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Establishing the ASEAN Economic Community Through Investment Integration

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There has been a surge of trade flows, foreign direct investments (FDIs), and monetary flows within and into the ASEAN economic block, brought about by the rapid expansion of inter- and intraregional trade in goods, services, and FDIs via trade and investment liberalization policies, preferential trading arrangements, and the creation of production networks. However, in order to attain a higher share of FDIs relative to previous decades, there is a need to advance the state of investment climate facilitation in the region, despite stiff competition from other destinations. Hegemony can be a viable means to facilitate investment integration because of the ability to harmonize investment incentives within the ASEAN region. This paper aims to open the amendment of the ASEAN charter, emphasizing ASEAN centrality and regional cooperation as a topic of discussion, and explore the possibility of Singapore as the regional benchmark for investment integration.

Keywords: ASEAN, ASEAN economic community, hegemony, investment, trade flows

Past decades witnessed the surge of trade flows, foreign direct investments (FDIs), and monetary flows within and into the Association of the Southeast Asian Nations (ASEAN). The rapid expansion of inter- and intraregional trade in goods, services, and FDIs is attributable to trade and investment liberalization policies, preferential trading arrangements, and the creation of production networks (Castell et al., 2009). Monetary flows are also increasing due to capital account liberalization, deregulation, and financial market development (Castell et al., 2009). Thus, economies emerged and became vital drivers of global investment flows (Ing, 2011).

In the advent of globalization, ASEAN is aware that the world economy continues to present both opportunities and challenges to ASEAN. As such, ASEAN must proactively utilize and respond, keep itself constantly relevant, and maintain its centrality and role as the primary driving force in directing the evolving regional architecture. Hence, member countries of the establishment of an ASEAN Economic Community (AEC) intended to act as a single market and production base leading to free movement of goods, services, skilled labor, and capital. However, these moves towards integration are unlikely to lead to a customs union. As such, investment integration is deemed as one of the key elements in realizing the AEC. Todaro and Smith (2008) argued that investments are considered vital factors for economic expansion and advancement of international competitiveness. Meanwhile, Ing (2011) emphasized that investments are the source of economic transformation, employment creation, and transfer of technology and management. For this to materialize, Intal, Narjoko, and Simorangkir (2011) regarded that investment of firms to technologically improve, intensify market linkages, and strengthen capability and flexibility must be accompanied by superior infrastructures, trade facilitation services, and other types of services and facilities provided by the government—all of which would demand investment funds.

According to Urata and Ando (2010), as cited by Intal et al. (2011), the Philippines, together with Singapore and Cambodia, is one of the most open economies in terms of investments. Intal et al. (2011) furthered that Singapore has virtually the best practice in doing business in the ASEAN region. Meanwhile, Malaysia is ranked second in doing business and is one of the highest in Investment Promotion and Facilitation Program (IPFP) and Investment Promotion Agency (IPA) quality and is outstanding in image building and promotion. On the other hand, Thailand is high on IPFP and image building and moderate on investor servicing, ease of doing business, and investor linkages, but very low on IPA quality. However, the Philippines, though it is high on IPFP, IPA quality, and investor servicing, ranks very low on ease of doing business.

