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PROBLEMS AND PROSPECTS FOR INTRA-ASEAN INVESTMENT

Note by the UNIDO Secretariat

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1. The Challenge Facing ASEAN

ASEAN member countries see the organization in a period of crisis following two decades of operation. Although collaboration on political questions has been fruitful, there is considerable dissatisfaction with the progress made in the economic sphere. The unwillingness to press ahead with the formation of a free trade area, still less to aim for much more ambitious schemes such as a customs union or a common market, has meant that economic co-operation has been confined to more limited areas. Among these the issue which has perhaps received the most regular attention is that of industrial investment, and specifically the ways of encouraging joint investment (public and/or private) among countries of the region. This note again addresses itself to the investment question, trying to put it in a broader perspective encompassing the circumstances now facing ASEAN members, the rationale for promoting various forms of joint investment, and the prospects for increasing such activities.

The ASEAN countries are looking for ways to increase economic growth at a time of much slower progress in the world economy as a whole and when major changes in technology, industrial organization and industrial location are taking place. Industrial co-operation is therefore seen as a means of accomplishing two aims: reinforcing economic growth and cementing economic unity among the members. At no time in the past, nor indeed now, does ASEAN view these two aims as anything other than complementary - there is no question of sacrificing overall growth in order to increase co-operation. The dissatisfaction regularly expressed about both the absolute extent of industrial co-operation so far and its contribution to economic expansion in the region nevertheless needs to be put in perspective. On most indicators of economic progress, including changes in income per head, increase in industrial exports, control of foreign debt, or the degree of foreign investment, the ASEAN countries have performed well in relation to developing countries as a whole. However, their own yardstick of comparison is constantly with some other countries in the region, particularly Republic of Korea and Japan, against whom ASEAN performance seems less satisfactory. The frequent exhortations to improving co-operation have to be seen in this context. It is not correct to argue that ASEAN economic expansion has been below average; quite the contrary, it has been good against any comparisons save those with a few of its neighbors.

On the particular issue of industrial co-operation it is also by no means clear that ASEAN performance has been weak compared with that of other developing country groupings. While several schemes have been tried in Latin America over the past quarter of a century (ranging from endeavors to expand intra-trade through LAFTA and LAIA, explicit attempts to create joint investments and allocate production among members through the Andean Pact, and on to significant bilateral arrangements of which the 1986 accord between Argentina and Brazil is the most substantial) the actual results, in contrast to the declared objectives, have been quite inadequate. Intra-trade in industrial products has not gone beyond a tiny proportion of aggregate trade for the larger member countries and even for the small ones the shares of items receiving preferential treatment has rarely approached more than about one-sixth of the total. Industrial investment among Latin American countries has also received much more attention than the figures would seem to warrant. Most of the Andean Pact schemes, which relied heavily on commitment of public funds, have failed to materialize or, where they did, to survive. The burst of private investment observed, particularly from Argentina and Brazil, towards the end of the last decade and the beginning of this, also has to be put in its proper setting. In aggregate terms the proportion of total foreign investment accounted for by these transactions did not for any country reach as much as five per cent; the investments were not carried out, except in a handful of cases, under the aegis of bilateral or multilateral co-operation agreements; and in any case the latest information suggests that a by no means negligible number of these investments have subsequently been discontinued.

It is correct to argue that ASEAN co-operation has been much more limited than that of the EEC. Yet even there the circumstances have to be kept in mind. There was a clear commitment from the beginning to a timed creation of a customs union heading on towards a common market - this has been exactly three decades in the making and even now further steps to establish the Common Market are still required. Moreover, the question of co-operative investment was not explicitly considered by the EEC countries, since they believed that the expansion of trade would itself be sufficient for production and industrial specialization to increase via the growth of individual firms in the Community. Thus, although there could admittedly be some debate over the appropriate figures to employ in any comparison, it is almost certainly correct to assert that intra-EEC industrial investment, at least in the sense in which ASEAN countries understand the term, is but a minor and probably only a tiny proportion of aggregate industrial investments in the European countries.

