operable infrastructure; and continuous productivity growth. *To the inward investor from Japan, and elsewhere, the* cost of doing business is also key. In this context, the investment decision-making behaviour of investors from Japan, North America and Europe differ, and policy-makers in developing countries need to be sensitive to this factor. Japan's foreign investors are relatively slow in decision-making, partly due to the cross equity holding structures of MNEs' industrial organisation.

The requirements of FDI policy craft, alluded to in earlier presentations and discussions, can be supported by various public goods interventions. First among the most effective are information services attuned to facilitating the FDI decision and the needs of the foreign investor. Second is the active engagement of IPAs in searching for, tracking and targeting specific

components of the integrated global factory. In respect of both these approaches, the importance of IPAs being open and generous with information in order to reduce uncertainty and encourage extant investors to do investment promotion cannot be over emphasised.

The uniqueness of UNIDO's capacity-building network of Investment and Technology Promotion Offices (ITPOs) located internationally was illustrated. Through institutional mechanisms for strengthening partnerships, ITPOs enable investors in OECD countries and emerging markets to link up with investment opportunities in developing countries. The flagship service -- the Delegate Programme -- in which investment promotion professionals from developing countries spend time in ITPOs is available to all UNIDO member states. The Delegate Programme enables IPA professionals to apply the techniques of investor targeting in situ within the source countries of FDI. The importance of business networking, developing professional approaches to investor selection and capacity-building are the hallmarks of the UNIDO ITPO Delegate Programme.

Commentary and discussion

Frank Bartels commented that the ITPO (public good) service provided by UNIDO to developing countries should be seen as a strategic facility which could extend the capacity of most IPAs. The enabling services from UNIDO should be viewed as a means of leveraging the national resources available to IPAs. And in participating in the Delegate Programme, the quality of preparation -- itself an indication of commitment and capacity-building -- was of crucial importance.

The importance of integrating investment promotion with domestic industry upgrading programmes was pointed out as of vital significance to promising local companies, especially considering the industrial organisation of developing countries which depends overwhelmingly on SMEs.

The logistics of the UNIDO ITPO Delegate Programme were discussed with respect to funding issues, capacity-building and investment networking. It was also pointed out that project profiling with high fidelity to the actual facts 'on-the-ground' was of vital importance to potential investors. Finally, the key to the ITPO Delegate Programme was skills upgrading in respect of understanding the needs of investors.

Conclusion
Emerging Policy Directions and Research Agenda

Comments

At the final session of the EGM, the panellists were invited to provide some concluding comments, based on the presentations, commentaries and discussions of the previous two days.

Brian Caplen noted the increasing complexity of FDI activity, and the challenges this poses for policy-makers and IPAs. In response, the general trend amongst several Southeast Asian countries has been to shake up their FDI attraction processes and targets. There have also been responses at the regional level, including efforts to harmonise regulatory regimes and standards. The rise of China as an unparalleled magnet of FDI inflows poses a threat, but also provides an opportunity for Southeast Asian countries. The somewhat intangible, but clearly evident, entrepreneurial spirit to be found in many countries of the region is perceived by overseas investors as a genuine asset that will attract foreign capital inflows.

The conundrum as to whether strong FDI inflows reflect the strength or weakness of a host country, and its domestic corporate sector, was also a point of discussion. If there is a trend by MNEs to move away from vertical organisational structures, primarily linked by direct shareholdings, and towards looser structures with less equity underpinning, then this would imply that conventional FDI activity will diminish, to some degree at least. Instead, domestic firms will participate in MNEs' 'integrated global factory' as suppliers, contractors and in other (non-equity) relationships that have relatively little or no FDI component. Therefore, a country and its domestic corporate sector that is successful in plugging into this new breed of production from the 'integrated global factory' might actually expect to see its aggregate FDI inflow figures to diminish. If so, annual 'headline numbers' for cumulative FDI inflows, so often used by countries to indicate their relative success as a conducive host country environment for business, may

no longer be an appropriate indicator. This in turn underlines the value of bench-marking across a range of variables.

Peter Buckley noted that the challenge for policy-makers is not about capturing larger amounts of FDI activity per se, but rather in optimising the linkages and positive spillovers that can be derived from foreign investors. And this in turn is primarily about positioning the country, and its domestic corporate sector, in a way that allows it to plug into the 'integrated global factory'. Part of the solution to this challenge lies in creating the kind of supportive enabling environment that is beneficial to both domestic and foreign investors alike – in effect, moving towards fourth generation investment promotion. There is a tendency for some countries to favour foreign capital and investment over that of domestic firms, such as through the provision of additional incentives for FDI projects, sometimes for inconsistent reasons. This could be quite erroneous because a vibrant domestic sector is necessary to attract FDI in its global value chain and global production network forms.

Hafiz Mirza stressed the need to create mechanisms and institutions that can better channel and harness the not inconsiderable quantities of capital that flow into countries, but are not invested in productive assets. For this to happen, social issues such as corruption also need to be addressed, and the capacities of local companies need to be built up. Success in this regard will better enable domestic firms to insert themselves into the 'integrated global factory'. Axèle Giroud and Adam Cross stressed that a single policy model does not fit all countries facing very different challenges, and that FDI strategies need to be tailored to meet the specific needs of economies and corporate sectors with different profiles and at different stages of development. The challenge of actually implementing good policies was also highlighted, as was the need to pursue some pro-FDI initiatives at the regional level, through regional co-operative endeavour.

In conclusion, Frank Bartels suggested that key lessons for policy-makers included: i) being open to new approaches and innovative ideas; ii) seeking ways to differentiate one self from others, in terms of FDI policies; iii) identifying ways to better harness FDI inputs and generate synergies from these inputs; iv) adopting a holistic approach to investment promotion, and not focusing exclusively on MNEs; and v) working to make the enabling environment conducive to all investors, through long-term strategies, rather than short-term palliatives, such as incentives.

Research needs

Stemming from the EGM, a number of issues were identified where the current body of knowledge is still relatively limited. These issues merit further and deeper empirical research and analysis, so as: i) to better understand their characteristics; and ii) thereby assist policy-makers to design new FDI policies and strategies appropriate for the foreign investment activity of today and tomorrow.

There is definitely a need to more clearly and accurately depict, and better understand, new dynamic trends within the 'integrated global factory' concept. Notably with regard to the emergence of looser and less vertically integrated international production networks, and what impact this is (or should be) having on FDI promotion policy. For example, should policy-makers shift further away from conventional investment promotion policies, and design new strategies that are better tailored to meet the rise of the 'integrated global factory'? Indeed, to what extent is the conventional role of IPAs becoming redundant, as the emphasis on FDI promotion shifts to a more holistic approach of improving the business-enabling environment, for domestic and foreign investors alike?

A key missing element in our current body of knowledge are the FDI (and possibly FPI) aspects of global value (and supply) chains, which serve to inter-connect the nodal points of the 'integrated global factory'. Until recently, global value and supply chains have not been viewed through the

FDI lens. Consequently, some IPAs have been relatively slow in formulating policies to increase the scale and quality links of such chains, situated within their sovereign borders.

As asset-based FDI is increasingly redistributed across OECD countries, and relationship-based foreign involvement (FDI, FPI and, more frequently, international contracting) is redistributed across emerging markets, IPAs need to reassess the validity of their policy instruments. IPAs also need to re-evaluate the analytical basis of their policy research. The significant variables that determine vigorous FDI, and other investment activity, are increasingly less economic, and more social capital in their properties. This calls for greater attention to the correlation between quantitative and qualitative, as well as economic and non-economic variables.

The increasingly blurred line between foreign portfolio investment and FDI activity has received relatively little attention, to date. There would be merit in examining this important nexus in greater detail, to better understand the interplay between the two, and the role that capital and equity markets can play in FDI promotion and support. In this context, the role of private equity investors also merits attention, to identify ways in which this important source of investment can be encouraged and its benefits maximised.

The increasing role played by international SMEs in FDI activity, both as indigenous participants linked into the 'integrated global factory', and as foreign investors in their own right, merits closer attention and research. While much of the attention towards FDI activity had traditionally focused on large MNEs, the activities and needs of SMEs are far less well understood and would be a policy-pertinent object of empirical study. Also useful would a study to examine institutions and instruments that might be introduced to better harness remittances for investment in productive assets.

Taking the above research needs into account, the specific research areas of merit -- geared towards greater facilitation and attraction of FDI activity -- can be broadly seen as follows:

- Investment strategies of group-based global production networks.
- Models of collective competition in group-based global production networks.
- Firm positioning and resource management in FDI networks.
- Policy modelling of FDI networks.
- Strategic and operational governance of global value chains.
- Impact of third countries on inward and outward FDI to/from host/source countries.
- Services offshoring and outsourcing.
- FDI-trade spatial linkages.
- Firm-country-sector competitiveness relations.
- Global production network dynamics and productivity, and FDI flows.

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Annex 1: Presenters at the EGM

Name	Position	Organisation
Frank Bartels	Senior Industrial Development Officer	UNIDO, Viena, Austria
Ms. Atchaka Brimble	Senior Executive Advisor	Board of Investment, Thailand
Peter Buckley	Professor and Director	Centre for International Business University of Leeds, UK
Brian Caplen	Editor-in-Chief	fDi FT Business, UK
Adam Cross	Senior Lecturer in International Business	Leeds University Business School, UK
Nick Freeman	Independent consultant, Director	Mekong Capital Ltd., Vietnam
Ms. Axèle Giroud	Senior Lecturer in International Business	Bradford University School of Management, UK
Hafiz Mirza	Professor of International Business	Bradford University School of Management, UK

Annex 2: Participants at the EGM

Country	Name	Position	Organisation
BRUNEI DARUSSALAM	Mr. Ahmad ISA	Chairman	Brunei Darussalam International Chamber of Commerce
CAMBODIA	Mr. Chenda Sophea SOK	Secretary-General	The Council for the Development of Cambodia
	Ms. Sotheavy SOK	Administrative Supervisor	Cambodia Chamber of Commerce
INDONESIA	Mr. Sugihono KADARISMAN	Chairman	ICC Indonesia Menara KADIN Indonesia
	Mr. Achmad KURNIADI	Director of Overseas Promotion	Investment Coordinating Board
LAO PDR	Mr. Khampanh SENGTHONGKHAM	Secretary General	Lao National Chamber of Commerce and Industry (LNCCI)
MALAYSIA	Mr. Kim Chong TAN	Deputy Director	Malaysian Industrial Development Authority (MIDA)
MYANMAR	Ms. Daw MYA THUZA	Director	Department of Investment and Company Administration Ministry of National Planning & Economic Development Myanmar Investment Commission
	Mr. Min Win ZAW	Vice-President	Union of Myanmar Federations of Chambers of Commerce and Industry
PHILIPPINES	Ms. Celestina B. ILAGAN	OIC-Executive Director	Investment Promotions Group, Philippine Board of Investments
SINGAPORE	Mr. Kah Chuan HO	Assistant Head (Policy)	Economic Development Board (EDB)
	Mr. **(Yoi Seong) Jeffrey** LIEW	Senior Manager	The Singapore Business Federation (SBF)
THAILAND	Mr. Satit SIRIRANGKAMANONT	Secretary General	Thailand Board of Investment
	Mr. Suchart PHISITVANICH	Senior Executive Advisor	BOI

	Ms. Warubon SUKASAME	Director, Marketing Division	BOI
	Mr. Vittaya PRAISUWAN	Director, International Affairs Division	BOI
	Mr. Yuthasak KANASAWAT	Director, Management Information System Division	BOI
	Ms. Bussarakum SRIRATANA	Senior Investment Promotion Officer	BOI
	Ms. Siriporn NARKJURE	Investment Promotion Officer	BOI
	Ms. Susan CRAWFORD	BOI Advisor	BOI
	Mr. Andrew SCARVELL	BOI Advisor	BOI
	Ms. Alisa KUKARJA	BOI Advisor	BOI
	Mr. Donald LINDER	BOI Advisor	BOI
	Mr. Peter BRIMBLE	President	Asia Policy Research Company Limited
TIMOR LESTE	Mr. Florencio FERNANDES	Investment Consultant	Secretarial of State of Tourism, Environment and Investment
	Ms. Georgina Maria Augusta Benrós DE MELLO	Executive Director, International CEO	East Timor Investment and Export Promotion Agency (IEPA)
VIET NAM	Mr. **Tran Hoa** BINH	Senior Officer	Foreign Investment Agency Ministry of Planning and Investment
	Ms. Chi Lan PHAM	Senior Advisor	Prime Minister's Research Comission

Appendix I: Thematic Programme of the EGM

United Nations Industrial Development Organization

Expert Group Meeting

Foreign Direct Investment in Southeast Asia: Experience and Future Policy Implications for Developing Countries

21-23 March 2005, Bangkok, Thailand

Day 1: 21 March 2005

0800 – 0900 Registration

0900 – 1030 Opening Statements by UNIDO & BOI, Thailand
Election of Chairmen & Rapporteur
Adoption of Programme & Indications of Programme Management

1030 – 1100 Coffee/Tea

1100 – 1230 **Theme I: FDI & MNE in SE Asia: Globalisation's Challenges**
Chair: Frank L. Bartels
Senior Industrial Development Officer, IPT/PTC, UNIDO

Session 1: A long view of global and regional FDI
by Peter J. Buckley, Professor of International Business & Director, Centre for International Business, University of Leeds. U.K.