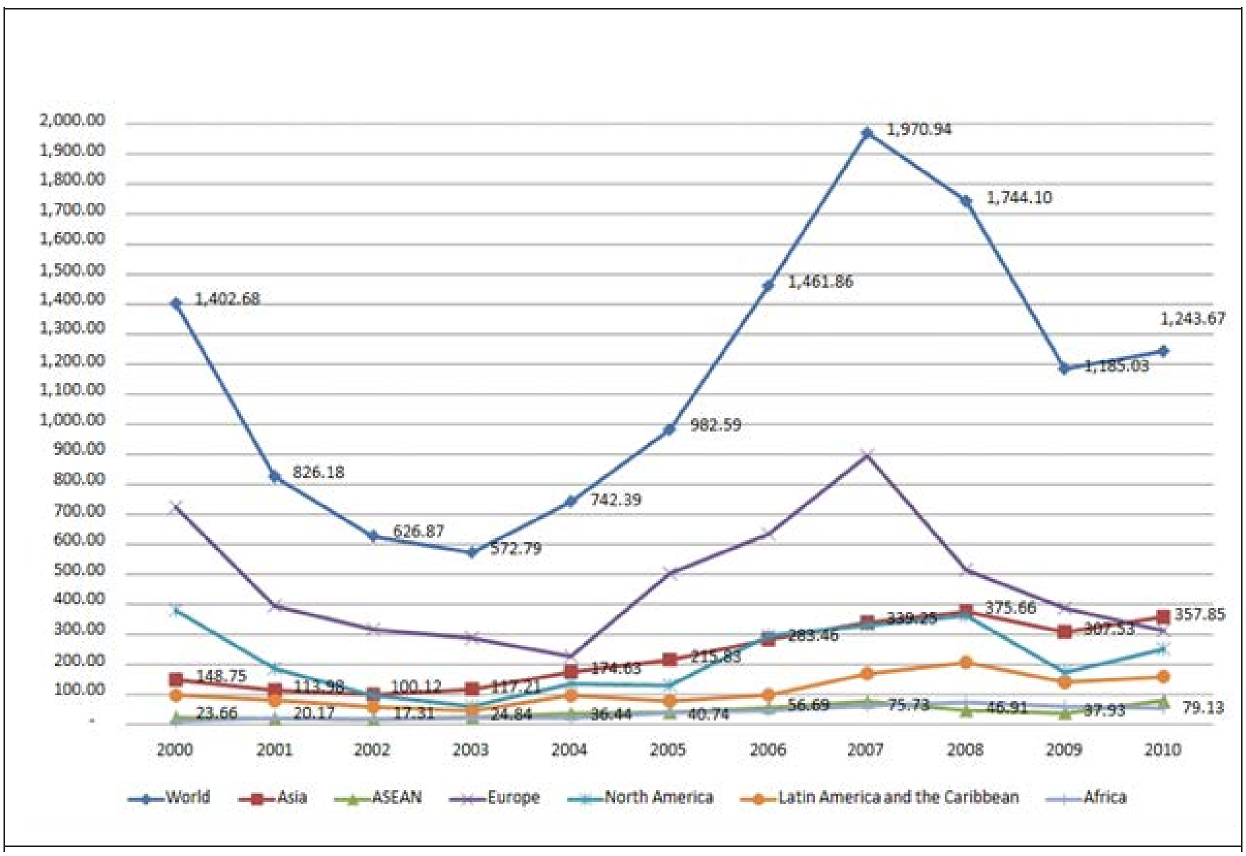
These disparities among investment climate and facilitation among economies in the region highlight different starting points with respect to opportunities, capabilities, sources of growths, and income. Likewise, the structural issues, inclusive of differences in endowments, uncontrolled circumstances, and government and market failures also cause these disparities. Hence, Oum (2011) recommended that one of the initial solutions is an effective–efficiency search method or a context–environment specific method wherein policies developed must not be generalized for the entire region. Similarly, Intal et al. (2011) emphasized that the characteristics of effective investment facilitation are the following: (1) minimize time and cost for investors to start up business; (2) processes that are expeditious, clear, coordinated, and transparent; (3) one-stop shops' effectiveness lying on good interagency coordination and efficient systems; (4) ease of doing business and reduced barriers to starting and operating business; and (5) quality of investor–government interactions, consultations, and policy transparency. Hence, the key common investor concerns and problems that arise are (1) too much red tape, long and complex procedures, and long time; (2) lack of transparency, corruption, and unofficial payments; (3) local permit process from local governments and unnecessary regulations of local governments; and (4) lack of coordination among government agencies (Intal et al., 2011). For this reason, Singapore can be used as a benchmark with essentially no investor processing concern.