One final initial remark needs to be made on the circumstances in which ASEAN countries are trying to expand joint industrial investments. Their economies are closely bound to the fortunes of others whose presence in the Pacific is extremely powerful, viz. Japan, China, Republic of Korea and U.S.A. These countries are now in a phase where the economic links among them seem to be growing much faster than their overall economies and in which each of them is paying progressively more attention to other countries in the Pacific, above all the ASEAN members. It is scarcely surprising that ASEAN feels not only that such expansion may create new opportunities for it but also, and in a contrary sense, that there is a real danger of being overwhelmed by fast-growing, technologically powerful and overseas-oriented industrial and industrial service economies. Undoubtedly joint investments, even if they also involve some non-ASEAN participation, are seen as a means of preserving industrial identity in the face of such a challenge.

2. <u>The Rationale for Intra-ASEAN Industrial Investments (IAII)</u>

IAII is subject to conditions both general and specific. Like foreign investment of all kinds it will respond primarily to economic conditions within the country where it is established along with the circumstances facing foreign investors in their own enterprises, e.g. the comparative attractiveness of foreign production sites, the availability of funds for foreign expansion, the impact of technological change, and so on. A secondary set of considerations would seem to be that connected with the legal and institutional framework for foreign investment. Surveys over the past twenty years on the behavior of foreign investors have repeatedly stressed that, notwithstanding the vociferous petitions made by foreign investors for greater liberalization of the legal requirements they must meet, actual investment decisions appear to be affected only to a limited extent by the institutional and legal environment. This point will be used again in discussing the intra-ASEAN situation.

A variety of characteristics would seem to distinguish the actual and potential IAII. Capital participation can be any mix of public and private, may involve just two as well as more ASEAN member countries, and may be with or without involvement of third parties. The firms themselves are usually new ventures but may well be offshoots of enterprises already in operation; there seem to be few if any examples where joint investments have come from purchases of already established firms (whether public or private sector, locally or foreign owned). Enterprises themselves seem to vary according to size, branch, market orientation and main aspects of technology. Moreover, there is some hint in the figures that cultural ties, especially among Chinese entrepreneurs who are nationals of different ASEAN countries, may be a factor impelling joint investment.

What are the determinants of such investments? Are there genuine 'natural' advantages which are there waiting to be utilized or must advantages be 'manufactured' so as to bring about investments which would not otherwise take place? On the face of it, and although the items are not easy to quantify, private entrepreneurs in the ASEAN region may enjoy some real edge over external investors. That edge stems primarily from greater knowledge of the region. It can take several forms including knowledge of product markets (valuable on the assumption that production is destined mainly for ASEAN consumption), greater understanding of management of local labor, familiarity with administrative systems, and quite possibly a fairly similar business history which permits entrepreneurs to operate from similar perspectives. There is, furthermore, an advantage which by now has been acquired as a result of the operation of ASEAN itself, viz. through the ASEAN business associations functioning at branch level entrepreneurs in the region now have plenty of contact with each other and awareness of common problems and potentials. These advantages are not, however, necessarily exclusive. In particular those TNC which have operated in ASEAN member countries for many years, and indeed which are themselves represented in ASEAN-wide industrial associations, may also possess some of these advantages. Nevertheless the linkage which the affiliates must perforce retain with overseas headquarters does put them in a somewhat different category.

To the extent that these advantages can be translated into production terms, it would be expected that local private entrepreneurs would utilize them even in the absence of specific incentives from member governments (the same argument would not apply to public sector investments of a joint character since the legislative restrictions on such activities would need explicit handling). As has often been indicated in economic policy discussions, however, the deficiencies of information across countries along with a certain degree of risk aversion by relatively new entrepreneurs may warrant some type of special support. Those incentives could take the following forms: national treatment of fellow ASEAN investors within member countries; trade preferences for products manufactured by firms with IAII; various devices to reserve markets within ASEAN for such firms, e.g. through preferential public procurement; and incentives in specific branches linked to R & D efforts by the firms concerned.

Thus far ASEAN has tackled the question of incentives only in an ad hoc and perfunctory fashion. Explicit national treatment has not been established on a firm basis; trade preferences have been granted partially but not fully; the reservation of markets, which was certainly envisaged in the early days of AIC schemes, has not in fact been practiced, and there is little evidence of the R & D connection. Indeed, those advantages which have been legislated have also been extended in various instances to all enterprises legally established in the region without regard to who really controls them - in this sense, just as has frequently occured in Latin America, the benefits can also be captured by TNC affiliates.