Commentator: Brian Caplen

Editor-in-Chief, FDI Magazine Financial Times Business

Plenary Discussion {Discussion lead off by Brunei and Singapore Participants}

12:30 – 14:00 Lunch

14:00 – 15:30 **Theme II: Intra-regional FDI & Regional Trade & Investment**
Chair: Hafiz Mirza
Professor of International Business & Director, Strategy, Economics and International Business Group, School of Management, University of Bradford, U.K.

Session 2: Dimensions of key problems regarding FDI and differentiated policy, regulatory and strategic responses
by ASEAN Investment Promotion Agency Practitioners

Commentator: Peter J. Buckley

15.30-16.0 Coffee/Tea break

16.00-17.30 *Session 3: The Thailand Experience in FDI*
by BOI, Thailand

Commentator: Frank L. Bartels

Plenary Discussion {Discussion lead off by Malaysia and Philippines Participants}

Day 2: 22 March 2005

0800 – 0900 Breakfast Roundtable on *Identifying the Research and Policy Agenda on FDI, International Business and MNEs for Developing Countries - I*

0900 – 1030 **Theme III: Boundaries, Hierarchies, Markets & FDI**
Chair: Peter J Buckley

Session 4:
Advantages & disadvantages of FDI policy instruments
by Frank Bartels

Commentator: Hafiz Mirza

Plenary Discussion {Discussion lead off by Indonesia and Vietnam Participants}

1030 – 1100 Coffee/Tea

1100 – 1230 *Session 5: Spatial distribution of international production – regional characteristics and implications*

by Axèle Giroud, Associate Professor, Director of Studies for the MA in International Business, School of Management, University of Bradford, U.K

Commentator: Hafiz Mirza

Plenary Discussion {Discussion lead off by Thailand and Malaysia Participants}

12.30-14.0 Lunch

14.00-15.30 **Theme IV: The China Dimension to FDI in SE Asia**
Chair: Brian Caplen

Session 6: China, and regional FDI
by Adam Cross, Associate Professor, Director of the Centre for Chinese Business and Development, Centre of International Business, University of Leeds. U.K.

Commentator: Hafiz Mirza

Plenary Discussion {Discussion lead off by Cambodia and Mexico Participants}

15.30-16.00 Coffee/Tea break

16.00-17.30 *Session 7: Competition or complementarity in intra- and inter-regional FDI?*
by Hafiz Mirza

Commentator: Peter J Buckley

Plenary Discussion {Discussion lead off by Laos PDR and Myanmar Participants}

Day 3: 23 March 2005

0800 – 0900 Breakfast Roundtable on *Identifying the Research and Policy Agenda on FDI, International Business and MNEs for Developing Countries - II*

0900 – 1030 **Theme V: Capital Markets and FDI in SE Asia**
Chair: Peter J Buckley

Session 8: The role of regional capital and financial markets
by Nick J Freeman, Member of the Board of Directors of Mekong Capital Ltd., Ho Chi Minh City, Vietnam.

Commentator: Frank L. Bartels

Plenary Discussion {Discussion lead off by Cambodia and Vietnam Participants}

1030 – 1100 Coffee/Tea

1100 – 1230 *Session 9: International lessons of experience*

by Japan ITPOs

Commentator: Frank L. Bartels

Plenary Discussion {Discussion lead off by Laos PDR and Myanmar Participants}

12.30-13.00 **Concluding Session**
Chair: Jean-Marc Deroy
Regional Director, UNIDO Field Office in Thailand

Concluding Remarks by Panel

Frank Bartels	Jean-Marc Deroy
BOI, Thailand	Axèle Giroud
Peter Buckley	Hafiz Mirza
Brian Caplen	UNIDO ITPOs

Adoption of Conclusions and Recommendations

Closing of EGM

Appendix II: Opening Statement by the Secretary-General of Thai Board of Investment

Mr. Satit Sirirangkamanont

Distinguished guests, ladies and gentlemen: it is my great honour to open and welcome you to the united nations industrial development organization expert group meeting on foreign direct investment in Southeast Asia. This conference, jointly implemented by UNIDO and the Thailand board of investment, will examine the experiences and future policy implications for attracting FDI among developing countries.

We are all aware that foreign direct investment is one of the most crucial drivers of industrial development, competitive industrial performance, and the capacity to trade among developing countries. in this challenging era of globalization, the nations of Southeast Asia have been particularly effective in competing for and attracting FDI. The successful Asian development experience, and the central part played by FDI in-flows and their linkages to domestic investment, holds significant lessons for other developing regions. The Asian experience will continue to develop policy coherence that is well-attuned to prevailing economic conditions and articulated by policy-makers according to local, regional, and global investment dynamics.

Therefore, the assumed outcomes of this EGM are as follows:
First, to meet the needs of developing countries for improvement of national policy, strategies and regulatory frameworks for industrial development promotion.
Second, to build institutional capacities in developing countries with respect to making available strategies for integrating their industrial sectors, through FDI, with global production networks.
and, third, this EGM will create a global public good in the form of publication of its deliberations, conclusions and policy messages.
While examining such specific themes as
"Foreign direct investment & multinational enterprises in Southeast Asia"
"Intra-regional FDI, regional trade, and investment"
and,
"Capital markets and FDI in Southeast Asia".
This EGM will most importantly provide a free-ranging, specialized dialogue among experts and policy-makers on FDI-related matters and their effects on industrial development strategies.

This type of deep information exchange and knowledge sharing will assist the participating policy-makers to facilitate and promote FDI co-operation among developing countries.

This EGM falls within the service delivery framework of UNIDO's corporate strategy and priorities for 2004-2007, so, in many ways, we are at the beginning of a long road forward.

As such, this meeting is aimed at assisting developing countries in several key ways:
To match their FDI performance to their FDI potential; and to match their industrial capacity to their industrial complexity.

The overall objective of this EGM is to enable policy-makers and government officials to work with members of the FDI policy community from Southeast Asia, as well as from other developing regions, to use advanced investment and manufacturing policy analysis, research, instruments and modalities to become more competitive in attracting FDI, as well as to maximize the impact of FDI in-flows on industrial growth trajectories.

Our discussions these next few days will help to meet the needs of developing countries for improvement of national policy strategies and regulatory frameworks for investment and industrial promotion. just as critically, this EGM will improve the quality of UNIDO advisory and enabling services by advancing a "state-of-the-art" policy for FDI and expanding the links among UNIDO, practitioners and policy-makers.

Last week, I was honoured to be among the speakers at the international investment promotion forum in Tianjin, china, where I outlined the strategy and construction of the board of investment. Joining speakers from UNIDO and other ADI experts, I was able to highlight the wide-ranging role the BOI has played for almost four decades of developing foreign and domestic direct investment in Thailand. We are very eager to openly share our experiences – both positive and negative – to assist our regional neighbours, as well as other countries, to develop their own relevant national economic agendas.

So, ladies and gentlemen, I am especially pleased that Thailand has the opportunity to serve as the host country for the next three days of stimulating, effective, and necessary discussion.

Once again, I want to welcome you to this expert group meeting -- and to Thailand.

Thank you.

Appendix III: Opening Statement by UNIDO Regional Director Mr. Jean-Marc Deroy

Secretary General of the Thailand Board of Investment -- Your Excellency Satit Sirirangkamanont, Distinguished Delegates and Participants, Experts, Ladies and Gentlemen, on behalf of Mr. Carlos Magarinos, Director General of the United Nations Industrial Development Organization (UNIDO), I am delighted to welcome you all to the UNIDO Expert Group Meeting on "Foreign Direct Investment (FDI) in Southeast Asia: Experience and Future Policy Implications for Developing Countries".

The genesis of this Expert Group Meeting is the Director General's acknowledgement of the success of the Southeast Asian Member States of UNIDO in attracting Foreign Direct Investment (FDI) and enabling that FDI to contribute significantly to the respective industrialisation processes in the region; and his concern for enabling and facilitating, through the global forum activities of the Organization, an exchange of experience and practice for the benefit of the region, other developing countries and the technical co-operation programmes of UNIDO. Importantly, it is intended to act as a visible demonstration of UNIDO's commitment to its Member States and to strengthen the relationships and ties that enable co-operation and resolve to translate the benefits of industrialisation into improvements in the quality of economic performance, enhanced levels of employment and sound environmental practice.

UNIDO's mandate, re-affirmed at the 10th General Conference in December 2003, gives a prominent place to investment in industrialisation. At that Conference, the special challenges confronted by those developing countries marginalised from global investment, technology and trade flows were highlighted for attention. This EGM is one response to that call for attention – because the lessons of experience from your regions' success may, when adapted to the different conditions of other economies, provide means for policy-makers to enhance their contributions to national economic success.

The globalisation process of the world industrial economy -- and the key role played by FDI -- presents multi-dimensional challenges to governments, institutions and industry at policy, regulatory and managerial levels. This EGM is part of UNIDO's services, and the international community's efforts, at making available, to developing countries, the best in thought and practice.

The extent of FDI effects and their correlation with industrial performance at various sectoral levels are the subject of continuing policy analysis and empirical research. The interactions between economic agents, markets and institutions can benefit from the dynamics of international investment, technology and trade flows; and global production networks can contribute to strengthening domestic capabilities. However, the articulation of the various linkages remains a serious policy task.

The EGM is organised by UNIDO in co-operation with the Thailand Board of Investment, and this three-day meeting will provide a much welcome opportunity for policy makers and managers, institutional managers and Investment Promotion Agency directors from across the region to discuss the trends, patterns and emerging issues in FDI in the context of global economic dynamics, the region's economic trajectory and national strategies for attracting, retaining and leveraging the positive externalities of FDI in industrialisation.

The EGM is intended to enable your responsibilities as high-level officials, and assist you to examine -- with the valuable inputs of the UNIDO Experts and leading thinkers, and Commentators on FDI -- the key issues that determine the dynamics in FDI, the role of multinational enterprises in the economy, and the investment and industrial implications for your respective countries. The agenda is intended to bring to the fore areas of concern; namely, the challenge of globalisation; intra-regional FDI, trade and investment; boundaries, hierarchies, markets and FDI, the China dimension to FDI, the role of capital markets and FDI in Southeast Asia. The work of the EGM is also intended to provide a useful opportunity for you to share knowledge, to extend your network of expertise, to improve the possibilities of collaboration and -- bearing in mind, the on-going developments in regional integration and trade arrangements -- to seek innovative ways to enhance international co-operation in the area of FDI.

The presentations from the Experts, leading researchers and practitioners, and the commentaries, will delineate the evolving characteristics and the convergent factors and variables of FDI and the role of investment in economic development and industrialisation. The plenary discussions will, I am sure, elicit a valuable exchange of experience.

The global forum activities of UNIDO, such as this Meeting, are a vital public good. The dissemination of the results of this EGM, in the form of a Report, will assist other policy-makers

and practitioners in other developing countries to share in your experience -- and given the relative successes of the region in FDI -- to learn from what is possible, what the key emerging issues are and what policy mechanisms are available to assist in overcoming some of the problems of industrialisation.

Secretary General of the Thailand Board of Investment, Distinguished Delegates and Participants, Experts, Ladies and Gentlemen, the Asian experience holds significant lessons for other developing regions. It is the Director General's hope that this UNIDO EGM will assist in advancing the 'state-of-the-art' for FDI policy in relation to industrial development and the technical co-operation delivered by UNIDO to its Member States. It is my hope that the experience of these three days will draw us closer in international co-operation. Once again, I welcome you; and I wish you a successful meeting; and I thank the Secretary General of the Thailand Board of Investment, His Excellency Satit Sirirangkamanont for the hospitality extend to UNIDO, Experts and Participants.

Appendix IV: Opening Statement by UNIDO EGM Project Manager
Mr. Frank Bartels - Senior Industrial Development Officer

Secretary General of the Thailand Board of Investment -- Your Excellency Satit Sirirangkamanont, Distinguished Delegates and Participants, Experts, Ladies and Gentlemen, as Project Manager for this EGM, I am delighted to be here and to extend a warm welcome to you all. I am looking forward, as I trust you are, to a serious engagement with the issues of FDI in industrialisation, the themes of the EGM and outcomes that are valuable to us.

The gestation of this EGM has necessarily taken sometime in order to bring together the requisite quality of Experts, Commentators and high-level Participants to make this exercise in international co-operation worthwhile. The UNIDO Regional Office and the Thailand Board of Investment have assisted in the organisational requirements – and for their assistance I extend the appreciation and thanks of UNIDO Headquarters, and those of the Investment and Technology Promotion Branch.