In short the present position seems roughly as follows. Local capital may possess some advantages based primarily upon local knowledge of markets and production problems but it is not in exclusive possession of those advantages. Such incentives as have been established are not yet clear-cut and certainly do not aim sharply at the position of local entrepreneurs as compared with foreign-controlled enterprises. It is, then, not surprising that the number of IAII, of whatever form, remains small (it appears that only 9 AIJV currently operate and there are even fewer AIC arrangements). Those entrepreneurial groups in the region which are eager to penetrate markets of member countries currently place heavy emphasis on trade liberalization measures by ASEAN from which it could be deduced that they would by more ready to export directly from their own countries rather than set up production facilities in collaboration with local capital in the recipient country. There is unquestionably a strong interest in expanding sales but it is not obvious that a commensurate interest exists in expanding investment. Moreover, there is some evidence to suggest that entrepreneurial groups in Singapore and the Phillipines have been directing attention abroad towards one or two OECD countries, especially U.S.A. Indeed UN data on the stock of investment held abroad as of end 1985 suggests that for both of these countries their holdings in U.S.A. are already some 12 - 14 per cent of U.S. investments in those countries. Intra-ASEAN investments, therefore, have in fact taken very much the back place as compared with those investments abroad made from the region.

3. Possibilities for IAII

The picture sketched in the preceding section is not an encouraging one. First, within the region itself the advantages possessed by and incentives offered to local entrepreneurs have not been exclusive to them nor have they been very strong. Second, the absence of more open trading possibilities has created a situation where joint investments could easily mean sales in just one member country rather than several. Third, public sector investments of a collaborative character have been most unsuccessful. Fourth, the experience of other regions, especially Latin America, is not too positive when put in the ASEAN context. Specifically, where joint ventures of a public sector type have occured in Latin America, the partners have often been very unequal in the sense that big companies from the bigger countries operating in fairly large scale and heavy industry branches have been providing some equity along with much technology and loan capital to create production in smaller countries. Where private investors have been involved again entities from the bigger countries have been by far the most active and much of that behaviour has been connected with defensive strategies against highly uncertain conditions in their own countries. Fifth, it is necessary not to lose sight of the very different environment and approach to industrial development as between ASEAN countries and Latin American ones. ASEAN has been concerned, by and large, to follow the trends of international markets and to pursue integration with them; this approach has been in a context of quite rapid overall growth, an acceptable degree of price stability, and the avoidance of chronic debt problems. In Latin America the perspective has been different, particularly for the three largest countries and the members of the Andean Pact. Their aims have been explicitly to build integrated industrial structures with promotion of capital goods industries being a constant theme. Although actual performance, particularly in the present decade, has often been disappointing in relation to those objectives, the accent has nevertheless been on creating industrial systems which are self-sustaining.

Against this somber background expectations for IAII cannot be great. Even the establishment of a handful of such ventures within the next year or two would have to be counted as real progress compared with performance in the past. But to encourage these investments a number of conditions, both general and specific, would seem necessary:

- ASEAN would have to provide clear evidence to investors that it is indeed committed to creating an economic zone where trade and investment among partners is given strong preferential treatment at least in some key branches

- this commitment would have to include an explicit time schedule of measures to be introduced so as to make investment planning an easier activity

- a striking example or two of joint public sector investment could act as a strong catalyst for actions by private entrepreneurs

- encouragment in the form of funding by ASEAN of feasibility studies could be a helpful first step to overcoming reticence, especially by medium-size firms in the region

- some form of encouraging particular branches, and not just ASEAN investors, may well be required. This could be through the establishment of priority areas to which additional support would be given or it could be via some form of market reservation in those branches.

- the provision of capital may itself be a problem given the limited nature of capital markets in the member countries. ASEAN may therefore have to establish much larger funding sources to which would-be local investors can apply in their attempts to establish IAII.

- given the current pressures on ASEAN by the main OECD investor countries to liberalize legislation it may be necessary to retain the possibility of non-ASEAN participation in some of these joint ventures

- since the satisfaction of regional demand and the expansion of exports are both key elements of existing industrial strategies, it may be necessary to give equal treatment to joint ventures whichever market orientation they have

- if ASEAN countries can agree on key industrial areas where they wish to make an innovative effort, then additional incentives for joint ventures in those branches could well be justified.