The role of investment in economic development and industrialisation relates to UNIDO's own analysis which identifies FDI as one of the key drivers of a country's industrial organisation and competitive industrial performance, as well as of its capacity to engage in international trade and to absorb increasing levels of technology -- and with it higher levels of value-added FDI. UNIDO's analysis shows that Southeast Asia attracted on average 7.0% of annual global FDI flows in the 1980s and 14.7% in the 1990s. Latin America -- the other best performing region -- attracted 7.9% and 9.4%, while Sub-Saharan Africa only 1.2% and 0.8% in the same periods. To compete effectively for FDI through viable policies and instruments, the sharing of international experience, in forum like this one, is essential.

This EGM, which is a manifest part of the UNIDO's mandate that gives a prominent place to investment and the special industrialisation challenges confronted by developing countries marginalised from global investment flows, will enable UNIDO to continue to enhance the delivery of its capacity-building enabling services to developing countries. By engaging with the latest thinking and views on the challenges of FDI and the policy prescriptions available to address those challenges, the efforts of developing countries will be enhanced and reinforced through UNIDO's global forum activities.

The themes of the EGM have been carefully selected in an attempt to capture the essential problems, policy challenges and mechanisms for generating policy solutions for economies and industrial sectors operating under different dynamic conditions and moving along different trajectories. The competition for recently diminished flows of FDI is increasingly intense – and the sharing of valuable experience and best practise derived from success in attracting FDI, informed research and the latest thinking on the dynamics of FDI and the behaviour of Multinational Enterprises is vitally important.

The strategies of developing countries attempt to enable their economies to compete more effectively for FDI using a variety of policy designs, frameworks and instruments that, in application, create differing characteristics in their FDI climates. The Asian experience of FDI holds significant lessons for other developing regions. This particularly so with respect to path dependency; and the role of the state in integrating the local and regional economies with the global economy. This EGM, through its discursive process will assist in advancing the state-of-the art in policy making.

I have just attended the Second International Investment Promotion Forum held in Tianjin, China during 17 – 18 March which was hosted by the authorities of the Tianjin Economic Technological Development Area. That Investment Promotion Forum demonstrates that -- even with its impressive flows of FDI -- China is not standing still in its attempt to enhance its institutional skills, policy knowledge and promotional capability in matters related to FDI. The need for increasing capacity and capability, knowledge and skills through shared experience and practise is therefore absolutely necessary and UNIDO is privileged to be able to facilitate an EGM such as this in order to assist developing countries.

Permit me to make one or two indications about the faculty of Experts that UNIDO has gathered for the purpose of this EGM. Knowledge and practise are intricately woven together and the body of the knowledge and the practise of FDI encapsulated by the Experts here is considerable. You will get to know them collectively and individually in the course of the next three working days. They represent collectively authorship of over 80 books and over 300 articles on FDI. Collectively they are responsible for over 1500 citations in the discipline of the international business of FDI. Individually, we have among us leading consultants to leading corporations and the international agencies – and each has published an authoritative work on the subject in the last five years. Our Experts have contributed to the international thinking not

only of UNIDO but also other UN specialised agencies including UNCTAD, and regional multi-lateral organisations such as ASEAN and regional development organisations including the Asian Development Bank.

It is our hope that the EGM will result in valuable exchange of views on the dynamic factors underlying the asymmetries in FDI flows and provide viable responses to issues regarding the magnitude of FDI effects, and the changing nature of the linkages within the new knowledge-based economy. These issues, I am sure you will agree, have major implications for developing countries at various levels.

I would very much like to express our thanks to the Secretary General of the Thailand Board of Investment – His Excellency Satit Sirirangkamanont for the co-operation that he has enabled his organisation to extend to this EGM. Thank you Secretary General.

With your permission, it is now time to proceed with the agenda and programme of Electing the Chairmen and rapporteur; and adopting the Programme by acclaim.

Thank you.

United Nations Industrial Development Organization

Expert Group Meeting (EGM)

Foreign Direct Investment in Southeast Asia: Experience and Future Policy Implications for Developing Countries

21 – 23 March 2005, Bangkok, Thailand

Working Paper IWPS 001/05[*]

The Evolving Nature of FDI Industrial Organisation and Challenges for Policy and Practice

Frank L. Bartels[**]

[*] The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations Industrial Development Organization (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. This document has been produced without formal editing. The views expressed in this document do not necessarily reflect the views of the Secretariat of the United Nations Industrial Development Organization. Any indication of, or reference to, a country, institution or other legal entity does not constitute an endorsement.

[**] Frank L. Bartels is Senior Industrial Development Officer, Industrial Promotion and Technology Branch, Programme Development and Technical Cooperation Division, UNIDO, Vienna

This document was prepared with the assistance of Ms. J. Mundt, Mr. C. Chiemeke and Mr. Nick J. Freeman.

LIST OF ABBREVIATIONS

AFTA - ASEAN Free Trade Area

AIA - ASEAN Investment Area

APEC - Asia-Pacific Economic Cooperation

ASEAN – Association of Southeast Asian Nations

ASEAN-5 - Indonesia, Malaysia, Philippines, Singapore, Thailand

BITs - Bilateral Investment Agreements

CFMs - Capital and Financial Markets

DTTs - Double Taxation Treaties

EGM – Expert Group Meeting

FDI - Foreign Direct Investment

FPI - Foreign Portfolio Investment

FTAs - Free Trade Agreements

FTZs – Free Trade Zones

HQs – Headquarters

IP - investment promotion

IPAs - Investment Promotion Agencies

ISMEs - International Small and Medium-size Enterprises

LSAs - Location Specific Advantages

MNEs - Multinational Enterprises

MVA - Manufacturing Value-added

NIS - National Innovation System

RTAs - Regional Trade Agreements

SMEs - Small and Medium-size Enterprises

STI - Science Technology and Innovation

UN – United Nations

UNIDO - United Nations Industrial Development Organization

XBMAs - Cross-border Mergers and Acquisitions

ABSTRACT

This working paper discusses the reinforcing role of investment in economic development and industrialisation. In this process, Foreign Direct Investment (FDI) is widely regarded as a key driver and enabler of industrial performance. The paper highlights the imbalances that exist within both FDI in-flow patterns and FDI stocks, at both global and regional levels. The paper also addresses major issues for developing countries in understanding the complex and continually evolving dynamics of FDI activity, and the need for clear, effective and cogent policies to attract and retain FDI. These key issues concern not only how developing countries articulate policies and strategies to compete effectively for FDI, especially from the integrated international operations of Multinational Enterprises (MNEs); but also ways in which developing countries can best harness motivations for FDI, and thereby maximise the positive effects from FDI and minimise any negative spillovers. In this context, developing countries can learn much from Southeast Asia's relative success in attracting FDI.

1. INTRODUCTION

The intentions of this working paper, to serve the UNIDO Expert Group Meeting (EGM) on *Foreign Direct Investment in Southeast Asia: Experience and Future Policy Implications for Developing Countries*, are twofold. Firstly, to provide a backdrop for deliberations on the evolving context and nature of inward Foreign Direct Investment (FDI), and their policy dimensions for host countries. Secondly, to provoke thought on the various aspects of investment promotion (IP) and facilitate a forward-looking view that goes beyond the increasingly redundant host country IP strategies of the past[12].

These intentions are based on the fundamental premise that FDI is crucial to industrial development and policy for attracting FDI should be closely aligned with a country's industrial policy. It is important to note from the outset that, given the complexity of FDI as actually practiced by Multinational Enterprises (MNEs) and their supply and marketing networks, the paper will not revisit in detail either the FDI data or the theoretics and empirics of FDI determinants and motivations. Suffice it to say that there is a rich body of literature dating from the late 1950s that is available to inform policy[13]. Rather, this paper attempts to bring out salient features in the complexity of FDI for the benefit of policy craft in developing countries, bearing

[12] It is hoped that this forward-looking view will advance policy research and analysis on FDI. Also it is anticipated that the empirical conclusions put forward in the publication, *The Future of Foreign Investment in Southeast Asia*, Nick J. Freeman and Frank L. Bartels, Eds., London: RoutledgeCurzon, 2004 will be added to by the deliberations and lessons from FDI in actual practice.

[13] See *inter alia* Dunning J. H., 1958, American Investment in British Manufacturing Industry, London: George Allen and Unwin; Dunning J. H., 2000; The Eclectic Paradigm as an Envelope for Economic and Business Theories of MNEs Activity, International Business Review, Vol. 9, No. 1, pp. 163-190; UNIDO, 2003, Guidelines for Investment Promotion Agencies: Foreign Direct Investment Flows to Developing Countries, Vienna: UNIDO; and The Future of Foreign Investment in Southeast Asia, Nick J. Freeman and Frank L. Bartels, Eds., London: RoutledgeCurzon.

in mind that host policy for attracting inward FDI is manifest at different and interacting levels[14]. The emerging issues within the dynamics of international capital flows and the organisational behaviour of the principal actors in the world economy -- MNEs and the State [Stopford, Strange and Henley (1991)] -- are best illustrated by the international business of FDI. FDI is widely accepted as a key driver of economic growth in both developed and developing countries. Consequently, the industrial development plans of developing countries seek to articulate strategies for winning greater shares of global and regional FDI flows.

Notwithstanding the very real issues in FDI statistical concepts and definitions; methodological problems and challenges of measurement[15], it is clear that global and regional flows and stocks have increased dramatically (see below). However, substantive empirical evidence from economic, managerial and organisational studies points to the positive correlation between FDI and; (i) trade capacity, (ii) productivity growth, (iii) industrial and export performance, as well as (iv) poverty reduction[16]. The significant role of FDI in socio-technological and economic development was recognised and confirmed by the UN Financing for Development Conference, Monterrey, Mexico, in 2002[17]. In spite of potential negative spillovers from FDI, policy choices are critical determinants in economic performance [Asiedu and Lien (2004); Comeau (2003); Zhang (2001)]. Maximising positive externalities while moderating negative spillovers is important. FDI, and its policy environment, are therefore of crucial concern for policy makers in developing and industrialised countries alike[18].

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[14] These are the meta- or supra-national level of Multi-lateral Organisations and trade blocs, macro- or national level of government policies, meso- or regional and cluster level, micro- or level of industrial sectors, sub-sectors, and firm level of organisational strategy and competitiveness.

[15] See Maitena Duce, Definitions of Foreign Direct Investment (FDI): A methodological note; material prepared by Banco de Espana for the BIS meeting of the CGFS Working Group on FDI, 2003, for methodological issues related to FDI from the perspective of balance of payments, and the international investment position, and data comparison. Note also that, while measurement is aggregated, FDI is ultimately an international business decision taken and executed at the level of the firm. This macro- micro- dichotomy presents challenges to policy.

[16] See UNIDO, 2002, Industrial Development Report 2002/2003, Vienna: UNIDO. Wolfgang Keller and Stephen R. Yeaple, 2003, Multinational Enterprises, International Trade, and Productivity Growth: Firm-level Evidence from the United States, NBER Working Paper No. W9504, February 2003. World Bank, 1993, The East Asian Miracle: Economic Growth and Public Policy, Oxford, Oxford University Press. Luiz R. De Mello, 1997, Foreign Direct Investment in Developing Countries and Growth: A Selective Survey, The Journal of Development Studies, Vol. 34, No. 1, pp. 1-34, October.

[17] United Nations, A/55/1000, 26 June 2001, General Assembly 55th Session Agenda item 101, High-level international intergovernmental consideration of financing for development – Technical report of the High-level Panel on Financing for Development (known as the Zedillo Report), pp. 45-48.

[18] See Asian Development Outlook 2004, part 3, Foreign Direct Investment in Developing Asia, for the importance of FDI; and how in some instances the policy framework has been unable to keep pace with the changing complexity of FDI.

In recent years, we have seen increasing competition for diminishing levels of global FDI[19]. Simultaneously, there is increasingly dynamic cross-border configuration, reconfiguration and articulation of the manufacturing assets and servicing operations of international investors. The increasing complexity of FDI is demonstrated by the integrated international sourcing, technology, production, marketing and servicing networks of MNEs as inter-connected systems which are geo-economically and spatially distributed. Further, the distribution and performance of these networks is operationally and contemporaneously managed through strategic relations (co-operation with, co-ordination, command and control) between subsidiaries and suppliers using information and communications technology. The systemic nature of MNEs networks leads to the emergence of asymmetric properties of, and synergistic relations between, the constituent elements (HQs, Regional HQs, Subsidiaries and out-source partner firms, etc.). In concert, the various network nodes responsible for manufacturing value-added (MVA) transformations; and the inter-relationships accountable for economic transactions, comprise what has been referred to as 'the global factory' [Buckley (2003)]. This is illustrated stylistically in Figure 1 below.

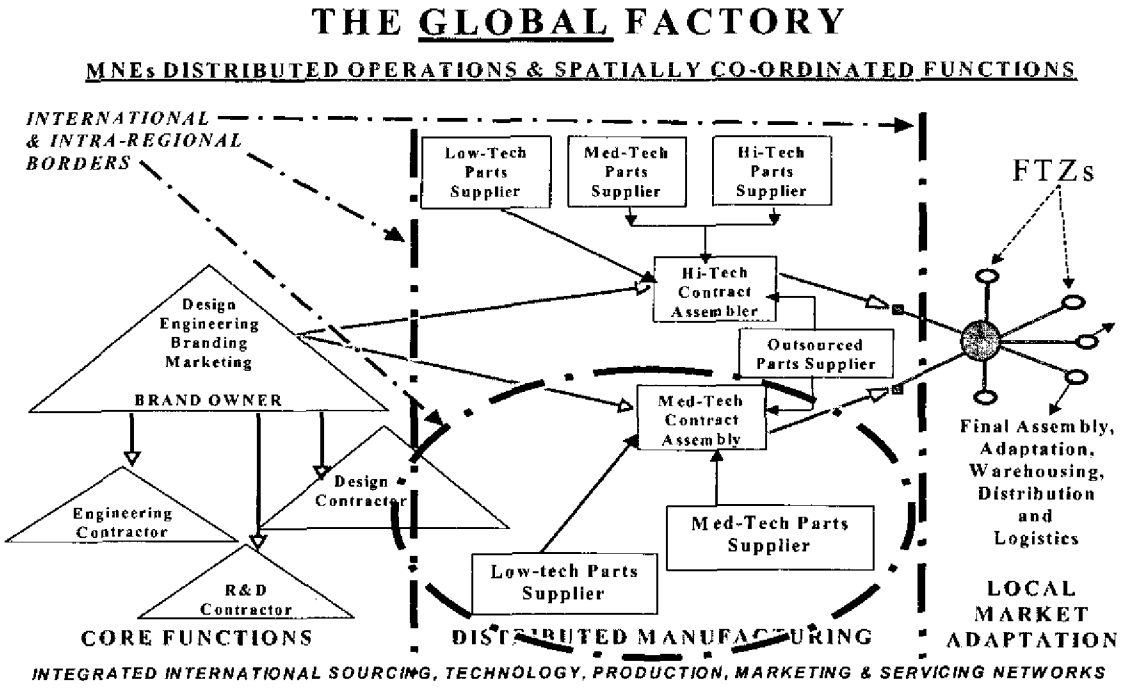

Figure 1 - The Global Factory

'The global factory' is co-evolving with the policy environment. It is characterised by inter-changeability and is in dynamic tension with its internal constituents as well as with external

[19] Global levels of inward FDI have fallen since the peak of US$1,400 billion in 2000, through US$800 billion (2001) and US$700 billion (2002) to US$560 billion (2003); and preliminary estimates suggest a modest increase to US$612 in 2004 according to UNCTAD [UNCTAD/PRESS/PR/2005/002, 11 January 2005].

forces of competition and co-operation. Thus the shape, boundaries and extent of 'the global factory' and the industrial landscape it inhabits (and forms) are continuously changing resulting in a complex system that approaches 'self-organisation'[20] [Dagnino (2004); Fioretti and Visser (2004); Price (2004); Urry (2003); Walby (2003); Krugman (1996);].

The complexity of FDI and 'the global factory' is therefore increasingly difficult to view through isolated economic and management disciplines. It is even more testing to capture in terms of data and information as well as FDI policy research and analysis; IP policy design and implementation. This is especially so for developing countries and is due partly to the rapidly changing characteristics of industry competition and factor markets; and partly to the inadequate levels of capacity-building in some developing countries. Competition is evolving into more internationally collaborative forms[21]. And while capital and financial markets are global, the markets for goods and services are overwhelmingly regional. In contrast, most labour markets are national. Developing countries in general, and particularly those marginalised from FDI flows, often lack high-resolution instruments to calibrate and recalibrate their policies fast enough to keep pace with the rapidly changing context and dynamics of FDI, international production and markets.

UNIDO's analysis of FDI shows South and East Asia capturing most of the FDI flows to developing countries. On average South and East Asia attracted 7.0% of annual global FDI flows in the 1980s and 14.7% in the 1990s. In comparison, Latin America, the other best performance region, attracted 7.9% and 9.4% respectively. In stark contrast, Sub-Saharan Africa captured only 1.2% and 0.8% during the same respective periods[22]. In terms of transferable policy lessons from the success of Southeast Asia in attracting FDI, since the first development decade of the 1960s, this paper acknowledges that initial geo-strategic conditions were crucially important [Arrighi (2002); Arrighi, Hamashita and Selden (1997)].

As FDI and MNEs responses have co-evolved with increasing complexity in organisational form and processes, this paper puts forward a few notions for consideration. First, host country policy makers need to take a systems view of FDI and MNEs and understand the structural dynamics therein in relation to industrial development objectives and strategies. Secondly, as MNEs activities and systems co-evolve with the host environment, there is a pressing need for the host policy environment to reflect 'the global factory' of MNEs. Thirdly, the competition for FDI calls for host country attention to increase the efficiency of doing

[20] Phenomena which appear to determine their own form and processes.
[21] Dunning, J. H., 1997, Alliance Capitalism and Global Business, London and New York: Brunner-Routledge.
[22] See UNIDO, 2003, Guidelines for Investment Promotion Agencies: Foreign Direct Investment flows to Developing Countries, Vienna: UNIDO, Table 1 and 2, pp. 3-4 for regional comparisons.

business domestically (improving intermediation and lowering transaction costs). Fourthly, developing countries need to accelerate from *first*, *second* and *third* generation IP[23] to a new, *fourth generation* IP. A *fourth generation* IP should be seen as an adaptive response to the increasing complexity of MNEs, and is characterised by diminishing distinction between domestic and foreign investment activity in policy terms. Herein the thorny issue of 'incentives' should be addressed by focusing on information and communications technology infrastructure, human resource development and social capital formation; and positioning strategic domestic sectors and sub-sectors within the interstices of 'the global factory' and networks of MNEs.

The remainder of the paper is organised as follows. Section 2 – Background Issues, briefly presents the stylised facts of the political economy of FDI and the operations of MNEs. It then addresses the key trends as a complex systemic co-evolution of the integrating factors of the world economy and globalisation, and raises implications for FDI policy makers. The spatiality of 'the global factory' and its structural coupling with the policy environment, and the response of MNEs to greater competition and uncertainty, are examined for policy implications.

Section 3 - Thematic Challenges for FDI Policy Craft, addresses the five themes of the EGM by drawing out potentially transferable policy lessons and identifying problems posed by the changing nature of FDI industrial organisation. The implications of the 'new economy', and intra-regional FDI within trading arrangements are highlighted. The boundaries of 'the global factory' and its spatial distribution as well as implications for policy are addressed. Importantly, the China dimension to FDI competition and complementarity is examined with a view to identifying potential policy responses for Southeast Asia and other developing countries beyond the region. This section also addresses the intermediating role of capital and financial markets in FDI that is crucial to enabling deal flow especially in FDI activity that is dominated by cross-border mergers and acquisitions (XBMAs).

Section 4 - Concluding Remarks, looks ahead at the broadening agenda for FDI policy makers with respect to, for example, social capital formation, the role of the national innovation system (NIS), and the spatial sequencing and temporal switching of policy measures in IP. Related areas of concern are: trade policy; competition policy; labour policy; regional development policy; and science technology and innovation (STI) policy. This section points to those location factors and enterprise variables that are likely, in the future, to increase their significance for FDI.

[23] See UNCTAD, 2002, World Investment Report: Transnational Corporations and Export Competitiveness, Geneva: UNCTAD, pp. 234-242 for comparative descriptions.

2. BACKGROUND ISSUES

An accurate perspective on trends in the world economy indicates that the co-evolution of FDI, MNEs and host country policy is unfolding in an environment characterised by the fission in polities and fusion of markets[24]. At the same time, advances (and convergences) in technology 'drivers' have enabled greater differentiation in the various stages of industrial production. Also, the governance of the world trading system has increasingly become 'hard' law and rules-based thus not only reducing trade barriers but also narrowing the range of discretion available to policy makers. And, while economic maps of the world show the dominance of 'Triad' economies[25], apart from high performance Asian economies and newly industrialising countries of ASEAN[26], there are new influential players emerging onto the global economic stage – notably the vanguard of "Group-21"; Brazil, China, India and South Africa. Together, these background developments affect the relative ease with which policy to attract and contain inward FDI can be crafted, implemented and promoted by developing countries.

As noted above, UNIDO's analysis of FDI indicates consistently that South and East Asia have successfully and consistently captured the lion's share of FDI flows to the developing countries. Furthermore, as the total levels of official development assistance have decreased from the 1992 peak of US$ 67.5 billion through a low point of US$ 51 billion (1997) to US$ 65 billion in 2002, the value of FDI to industrial development and the formation of industrial assets, which developing countries can link to the global production networks of MNEs, has grown in importance.

The integrating factors of the world economy, and the central role of FDI, are revealed by four inter-connected facts. First, the rate of growth in world trade has outstripped world output growth since the 1960s. Secondly, the rate of growth in FDI from 1980-2000 outstripped that of world trade growth. Thirdly, an estimated three-quarter of world trade is held *internally* within the international operations of MNEs[27]. Fourthly, the growth of vertically integrated

[24] There were 62 states in 1914, 74 in 1946, 149 in 1978 and 193 in 1999 according to the Economist, A Survey of Geopolitics, 31 July 1999. In many countries, decentralisation, or subsidiarity (in EU terms), is extensive. Contemporaneously there is the remarkable growth of trading blocs ranging from customs unions, free trade areas to full-blown economic and monetary union (EU), and by 2000, there were increasing numbers of Bilateral Investment Treaties (BITs) (Approx. 963) Double Taxation Treaties (DTTs) (approx. 1413), Bilateral Trade Agreements (BTAs) (approx. 250), including Regional Trade Agreements (RTAs) (approx. 181), according to Jagdish Bhagwati and Arvind Danagariya, "Bilateral trade treaties are a sham", Financial Times, 13 July 2003.

[25] North America, European Union, Japan spheres of economic influence that dominate the world economy and technology (see Digital Access Index; and the New Map of the World, The Economists, 22 June 2004).

[26] Hong Kong SAR, Singapore, South Korea, Taiwan Province of China, Indonesia, Malaysia, Philippines, Thailand.

[27] Approximately 61,000 MNEs with over 900,000 subsidiaries spatially distributed within geo-economic space operationally constitute 65% to 75% of international business and world trade according to UNCTAD, 2004, World Investment Report 2004: The Shift Towards Services, Geneva: UNCTAD; and UNCTAD, 1995, World

intra-industry trade, which accounts for about 30% of world trade, at about 40% since 1975, has outpaced that of FDI growth[28]. The consequences of this structural change in the pattern of global economic activity are that FDI -- and the associated vertically integrated intra-industry exports-imports of intermediate goods -- are precursors to productivity gains for domestic firms. This assists in overcoming supply capability constraints, expanding trade capacity and linking developing countries to the Triad economies of North America, Europe and Japan. MNEs, FDI and export-import trade in intermediate products and services have therefore become the preponderant integrating factors in the world economy. Also trade in intermediate products and services resulting from FDI has become significant in improving the efficiency of resource allocation, specialisation, value-chain disaggregation and productivity.

Access by developing countries to this *'internalised'* market of MNEs is not possible without creating, through appropriate FDI policy craft and trade instruments, conditions that will either induce MNEs to seek out domestic firms in supply collaboration or enable domestic firms to pro-actively insert themselves into the global production networks and value chains of MNEs. Moreover, this access is increasingly framed by the over 250 preferential trading arrangements that cover, *inter alia*, services, investment, competition policy and government procurement[29]. Under these circumstances FDI policy is of crucial importance to the economic health and industrialisation efforts of developing countries.

The relatively successful East Asian development experience, and the central part played by MNEs, FDI in-flows and their linkages to domestic investment, holds significant lessons for other developing regions. This is especially so with regard to path dependency, and the role of the State in integrating the local economy with regional and global economies. The Asian experience assists us in advancing the 'state-of-the-art' policies for other developing countries [Dobson and Chia (1997)].

Empirical evidence indicates that increasing FDI stock to GDP ratio correlates positively with a decreasing share of the population living below US$ 1per day[30]; and increases in FDI are correlated with industrial development as manifest in the performance of South and East Asian

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Investment Report 1995: Transnational Corporations and Competitiveness, Geneva: UNCTAD. This geo-spatiality is operationalised in part as cross-border collaborative inter-firm relations (mergers and acquisitions, joint ventures, strategic alliances, etc.)