The above conditions add up to clear policy decisions in the areas of protection, investment legislation, public sector commitments, and innovation. They mean that IAII is likely to respond much more to improved overall organization within ASEAN than to minor adjustments of existing schemes, which in any case are reasonably flexible. Thus the point made earlier in this note resurfaces: the problem up to now has not been an absence of flexibility in ASEAN but rather the absence of a clear-cut commitment to some form of economic integration.

The experience in both Latin America and EEC in this regard has been instructive. Foreign firms, especially from U.S.A., managed to take full advantage of the integration schemes. In Latin America this was to an important extent at the expense of local enterprises while in Europe, despite the fears which were strongly debated some twenty years ago, the outward orientation of European investors themselves meant that there was a readiness to allow all firms to utilize the integration schemes. For ASEAN the situation differs in that Japan is clearly the strongest foreign investor (data on foreign investment in ASEAN over the period 1980 - 1985 show that Japan was the largest investor in the region in every year except 1982, that it is the only country not to have recorded any net disinvestment, and these trends have been recently reinforced by new measures announced by the Japanese government). The fear of too much foreign participation does exist, however. Against this there are only two positive directions which can be followed, i.e. for individual members to encourage national investment and/or for ASEAN countries as a whole to encourage joint investments. The latter will unquestionably remain only a small proportion of the former for quite some time to come. This note has argued that the relative weight of each factor would change only if ASEAN entrepreneurs were genuinely encouraged to adopt an ASEAN perspective in their thinking. That perspective is best served by setting up a broader market, by establishing financial facilities for conducting investment studies and raising loan capital, and by an indication that the public sector in member states is likewise interested in the same goals. If those conditions can be met, then IAII may become a more powerful stimulus both to co-operation and regional economic growth than it has been during the past few years.

Several remarks have been made in this note regarding experiences of, and co-operation with, other countries and institutions. It is only appropriate, therefore, that three areas of such co-operation be underlined. To begin with, the references to co-operative arrangements among firms can be looked at in the light of the recent (1985) program in the EEC for co-operation in R & D, the so-called EUREKA program. The member states include the EEC, EFTA and Turkey. The aim of the program is to increase competitiveness of European firms in the field of high technology. The focus is strongly towards the development of products for the market, most of the participants are firms rather than universities and research centers, more than half of the funding comes from the entities themselves, and they do most of their own co-ordination, i.e. EUREKA has only a small secretariat. Up till now 109 projects covering a wide range of products have been approved and it would seem that this kind of flexible approach could fit well within the perspective usually adopted by ASEAN.

The second area of explicit co-operation could be through the JV approach in which the foreign participants are welcomed. As noted earlier, Japanese investors are the leaders within ASEAN and the data so far point strongly towards the joint venture system as the preferred form of Japanese involvement. Moreover, although the EEC countries account for a far smaller proportion of total foreign direct investment in the region, they too have recently placed much greater emphasis on JVs as a preferred form of collaboration. Under existing provisions for AIJV these linkages with abroad are permitted; what may be necessary now is to integrate them more clearly with any changes in investment policies towards the OECD countries.

Finally the necessity to improve methods for raising capital in the region and encouraging cross-country investments could well receive support from the World Bank. Some ASEAN member countries have received structural adjustment loans from the Bank in recent years; that organization is by and large in agreement with the general directions for economic growth taken by the member countries of ASEAN; and it has within the past two or three years proposed a scheme for offering investment guarantees. Since joint investments by ASEAN entrepreneurs are also foreign investments, it may be worthwhile ASEAN pursuing the possibility of World Bank backup for such investments. This could include both methods of raising capital and the provision of guarantees against certain non-commercial risks. By the same token, and as was proposed in 1986 by one ASEAN ambassador to the EEC, the EIB can, according to Article 18 of its Constitution, assist EEC member states in investments outside the EEC itself. ASEAN could explore with EIB ways in which this provision could be effectively utilized in the context of collaborative arrangements where two or more ASEAN countries were involved. Under these circumstances IAII could be linked in more closely with the encouragement of investments from outside the region.