[28] Dicken P., 2003, Global Shift: Reshaping The Global Economic Map in the 21st Century, London: Sage, p. 53; David Hummels, Jun Ishi and Kei-Mu Yi, 1999, The Nature and Growth of Vertical Specialization in World Trade, FRBNY, Mimeo; and UNIDO, 2003, Guidelines for Investment Promotion Agencies: Foreign Direct Investment Flows to Developing Countries, Vienna: UNIDO for the growth of vertical specialisation as share of exports at between 26% and 82% from Australia, Canada, France, UK and USA from 1970 to 1990.

[29] Karolina Ekholm, Rikard Forslid and James R. Markusen, 2003, Export-platform Foreign Direct Investment, NBER Working Paper, No. W9517, February.

[30] OECD, 2002, Foreign Direct Investment for Development: Maximizing Benefits, Minimizing Costs, Paris: OECD.

economies. In contrast, Sub-Saharan Africa's policy capacity to capture the benefits of FDI has not performed as well[31]. FDI in-flows therefore are linked directly to poverty reduction and the Millennium Development Goals. However, FDI in-flows can contribute to poverty reduction in a particular country only when the enabling environment and actual FDI flows are enveloped by a policy coherence that is well-attuned to prevailing economic conditions and well-articulated, by that particular host country's policy-makers, to local, regional and global investment dynamics [Bartels and Pass (2000)].

As a consequence of successive GATT rounds resulting in the WTO, as well as policy liberalisation encouraged in part by the international financial institutions, the integrating factors of the world economy have increased their influence in policy making in line with decreasing barriers to factor mobility. However, FDI flows, and accumulations of FDI stock, are asymmetrically distributed between the industrialised and developing countries in overwhelming favour of the former. Also, FDI is highly skewed across the community of developing countries benefiting a few hosts at the expense of the majority[32].

These twin asymmetries in FDI flows (and stocks) and questions over the magnitude of FDI effects, vector and path dependency, as well as the changing nature of linkages within the 'new' knowledge-based economy, present challenges for industrial policies in developing countries at all levels. First, is in terms of the predominance of the Triad of North America, Europe and Japan as hosts to, and sources of, FDI; and the persistent production relations they have with relatively few emerging regional zones of growth including Southeast Asia, China and India. Second, is in terms of the local embedding of FDI decisions in individual cities and localities that display an attractive dynamism with specially incentivised areas and facilities, for example Singapore-Johor Baharu-Bintan and Bangalore on the one hand, and the cluster of cities of costal China on the other hand. Regional asymmetries in the growth patterns of FDI therefore can be explained econometrically by differences not only in factor costs, market access, availability and quality of production inputs between countries and regions but also, and perhaps more importantly, because governments and their policies differ in credibility [Janeba (2001)]. The implications of these asymmetries need to be disclosed more vividly for the benefit of policy-makers in developing countries.

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[31] UNIDO, 2004, Industrial Development Report 2004: Industrialization, Environment and the Millennium Development Goals in Sub-Saharan Africa, Vienna: UNIDO.

[32] Latest data for 2003 shows developing region shares of the US$172 billion total as 62.3 % to Asia Pacific, 28.9% to Latin America Caribbean, 12.2% to Central Eastern Europe and 8.7% to Sub-Saharan Africa [UNCTAD WIR 2004, Overview, Table 2, p. 3]; and estimates for 2004 show shares of US$255 billion total as 65.1 % to Asia Pacific, 27.1% to Latin America Caribbean, 14.1% to Central Eastern Europe and 7.8% to Sub-Saharan Africa [UNCTAD Press Release UNCTAD/PRESS/PR/2005/002].

The agglomeration of markets and diminishing constraints to factor mobility is associated with increasing environmental risk, uncertainty and volatility that has evoked a highly specialised response from MNEs. This response is encapsulated by 'the global factory' illustrated above. The tentacles of this system, HQs, regional HQs, subsidiaries, supply-chain network nodes, and relations, are cohered and orchestrated in a dynamic of value-chain integration, disintegration and reintegration that is distributed across economic space, countries and border regions [Giroud (2003a); McKinsey & Co. (2003)]. 'The global factory' permits MNEs to spatially distribute FDI and associated stages of production according to host location specific advantages (LSAs) related to cost efficiencies, market segmentations, input factors and/or strategic assets, thereby maximising the long-run value added to the firm.

The analytical basis of the FDI business decision itself has also evolved dramatically moving from the macro- to the micro- and firm- level, on the one hand. And, on the other hand, from gravity models of trade [Anderson and van Wincoop (2001a, 2001b)] and transaction cost economics [Williamson (1975)], location economics [Dunning (2000, 1988)] to the organisational morphology of MNEs [Buckley and Casson (2002)] and, more recently, to the real options approach [Roemer (2004); Chen and Funke (2003); Xiuyun (2003); Nordal (2000); Trigeorgis (1996)]. The later developments in the analysis of MNEs FDI decision-making are crucial for host country policy makers. They provide a powerful means by which the ways MNEs organise their operations and view risk, capabilities and flexibility in an increasingly uncertain and complex environment, can be incorporated into policy craft. There are a number of policy implications for developing countries at different stages of development. These may be seen in terms of (a) developing countries that have yet to match their *FDI performance* to their *FDI potential*, as well as those with above average *FDI potential* but below average *FDI performance*[33], (b) developing countries that have yet to match their *Industrial Capacity* to their *Industrial Complexity* and those with above average *Industrial Complexity* but below average *Industrial Capacity*; as well as (c) those with above average *Industrial Capacity* but below average *Industrial Complexity* in the UNIDO Competitive Industrial Performance Index[34].

First, the foreign investor is increasingly less of a 'stand-alone' operator and more of sophisticated agent in a complex co-ordinated chain, or network, of transactions and/or value-adding transformations. The foreign investor therefore is unlikely to consider the FDI decision in isolation. The location factor in FDI is likely to be increasingly influenced by the availability of domestic firms able to competitively intermediate within the investor's networks to lower

[33] See UNIDO, 2002, Industrial Development Report 2002/2003, Vienna: UNIDO; and UNCTAD, 2002, World Investment Report: Transnational Corporations and Export Competitiveness, Geneva: UNCTAD.
[34] See UNIDO, 2002, Industrial Development Report 2002/2003, Vienna: UNIDO, Table A3.1, pp. 177-178.

costs, boost quality and accelerate the distribution of goods to domestic and regional export markets[35]. In this vein, the capabilities of the domestic communications, logistics and distribution sector and its infrastructure capacities and orientation are of crucial importance. FDI policy would need to be well-attuned to this area. The key challenge for FDI policy makers is how, through anticipatory policy postures and adaptive incentive instruments, to insert their economies (and thereby their industrial sectors and firms) more robustly into the interstices of the global value-chains and co-ordinated networks of MNEs when the FDI decision is increasingly location specific relative to other locations? [Yeaple (2003)]

Secondly, the previous separated patterns of FDI by firms (in sequential time and place and, hitherto, more predictable modes of entry[36]) have been superceded by parallel modes of entry in multifaceted international patterns of 'alliance capitalism'[37]. This is illustrated stylistically in Figure 2 below.

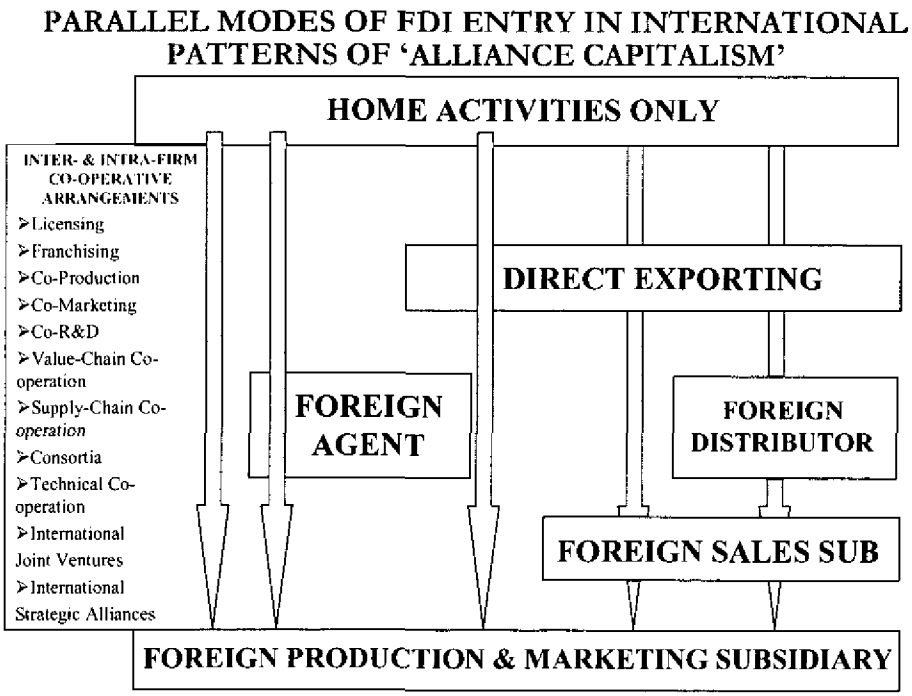

Figure 2 – Parallel Modes of FDI Entry in International Patterns of 'Alliance Capitalism'

[35] Factor analysis of data from Africa Foreign Investor Survey 2003: Implications for Investment Promotion, Vienna: UNIDO

[36] See Jan Johanson and Jan-Erik Vahlne, 1977, The internationalization process of the firm – a model of knowledge development and increasing foreign market commitments, Journal of International Business Studies, Vol. 8, No. 1, pp. 23-32; and Bruce Kogut, Foreign Direct Investment as a sequential process, in C. P. Kindleberger and D. Audretsch, Eds., Multinational Corporations in the 1980s, Cambridge, Mass.: MIT Press (1983).

[37] Including Joint Ventures, Strategic Alliances, Co-production and Marketing, Co-R&D, Contract Design and Manufacturing with Equity and Non-equity formalities.

These patterns are characterised by FDI involving simultaneous collaboration with competitors and rivalry (in different economic spaces and industrial sectors) with strategic partners, as well as participation in dense networks of technology suppliers [Hill (2002, 2001)]. In this context, policy makers need to move beyond the idea of capturing FDI with the lure of cheap labour and tax incentives[38]. The intricacies of these international networked systems of industrial sourcing, technology, production, marketing and servicing place a severe challenge on economic, industrial and development policy-making in developing countries. The essence of the challenge is the selection of appropriate economic and industrial policies on the one hand, and, on the other hand, how to sequence and switch policy instruments in a manner that captures the desired (but 'shape-changing') components of MNEs' networks.

The performance of Southeast Asian economies, since the 1960s and particularly over the last two decades, elucidated in part by, *inter alia*, the 1993 World Bank study -- *The East Asia Miracle: Economic Growth and Public Policy* -- highlights the essential role of government in overcoming market failures and assisting economic development. That performance also demonstrates what is possible for other developing countries. For developing countries, not sufficiently well-versed in the lessons from Southeast Asia, the practical issue is how to emulate, and compress into a shorter time, that kind of performance while coping simultaneously with the triple confrontation of: (i) a rules-based world trading system; (ii) technological 'componentisation' (the slicing up of the stages of production and its spatial distribution); and (iii) the emergence of China 'as the workshop of the world'[39].

Thirdly, in keeping with the view that the world economy is regionalised more than globalised [Hirst and Thompson (1999)], the regional dimension to 'the global factory' of MNEs becomes an important issue for FDI policy craft. Through mechanisms that contemporaneously reduce cross-border transaction costs, enlarge market access and market size by increased economies of scale, regional integration is positively correlated with the location of FDI [Yeyati, Stein and Daude (2003); Blomstrom and Kokko (1997)]. The key question, therefore, revolves around how an individual host country participates effectively in regional arrangements with FDI policy instruments that ensure optimal inward FDI flows in the face of other member countries' competitive and/or complementary policy postures.

[38] See Diana Farrell, Antonio Puron and Jaana K. Remes, 2005, Beyond Cheap Labor: Lessons for Developing Countries, The McKinsey Quarterly, No. 1.

[39] 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.

Fourthly, in terms of a framework for IP, there is a pressing need for developing countries to improve the sophistication of IP strategy and organisation [UNIDO (2003a)] and move towards a *fourth generation* of investment promotion policies, measures and techniques.

3. THEMATIC CHALLENGES FOR FDI POLICY CRAFT

Serious challenges and questions are posed by the five themes of the EGM. It is instructive to note that MNEs production networks and regional dimensions of FDI are major issues for the macro-economy and are very much to the fore[40]. The themes that encapsulate the major areas of concern for policies to attract and retain FDI can be categorised as follows:

- FDI and MNEs in Southeast Asia: Globalisation's Challenges.
- Intra-regional FDI and Regional Trade and Investment.
- Boundaries, Hierarchies, Markets and FDI.
- The China Dimension to FDI in Southeast Asia
- Capital Markets and FDI in Southeast Asia

These themes reflect the weight and importance of FDI to industrial development. They present host country policy makers with an unenviable task of 'aiming at' the fast moving target (with rapidly changing shape) of MNEs.

Without anticipating the content of thematic presentations and plenary discussions on the emergent issues identified, this paper -- acting as a lens -- should enable a sharper focus on key aspects of the co-evolving structure, behaviour and environment of MNEs and FDI in order to tease out key questions for host country policy makers.

3.1. FDI and MNEs in Southeast Asia: Globalisation's Challenges

The long view of the political-economy of cross-border transactions in FDI within the 'new economy' and its impact has resulted in crucial changes in strategic thinking within MNEs and MNEs decision-making. This carries serious consequences for FDI policy craft in developing countries [Buckley and Ghauri (2004); Buckley (2003); Caplen (2001)].

MNEs with predictably structured divisions locked into rigid linkages with other parts of the *same* firm have evolved into a new international structure in an environment that is very different from earlier times. This is very challenging from a policy perspective. With competitive pressures increasing relentlessly, the questions asked by MNEs are first, where to locate productive assets and manufacturing activity in a manner that efficiently differentiates

[40] See Tokyo Club Foundation for Global Studies, Major Issues for The World Economy to 2005, Macro Economy Research Conference, 8-9 November 2004, Tokyo, Japan for the range of issues which concentrated on regionalisation and MNEs strategies.

between locations and maximises the difference between manufacturing value-added (and, ultimately, sales) and locational cost structures? Secondly, how should the assets and activity be co-ordinated and controlled as a system? And thirdly, should the spatially differentiated manufacturing plants producing similar products use similar technology and production processes. In other words, how should capital/labour intensities be distributed across the system?

The location decision concerns the relative merits of the cost and market-related advantages between different locations. The control decision concerns whether or not to own, or to have *an option* on ownership [Trigeorgis (1996)] through collaboration (for example outsourcing, sub-contract, joint venture, strategic alliance with different firms). The similar manufacturing process decision concerns horizontal integration and the effective technology transfer between subsidiaries so as to enable rapid response to competitors and market changes. In the new economic environment, MNEs desire for flexibility militates against the rigid backward and forward vertical integration into input factors or into distribution of the earlier era of MNEs organisation. The more advantageous alternative is to sub-contract production and franchise sales (thereby distributing the associated risk profiles). The new economic perspective for MNEs, in managing the international operations of their FDI, concentrates managerial attention on: (i) the characteristics of volatility and uncertainty in markets; (ii) the value of options and flexibility in entry modes for FDI; (iii) alliances, collaborative and network forms of co-operation and competition; (iv) entrepreneurship within networks; (v) managerial competence; and (vi) a corporate and organisational culture that is progressively more adaptable to the demands of change. This set of valuable attributes translates into flexibility of operations. This is the ability to orchestrate the allocation, and re-allocation, of resources efficiently, smoothly and rapidly in anticipation of, and response to, change. The greater the amplitude and frequency of change in the business environment, the greater this need for organisational and operational flexibility.

The analysis indicated above highlights the issue of accelerated dynamic market entry and exit as the strategic preference for MNEs. In a volatile environment, FDI can be seen as a high-risk strategy - particularly in the absence of location specific compensating factors such as a transparent and coherent business climate with the provision of both the 'hard' and 'soft' infrastructure to do business. Reflecting the flexibility inherent in spatially distributed production networks, the 'hub' and 'spoke' strategies employed by MNEs enable responsiveness to market decline by divesting distribution assets to local partners (exercising one of the options

in joint venturing), while retaining production capacities with high appropriabilities[41] the output of which can be diverted to other markets. The implications for developing countries are that their Investment Promotion Agencies (IPAs) need to fully understand the dynamics of these decisions by MNEs and incorporate them fully into their development policy and FDI promotion strategy.

The concerted outcome of these decisions by MNEs is manifest as disintermediation and re-intermediation of spatially distributed production networks, the internalisation of external markets by MNEs, and knowledge combination [Buckley and Carter (2004)]. With managerial competence being ever-increasingly emphasised, subsidiary managers have incentives to secure greater freedom to deal with economic agents external to their own firm. The overall result of this powerful dynamic is a very complex strategic set that confronts decision-makers, managers and policy-makers in developing countries who aspire to capture parts of the MNEs' system of production and marketing. It is evident that, in the course of the four 'development decades', policy-makers in Southeast Asia have probably been the best at understanding how exploitation of these co-evolving dynamics can be built into economic development strategies.

A related set of issues concern the differences that the advent of electronic commerce (Business-to-Business formalities); the increasing significance of firms that are 'regional or global from inception' to the FDI policy regime of host economies; and how to structure FDI incentives in an 'asset light' economy[42].

3.2 Intra-regional FDI and Regional Trade and Investment

The regional dimension is crucial and correlates positively to FDI – given domestic liberalisation and macro-economic stabilisation efficiencies [Urata and Kiyota (2003)]. However, the regional dimension of FDI activity and FDI policy are arguably under some stresses and strains. This is so as the institutional mechanisms of the ASEAN Free Trade Area (AFTA), ASEAN Investment Area (AIA), and other 'concentricities' attempt to cohere the reality of the ASEAN + 3 initiative within a single market framework[43]. In this regard, the concept of a 'Fortress Europe' transposed to the ASEAN context is useful. The argument being that *outsiders* (in this case exporters to AFTA) would benefit from investing within the AIA, in order to

[41] Due to monopolistic-oligopolistic advantages that are derived, *inter alia*, from technological functions.
[42] Evidence suggests that the 'new' knowledge-based economy is disrupting the 'flying geese' paradigm of Asian development (and hence also the FDI policies that sustained the paradigm). See S. Masuyama and D. Vandenbrink, Eds., Towards a Knowledge-based Economy: East Asia's Changing Industrial Geography, Singapore: ISEAS for an analysis of the institutional and physical dimensions of connecting knowledge and production networks in the region and implications for policy.
[43] At the ASEAN summit, October 2003 in Bali, ASEAN declared the establishment of an ASEAN community notwithstanding the process, since 1997, to form closer economic cooperation with China, South Korea and Japan; and the complex multilateralism of APEC.

become *insiders* and thus avoid being discriminated against [Almor and Hirsch, 1995)]. Similarly, and despite ASEAN's open regionalism [Ariff (1994)], AFTA may be discriminatory towards *outsiders*. Earlier evidence pointed to the greater *de facto* integration of ASEAN with the rest of the world than within the region itself [Amelung (1992)]. This has improved, at least with respect to intra-regional FDI [Bartels (2004)]. However, intra-regional trade as a percentage of total trade decreased by 19% between 1994 and 2001 [Schwarz and Villinger (2004)]. Recent analysis points to these stresses and strains arising from factors such as the costs of fragmentation within AFTA, tariffs and technical barriers, costs of doing business and standards. A view of the fragmented nature of doing business in ASEAN is illustrated in Appendix I - Doing Business in ASEAN Indicators 2005; and Appendix II – ASEAN Investment Climate Indicators.

The challenge of AFTA and ASEAN + 3 from a FDI policy perspective is how to disentangle the potential regulatory inconsistencies within Asia-Pacific Economic Cooperation (APEC) and between most favoured nations; and avoid the 'spaghetti bowl' problem of rules of origin and harmonisation of investment and trade provisions across the free trade areas [Soesastro (2003)]. The AFTA will be successful in attracting FDI if it proves to be a catalyst for increased market size and greater market growth with lower costs of doing business [Scally (2000)]. Member countries would need to make a greater effort in co-ordinating their approaches towards economic, financial and political management, to ensure that factors identified above do not undermine AFTA aims.

The areas of increasingly significant policy concern for creating competitive location advantages at the regional level necessary for the (mobile) assets of MNEs networks, are: (i) regional markets; (ii) quality of cross-border communications ('hard' and 'soft' infrastructure); (iii) regional innovation systems; (iv) presence of agglomerative economies (cross-border clusters); and (v) regional institutions able to restrain 'free rider' or 'defection' strategies of national governments. Related issues concern the challenges of cohering regional and national IP policies and strategies, at the different levels of subsidiarity, and the avoidance of 'incentive wars' given the increasing gravitational pull of China for FDI.

3.3 Boundaries, Hierarchies, Markets and FDI

The challenges for FDI and IP policy craft in this theme lie deep within the complexity of the organisational form and networked operations of MNEs. The shape and operations of MNEs are increasingly based on collaborative relationships with supplier- and value-chains and less on wholly owned assets. This is especially prevalent in services which are currently

experiencing the kind of global relocation that manufacturing experienced during the 1980s and 1990s[44].

The manufacturing and servicing operations of MNEs have been fully incorporated into 'the global factory'. This internalisation allows the international firm to transact market exchange functions, *within* its organisational boundaries[45], throughout the spatially distributed network of affiliates and subsidiaries [UNIDO (2003b); Dicken (2003a, 2003b); Buckley and Casson (2002)]. The real option of joint ventures and strategic alliances between international firms, and domestic companies, ranging from simple co-operation in R&D for example to full mergers and acquisitions, enable organisations to answer operationally the 'make or buy?' question much more efficiently. The developing countries face the evident increasing pace of liberalisation in FDI, trade, and capital and financial markets as well as the agglomeration of markets. The underlying common factor to these concerns is that in operationalising FDI, the boundaries of the firm are no longer well-defined and are often far more 'virtual' than real. The notion of arm's length markets is less solid as firms merge with markets and markets merge with firms.

A comprehensive view of the implications of variables related to ownership, location, alliance relations, the internalisation of markets and the spatially distributed yet integrated networks linking global and regional production plants, is crucial to policy for attracting FDI [Fukao, Ishido and Ito (2003); Ito and Fukao (2003)].

Within the frame of reference provided by location specific advantages, ownership, internalisation and alliances, motivations that induce large MNEs and international small and medium-size enterprises (ISMEs) to invest overseas and spatially distribute their manufacturing and marketing comprise groups of variables impinge on FDI policy. These are:

(i) Those that relate to efficiency-seeking motives for FDI. Chief among these are: the productivity-adjusted cost of labour and relatively high quality to low input factor cost ratios. These variables are commonly a function of industry-wide technological adaptability.

(ii) Those that relate to market-seeking motives for FDI. The major market variables are; size, the demographic profile of various market segments, tariff jumping and the vectors of domestic market growth. The latter is a function of supply factor and demand conditions, and the nature of related and supporting industries[46].

(iii) Those that relate to vertical integration with respect to access to raw materials.

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[44] See "The new global job shift" Business Week, 3 February 2003, pp. 36-48.

[45] To this extent the MNE is a phenomenon that internalises external markets to avoid opportunism and transaction costs.

[46] See the determinants of national competitiveness in Porter M., 1990, The Competitive Advantage of Nations, London: Macmillan, p. 127.

(iv) Those that relate to the "pull" of economic agents in the host country such as government or large clients and customers. These often take the form of requests and invitations to 'come and set up shop' in the country.

(v) Those that relate to the "push" factors in the source country of FDI such as under-employed resources and pressures for risk diversification. These can take the form of various inducements from source governments, which are configured by strategic trade policy considerations[47].

(vi) Those that relate to the business and investment climate such as the stability of political economy and commercial ability to do business without 'a hassle'. These are largely a function of governance and transparency for investment (See Appendix I and II for ASEAN comparisons).

These motivations of MNEs for FDI are increasingly articulated in terms of reducing risk by cross-border collaboration with either domestic firms, their own subsidiaries, or those of other MNEs, in which the control of manufacturing assets is replaced by the control of options within multi-faceted economic relationships of supply [Giroud (2003b)]. The 'componentisation' of production -- that is, the slicing up of industry stages of production and firm value chains, and their subsequent global distribution[48] within the organisational boundaries of MNEs -- requires considerable analytical capacity and institutional understanding. Host governments require appropriate policy instruments and incentive measures to permit their selected strategic domestic sectors to intermediate industriously in international production networks.

As mentioned earlier, policy makers have to wrestle with the internationalisation of firms and the 'conflict' of markets [Buckley (2003)]. Capital and financial markets are international and the managerial implications therein concern the potential conflict with national policies in developing domestic capital markets. In contrast, the market for goods and services is overwhelmingly regional. For policy-makers the implications for managing industrial development in *a regionalised world* concern the integration and harmonisation of inter-country policies that permit networked MNEs to view developing country hosts to FDI *as part of a region* rather than isolated markets or locations for low cost production[49]. Labour markets, on the

[47] See for example J. A. Brander, 1995, Strategic trade policy, NBER, Working Paper, No. W5020, February; and W. M. Corden, 1995, Strategic Trade and Industrial Policy, Center for Economic Policy, Paper No. 339, Australia National University.

[48] See G. Abonyi, "Linking Asia Together", The Asian Wall Street Journal, 5 December 2000, Editorial page, for an elucidation of the dynamics involved in the spatial distribution of manufacturing value-added.

[49] In this respect, despite differences in comparative indices, the perceptions of investors regarding Southeast Asia and Africa are in contrast with the former being considered much more in regional terms relative to the latter.

other hand, being predominantly national in character, present the challenges of crafting viable policies for national employment, training and human skills development that will entice MNEs.

These three markets -- capital, goods and services, and labour -- conflict in the sense that the design of FDI policy instruments must weigh conflicting factors yet must be sufficiently coherent in application to achieve optimal developmental outcomes. For developing countries with youthful capital markets, policies for improving regional and national markets for goods and services as well as labour market flexibility are more significant to industrial development. FDI promotion and targeting then becomes a more concerted and subtle exercise regarding the stages of production which are distributed within the region on the basis of country differentiated strategies that reflect different -- but evolving -- location specific advantages rather than a process by which FDI is competed for, head on, through 'beggar-thy-neighbour' incentive wars.

Governments select from national policy choices and instruments to attract FDI in relation to, and in support of, overall economic development goals. These goals encapsulate the aim of creating wealth through industrialisation efficiencies that are gained ultimately from increases in total factor productivity growth. Hence government and institutional polices, and their effective implementation by ministries, can be crucially important determinants of FDI. However, as the empirical evidence on the industrial organisation of the firm clearly shows, the spatial location and dynamic distribution of vertical and horizontal international production is not territorially bound. The territorial freedom of the cross-border networks and organisational functions of MNEs therefore presents major policy challenges to developing countries as they attempt to capture FDI. Developing countries face difficulties such as:

(i) Limited capacity to exploit the determinants of growth, and the motivations for FDI by MNEs.

(ii) Constrained capability to design policy solutions that maximise the capture (and local embedding) of positive externalities from FDI while moderating the impact of negative spillovers.

Related issues concern the relative merits of policy instruments for technology diffusion and transfer, and R&D out-sourcing. As the boundaries of international firms become 'fuzzy' with constantly changing shape, critical success factors in FDI policy move towards an IP strategy and organisation that delivers ever decreasing costs of doing business; facilitates greater internationalisation of the investors operations while incorporating more domestic firms [World Bank (2005)]. An important concomitant to this is the need for developing countries to improve

their indicators[50] of industrial performance [UNIDO (2002)], as illustrated for selected ASEAN countries in Appendix III - Ranking of Economies by basic indicators of industrial performance and by Competitive Industrial Performance 1998 and 1985 (see earlier Section 2 – Background Issues).

3.4. The China Dimension to FDI in Southeast Asia

Recent analysis[51] and commentary on China yields generally two contrasting views on the China dimension to FDI (and economic performance)[52], which have challenging policy implications for Southeast Asia (and other developing regions). The first perspective suggests the highly competitive dynamics faced by Southeast Asia due to China's emergence as the pre-eminent host of the FDI flows to developing countries[53]. The second view looks to the growing complementarities between Southeast Asia and China (see earlier Section 3.2). The gravitational flow of manufacturing FDI to coastal China, which could have diversionary effects on intra-regional FDI flows, is unlikely to be reversed. In fact, should the efficiencies of reforms in China continue to increase, the FDI flow to China may well continue to accelerate[54]. The issue of diversion of ASEAN intra-regional flows is complicated by; (i) the reality of MNEs production networks, (ii) vertical intra-industry trade, (iii) intra-firm exports and imports and (iv) inter-sectoral exchange (within clusters of close industrial classification) between and within Southeast Asia and China. For example, the sourcing patterns of MNEs with respect to local input linkages in the electronics and textile sectors, in which the types of mandates given to MNEs' subsidiaries are crucial determinants [Mirza, Cheung and Leung (forthcoming 2005); Giroud and Mirza (2004)].

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[50] Per capital functions of manufacturing value added (MVA) manufactured export; share of medium- and high technology activities in MVA; and share of medium- and high technology activities in manufactured export.

[51] See Tokyo Club Foundation for Global Studies, The Emergence of China and The Evolution of Regional Economic Integration in East Asia, AT 10 Researchers' Conference, 3-4 February, 2004, Tokyo, Japan.

[52] See M. Schaaper, 2004, An emerging knowledge-based economy in China?: Indicators from OECD databases, STI Working Paper, No 2004/4, OECD DSTI/DOC(2004)4, Paris; and "The Chinese Boom…;" Comment and Analysis, Financial Times, 24 March 2004, p.11, for the upbeat assessment. See "Behind the mask: A survey of business in China"; The Economist, 20 March 2004, pp.3-18; "China: headed for a crisis?"; Business Week, 3 May 2004, pp 26-33; and "China's economy"; Special Report, The Economist, 15 May 2004, pp. 11-12, pp. 67-69,. for the downbeat assessment.

[53] This is notwithstanding key issues concerning the issues of measurement of flows to China. See Geng Xiao, 2004, Round-tripping Foreign Direct Investment in the People's Republic of China: Scale, causes and implications, ADB Institute Discussion Paper, No.7, June, ADB Institute; and Alex Erskine, 2004, The Rise in China's FDI: Myths and Realities, Conference Paper, Australia-China Free Trade Agreement Conference, 12-13 August, Sydney, Australia.

[54] Net in-flows of FDI to ASEAN and China have completely reversed in favour of China. While ASEAN hosted US$10,1 billion in 1990 by 2001 this had collapsed to US$2,5 billion. In contrast, China hosted US$2,6 billion in 1990 and by 2001was hosting US$37.4 billion according to World Bank data.

Also, the trade surplus (or deficit) perspective[55] may not indicate underlying policy strengths (or weaknesses) due to the fact that whereas US and Asian MNEs, particularly Japanese MNEs, tend to be vertically integrated across Southeast Asia and China, European MNEs tend to be more horizontally integrated [Chia (2004); Sachwald (2004); Taube (2004, 2002)]. So, while ASEAN enjoys a trade surplus with China, what may be more important -- for policy from a FDI host country point of view -- is the structure of export oriented FDI competition, between Southeast Asia and China, for Triad markets (in terms of medium- and high-technology MVA).

Analysis indicates that, despite China's rapidly growing exports to US and Japan relative to Southeast Asia's, the region enjoys a competitive advantage over China in some trade categories including: primary products, resource based manufacturing and electronics/electrical to both US and Japan; and in automotive and process to Japan [Chia (2004, Table 6)]. Apart from primary resources, these are characterised by vertical intra-industry trade within MNEs production networks. This view also has to take into account Japan's outward FDI to Southeast Asia compared to China. This shows that cumulatively the ASEAN-5 received Yen 7,143 billion (1989-2002) compared to China which hosted Yen 2,479 billion in the same period [Sussangkarn (2004)].

Overall, inter-location (ASEAN-5, China, Japan) vertical intra-industry trade in medium- and high-technology MVA favours Southeast Asia in finished products, electronics components, petro-chemical basics, petro-chemical derivatives [Kinoshita, Kishida and Amemiya (2004)]. And this tends to suggest that, despite the vast flows of FDI to China, a deeper scrutiny of the layers in industrial dynamics, in relation to export structures of ASEAN economies, Southeast Asia's FDI policies and IP strategies remain competitive especially at the level of *third generation* IP[56].

However, as the competition for inward FDI is relentless, policy needs to shift to reflect the exposed underlying changes to industrial organisation. And key issues in relation to the above concern, for example, the need to account for third and fourth party logistics and distribution as well as supply-chain programmes in FDI policy and IP strategies [D'avanzo, von Lewinski and van Wassenhove (2003); Quin (2002); Hertz and Macquet (2001)]. Additionally, FDI policy for Southeast Asia (and other regional groupings) as a 'single market' would need to

[55] Latest figures available indicate that ASEAN (mainly the ASEAN-5 i.e. Indonesia, Malaysia, Philippines, Singapore, Thailand) has a surplus trade balance with China of US$10 billion (1997); US$14 billion (2001); US$18 billion (2002); and US$ 30 billion (2003). See Stephen Green, 2003, Reforming China's economy: A Rough Guide, RIIA; and Eswar Prasad, Ed., 2004, China's Growth and Integration into The World Economy: Prospects and Challenges, Occasional Paper No. 232, IMF.

[56] Singapore's EDB and TDB have been exemplary since the 1960s in targeting export-oriented FDI. See UNCTAD WIR 2002: Transnational Corporations and Export Competitiveness, Geneva: UNCTAD p. 222.

evolve more rapidly to account for the increasing propensity for offshore decisions by MNEs especially with respect to the relocation of service industries[57]. In this respect, economic integration between Southeast Asia and China, already relatively well advanced, requires continued complimentary policy reform with respect to barriers to; (i) financial liberalisation, (ii) improved risk management, and (iii) financial integration in terms of management practice of financial institutions [Laurenceson (2003)].

3.5. Capital Markets and FDI in Southeast Asia

Notwithstanding some technical differences between FDI and Foreign Portfolio Investment (FPI)[58], rising FPI flows, and recent activity[59] in XBMAs as well as developments in global capital and financial markets (CFMs) have permitted FDI and FPI activity to converge. Furthermore, through venture capital and private equity mechanisms, equity funded growth prospects in SMEs have attracted FDI; and FDI -- especially in its backward and forward linkages to domestic industry -- can be a magnet for equity investments. Additionally, XBMAs are increasingly enacted using equity instruments. The co-evolution of FDI and FPI thus enables regional capital and financial markets to develop and facilitate FDI, especially when product development in financial assets enables foreign investors to use local CFMs to make direct investments [UNIDO (2004); UNCTAD (1999)].

However, most of the region's CFMs are relatively under capitalised and financial intermediation is still largely dependent on bank financing with resource allocation efficiencies that are often biased in favour of the State, and at the expense of investors. Also price discovery functions have historically produced lending rates lower than required given the risk profile (given by bank spreads of 1.5-2%)[60]. Furthermore, Southeast Asian CFMs, with low floats, are illiquid relative to their Triad counter parts thus deterring increased participation by global investment funds and institutions. And the regional CFMs arguably have been less than muscular in acting as checks on relatively poor corporate governance standards in a number of countries. The capacity of the region's CFMs to act as a conduit for FDI is therefore somewhat

[57] See A.T. Kearney's 2004 Offshore Location Attractiveness Index: Making Offshore Decisions, Chicago: A.T. Kearney; and Dan Roberts and Edward Luce, 2003, "Outsourcing", Financial Times, 20 August 2003, p.11 for the variables that determine the services outsourcing decision.

[58] See UNCTAD, 1999, Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI): Characteristics, similarities, complementarities and differences, policy implications and development impact, UNCTAD TD/B/com.2/EM.6/2, April.

[59] See Phillip Lee, "Bustling year for M&As", The Business Times, 19 May 2004, Singapore.

[60] According to Andrew Sheng, Chairman securities and futures commission Hong Kong, "The future of capital markets in developing countries: implications for China's equity markets", Stanford Centre for International development, China's Markets Reforms, 19 September 2003, Asia needs to deepen its CFMs with the full range of intermediating products and services in order to adequately take advantage of Asia's 'demographic endowment' of youth.

limited [Freeman and Bartels (2000)], due in large part to lower capitalisations and trading volumes[61].

Although FDI and FPI tend to have different velocities and characteristics, they both address financial needs that are converging, and therefore have congruent policy implications. Policy regimes have to be differentiated but must demonstrate a coherence that permits FDI liberalisation to be sufficiently well articulated with FPI regulatory reform, so as to avoid macro-economic shocks. Other issues concern the treatment of FPI in FDI and Bilateral Investment Agreements (BITs)[62] and measures to manage volatility[63].

Other areas that deserve policy attention include; (i) corporate governance practices and standards, (ii) transaction costs, (iii) protecting investors, and (iv) methods and standards necessary to deepen the symbiotic relationship between FDI and FPI. With respect to corporate governance, market contestability needs to increase in order to improve competition-based discipline. Transaction costs and efficiency related to financial transactions can act as a barrier to CFM development and therefore need improving. Policy should also be focused to clarify property rights[64], to assist in moderating the incidence of non-performing loans; and if regional CFMs are to play an improved FDI intermediating role, they need to integrate with the world's major CFMs by adopting international standards.

4. CONCLUDING REMARKS

The increasing international deployment of work[65] manifest as global production sharing [Yeats (1998)] and vertical intra-industry trade has networked MNEs with supply chains, domestic firms and ISMEs across geo-economic space. In a world of diminishing barriers to factor mobility, the reality of 'the global factory' has profound implications for FDI policy and IP strategies of countries wishing to attract and retain FDI. At a broad level, the long view of FDI indicates a change in the location decision from the sequential to the parallel in order to disintegrate and re-integrate differentiated stages of production and thereby maximise allocative and cost efficiencies as well as maintain flexible access to markets. This calls on developing country policy makers to create sensitive policy instruments and mechanisms to track the

[61] See Nick J. Freeman, 2001, A Regional Platform for Trading Southeast Asian Equities: Viable Option or 'Red Herring'? Journal of The Asia Pacific Economy, Vol. 6, No. 3, October, pp. 335-359, for a view on the dangerously close 'twilight zone ' of marginal asset allocation that some of the region's CFMs face.
[62] According to UNCTAD WIR 2003, the EU, Japan and US have signed a total of 963 BITs.
[63] For example the pre-1998 30% reserve requirement applied by Chile.
[64] According to the World Bank Doing Business in 2005 indicators, the regional average for protecting investors is 2.5 compared to the OECD's 5.6 on a scale of 0 to 7 with 7 being the best.
[65] See The Economist, A world of work: A survey of outsourcing, 13 November 2004, pp. 3-16.

changing morphology of MNEs with a view to targeting specific parts of their production networks.

The spatial relevance of free trade agreements (FTAs) for market seeking investments is crucial with respect to lowering transaction costs. The challenge posed to policy craft is how to: (i) harmonise the 'concentricities' of 'hard' and 'soft' regulations that spill across the FTAs and BITs, DTTs, RTAs[66]; (ii) cohere competitive policy instruments to attract FDI; and (iii) reduce the costs of doing business while increasing the robustness of the assets and intellectual property rights regime.

The boundaries of international firms are increasingly 'fuzzy' and permeable on the one hand while internalisation of external factor and intermediate markets, on the other hand, tends to militate against market-based measures to influence the location decision. The China dimension presents complex policy challenges to Southeast Asia as it attempts to compete with, and act as a viable complement to, China's FDI trajectory. How Southeast Asia deals with this successfully holds lessons for other developing countries with a 'giant' neighbour.

The role of CFMs and FPI is no longer tangential to FDI. The massive domestic savings profile of the region requires policies to create diversified financial assets that in turn will help spur the kind of domestic investment attractive to FDI in its more collaborative forms.

IP strategies, given the increasing complexity of FDI and its real options decision making, require a special sensitivity to the spatially distributed nature of FDI. Attention to the 'virtuous cycle' of policy intervention [UNIDO (2003a, Figure 1, p. 18)] is essential to enable IPAs to graduate from *first* and *second generation* IP to *third* and *fourth generation* IP. Beyond targeting export-oriented FDI, *fourth generation* IP focuses holistically on the dynamics of 'the global factory' of MNEs and aligns modal neutrality, market contestability and policy coherence in the reform of regulations[67]. It also takes a much broader and strategic view of the role of IPAs beyond the traditional focus on the 'foreign' in FDI attraction, advocacy, facilitation and regulation of entry. It is geared towards actively championing promising domestic firms in the supply-chain and networks of MNEs and ISMEs; and enabling cross-ministerial co-ordination in setting the regulatory regime. Furthermore, FDI policy needs to be increasingly coherent with a country's industrial development trajectory. Therefore attention to the overall system of national (and regional) economic incentives with respect to the national innovation system; science,

[66] Bi-lateral Investment Treaties, Double Taxation Treaties, Regional Trade Agreements.

[67] Modal neutrality describes policies that allow foreign investors to decide for themselves how best to serve the markets they enter. Market contestability embodies the ability of both foreign and domestic investors to compete on a level of playing field for the factors of production. Policy coherence refers to the degree of internal consistency of objectives, FDI policies and interpretation of policies, in their regulatory form, across a range of issues and at different levels of Government.

technology and innovation policy; human resources and social capital formation in relation to FDI is also necessary.

The successful Southeast Asian development experience thus far, and the challenges it faces in the future, and the central part played by MNEs and FDI in-flows and their linkages to domestic investment, hold significant lessons for other developing regions[68]. Especially with regard to path dependency, and the role of the State in integrating the local economy with the regional and global economies, this EGM aims to assist in advancing the 'state-of-the-art' policies for both Southeast Asian and other developing countries.

[68] In 1995, Asian Industrialization and Africa: Studies in Policy Alternatives to Structural Adjustment, Ed., Howard Stein, London: St. Martin's Press, raised issues pertinent to FDI, structural adjustment, industrial policy and the role of the developmental state which have still to be resolved by applying lessons of international experience.

Appendix I - Doing Business in ASEAN Indicators 2005

Variable	Brunei	Cambodia	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Singapore	Thailand	Vietnam	Timor Leste	Regional Average	OECD Average
Economy Characteristics 2004:													
Region: East Asia & Pacific													
GNI per capita (US$)	NA	310	810	320	3.780	NA	1.080	21.230	2.190	480	NA	5.464	25.773
Informal economy (% GNI, 2003)	NA	NA	19.4	NA	31.1	NA	43.4	13.1	52.6	15.6	NA	24.3	16.8
Population (millions)	NA	13.4	214.5	5.7	24.8	NA	81.5	4.3	62.0	81.3	NA	139.5	41.5
Starting a Business (2004):													
Number of procedures	NA	11	12	9	9	NA	11	7	8	11	NA	8	6
Time (days)	NA	94	151	198	30	NA	50	8	33	56	NA	52	25
Cost (% of income per capita)	NA	480.1	130.7	18.5	25.1	NA	19.5	1.2	6.7	28.6	NA	47.1	8.0
Min. capital (% of income per capita)	NA	394.0	125.6	28.5	0.0	NA	2.2	0.0	0.0	0.0	NA	100.5	44.1
Hiring and Firing Workers (2004):													
Difficulty of Hiring Index	NA	33	61	11	0	NA	22	0	67	44	NA	20.6	26.2
Rigidity of Hours Index	NA	80	40	60	0	NA	60	0	40	40	NA	30	50
Difficulty of Firing Index	NA	30	70	80	10	NA	40	0	20	70	NA	22.7	26.8
Rigidity of Employment Index	NA	48	57	50	3	NA	41	0	42	51	NA	24.4	34.4
Firing costs (weeks of wages)	NA	39	157	185	74	NA	90	4	47	98	NA	53	40.4
Registering Property (2004):													
Number of procedures	NA	7	6	9	4	NA	8	3	2	5	NA	4	4
Time (days)	NA	56	33	135	143	NA	33	9	2	78	NA	51	34
Cost (% of property per capita)	NA	4.1	11.0	1.1	2.2	NA	5.7	2.7	6.3	5.5	NA	4.3	4.9
Getting Credit (2004):													
Cost to create collateral (% of income per capita)	NA	0.0	2.5	3.8	3.2	NA	8.3	0.3	1.1	2.0	NA	1.9	5.2
Legal Rights Index	NA	4	5	2	8	NA	5	10	5	4	NA	5.4	6.3

Credit Information Index	NA	0	3	0	6	NA	2	4	5	3	NA	2.0	5.0
Public credit registry coverage (borrowers per 1000 adults)	NA	0	4	NA	339	NA	0	0	0	8	NA	33.9	76.2
Private bureau coverage (borrowers per 1000 adults)	NA	0	0	0	NA	NA	34	335	150	0	NA	67.3	577.2
Protecting Investors (2004):													
Disclosure Index	NA	0	4	1	5	NA	6	5	6	1	NA	2.6	5.6
Enforcing Contracts (2004):	NA					NA					NA		
Number of procedures	NA	31	34	53	31	NA	25	23	26	37	NA	27	19
Time (days)	NA	401	570	443	300	NA	380	69	390	404	NA	316	229
Cost (% of debt)	NA	121.3	126.5	30.3	20.2	NA	50.7	9.0	13.4	30.1	NA	57.0	10.8
Closing a Business (2004):	NA					NA					NA		
Time (years)	NA	no practice	6.0	5.0	2.3	NA	5.6	0.8	2.6	5.5	NA	3.6	1.7
Cost (% of estate)	NA	no practice	18	76	18	NA	38	1	38	18	NA	29.8	6.8
Recovery rate (cents on the dollar)	NA	0.0	10.6	0	35.4	NA	3.9	91.3	42.0	16.4	NA	30.4	72.1

Source: World Bank, 2005, Doing Business in 2005: Removing Obstacles to Growth, Washington D. C.: World Bank.

NA – Not Available

Notes:

Hiring and Firing Workers (2004): Three indices measure how difficult it is to hire a new worker, how rigid the regulations are on working hours, and how difficult it is to dismiss a redundant worker. Each index assigns values between 0 and 100, with higher values representing more rigid regulations.

Getting Credit (2004): One set of indicators measures the coverage, scope, quality and accessibility of credit information available through public and private registries. A second set measures how well collateral and bankruptcy laws facilitate lending. It ranges from 0 - 10, with higher scores indicating that those laws are better designed to expand access to credit. The Credit Information Index measures the scope, access and quality of credit information available through public registries or private bureaus. The index ranges from 0 - 6, with higher values indicating that more credit information is available from a public registry or private bureau.

Protecting Investors (2004): The Disclosure Index captures seven ways of enhancing disclosure: information on family; indirect ownership; beneficial ownership; voting agreements between shareholders; audit committees reporting to the reporting to the board of directors; use of external auditors; and public availability of ownership and financial information to current and potential investors. The index varies between 0 and 7, with higher values indicating more disclosure.

Appendix II - ASEAN Investment Climate Indicators: World Bank Investment Climate Surveys

		Policy Uncertainty			Corruption			Courts		Crime		
ASEAN Countries	Survey Year	Sample Size	Major constraint %	Unpredictable interpretation of regulations %	Major constraint %	Report Bribes are paid	Av Bribe % of Sales	Major constraint %	Lack confidence courts uphold property rights %	Major constraint %	Report losses from crime	Av. loss from crime % of Sales
Brunei	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Cambodia	2003	503	40.1	44.4	55.9	82.3	6.0	31.4	61.0	41.7	20.1	7.0
Indonesia	2004	713	48.2	56.0	41.5	50.9	4.6	24.7	40.8	22.0	15.6	3.1
Lao PDR	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Malaysia	2003	902	22.4	NA	14.5	NA	NA	NA	19.1	11.4	19.1	3.0
Myanmar	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Philippines	2003	719	29.5	49.1	35.2	50.6	4.0	NA	33.8	26.5	27.1	4.2
Singapore	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Thailand	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Vietnam	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA

Appendix II - Investment climate indicators: World Bank Investment Climate Surveys (Continued)

	Regulation and Tax Administration			Finance				Electricity			Labor	
ASEAN Countries	Tax rates as major contraint %	Tax Admin as major constraints %	Licensing as Major constraint %	Mgt. Time dealing with officials % mgt time	Avg. days to clear customs Day	Major constraints %	Small firms with a loan %	Major constraint %	Firms reportin g outages %	Lessons from outages % of Sales	Skills as major constraint s %	Labor regul. major constraints %
Brunei	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Cambodia	18.6	20.7	11.7	14.6	NA	9.9	7.9	12.7	38.6	5.2	6.6	5.9
Indonesia	29.5	23.0	20.5	14.6	5.8	23.0	16.7	22.3	33.0	6.1	18.9	25.9
Lao PDR	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Malaysia	21.7	13.3	10.9	10.2	3.6	17.8	57.3	14.8	40.6	5.2	25.0	14.5
Myanmar	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Philippines	30.4	25.1	13.5	11.0	2.8	18.2	16.8	33.4	41.6	9.6	11.9	24.7
Singapore	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Thailand	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Vietnam	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA

Notes: Data are based on enterprise surveys conducted by the World Bank and its partners in the year indicated. While averages are reported. there are significant variations across firms. The data are not intended for the ranking of countries. The WDR Survey of Micro and Informal Firms was also conducted in 11 countries: Bangladesh. Brazil. Cambodia. Guatemala. India. Indonesia. Kenya. Pakistan. Senegal. Tanzania. and Uganda. The findings of these surveys are not reflected in this table. "NA" indicates data is not available.

a. In 2002 the survey was expanded. so the earliest surveys include the firm performance measures. but not the full set of investment climate variables.

b. b. India's first round survey of 895 firms was conducted in 2000.

Appendix III - Ranking of Economies by basic indicators of industrial performance and by Competitive Industrial Performance (CIP) 1998 and 1985

Index of Competitive Industrial Performance 1998				
ASEAN 1998	Manufacturing value added per capita index (a)	(a)+ Manufactured exports per capita index (b)	(b)+ Share of medium-and high-tech activities in manufacturing value added index (c)	(c)+ Share of medium-and high-tech products in manufactured exports- final index (d)
Singapore	0.743	0.871	0.872	0.883
Malaysia	0.112	0.101	0.103	0.278
Philippines	0.022	0.017	0.015	0.241
Thailand	0.069	0.046	0.045	0.172
Indonesia	0.013	0.008	0.009	0.054
Index of Competitive Industrial Performance 1985				
ASEAN 1985	Manufacturing value added per capita index (a)	(a)+ Manufactured exports per capita index (b)	(b)+ Share of medium-and high-tech activities in manufacturing value added index (c)	(c)+ Share of medium-and high-tech products in manufactured exports- final index (d)
Singapore	0.434	0.717	0.616	0.587
Malaysia	0.093	0.083	0.067	0.116
Thailand	0.041	0.025	0.020	0.058
Philippines	0.035	0.020	0.015	0.044
Indonesia	0.020	0.012	0.009	0.012

Source: UNIDO Scoreboard data set, UNIDO Industrial Development Report 2002/2003

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