Given the backdrop on the state of investment climate and facilitation in the region, the challenge now is to determine how ASEAN can become a better investment destination in the world in order to attain a higher share of FDIs relative to previous decades despite stiff competition from other destinations. Moreover, this includes how to improve the region's investment lucrativeness. Making the region investable can be achieved by an investment facilitation scheme that is geared towards successful investment integration. Hence, we aim to depict the state of investment inflow in the region, as well as the pertinent issues regarding investment and business climate. In the end, we intend to suggest measures on drawing more investments through the upgrading of the region's branding by facilitating investment integration that will improve ease of doing business.

THE INVESTMENT CLIMATE IN ASEAN

The increasing desirability of ASEAN as the preferred destination of FDIs, as seen from Figure 1, simulates the success of the region in enticing foreign investment despite stiff competition from other regional trading blocs. This is one of the key factors that has been causing the rapid economic growth of the region. This is reinforced by the investment accelerator effect. Solow (1956) and Oman (2000) emphasized the importance of this phenomenon since capital accumulation leads to economic growth. This link can be credited to the increase in capital stock that augments resources in financing new investments; innovation, technology transfer, and diffusion; trade promotion; development of management expertise; productivity enrichment; job creation; and market access (Baliamoune-Lutz, 2004; Kohpaiboon, 2003; Nakamura & Oyama, 1998; Sakakibara & Yamakawa, 2003).

According to Aminian, Fung, Iizaka, and Siu (2008); Kawai and Wignaraja (2007); and Hattari and Rajan (2008), the salient features of ASEAN's emergence as a trading and investment region include the increasing importance of intraregional trade, especially in intermediate goods; the rise of the People's Republic of China (PRC) as a source and destination of goods and FDI; and the decreasing dependence on the United States of America (USA) and the European Union (EU) as traditional markets for the region's products and services and source of foreign investment.



Source: United Nations Conference on Trade and Development (UNCTAD) as cited by Oum (2011)

Figure 1. FDI Inflows by region and economy for (2000 to 2010)
(in billions of USD)

The expansion of FDI, as can be seen from Tables 1 and 2, can be attributed to the key factors enumerated by the Danareksa Research Institute (DRI; 2004), Koike (2004), Aminian et al. (2008), and Kawai and Wignaraja (2007): (1) deregulation and liberalization reform in trade and investment under the General Agreement on Tariffs and Trade (GATT), the World Trade Organization (WTO), and the Asia-Pacific Economic Cooperation (APEC); (2) the rise and improved integration of production networks that paved the way for specialization of the international work force based on comparative advantage and the emergence of vertical integration in trade in components, other intermediate goods, and final products; (3) enhanced service support and linkages that drastically lowered communication, transportation, and other costs, thereby facilitating the formation and sustainability of production networks and cross-border trade and investment; (4) the rise of PRC as the principal growth center and trade market in the East Asian region, which is very close to ASEAN; and (5) the robust macroeconomic climate and the advantages bought about by the region's abundant supply of low cost, well-educated, and skilled labor that characterizes many of the labor markets in ASEAN.

As seen in Table 2, world FDI inflows increased four times from USD 342.4 billion in 1995 to USD 1,461.9 billion in 2006. Moreover, developed economies, led by the EU and the USA, continue to serve as primary recipients of FDI. However, the collective shares of the two lead economies in FDI inflows declined after the 2008 Global Financial Crisis (GFC). Thus, while the EU and the USA continue to dominate FDI inflows in terms of magnitude (as seen from Table 3), the ASEAN region has slowly emerged as one of the principal growth centers—evidenced by the region's growth in FDI inflows from 2008 to 2010.

Consequently, FDI inflows have accompanying cost. The negative economic and environmental effects associated with the installation of foreign capital to recipient economies include, as enumerated by Castell et al. (2009), (1) higher than normal profits earned by multinational enterprises (MNEs) wherein a considerable share is remitted back to the parent company located in the home economy instead of being reinvested in the host countries; (2) negligible local content of products manufactured in host countries due to heavy dependence on imported inputs; (3) unfair commercial practices; and (4) export of industries that degrade the environment in host countries. However, despite these costs of FDI, economies still compete for foreign capital as a vital vehicle for economic growth and development—specifically, host countries continue to provide less strict laws on the environment and labor in addition to additional tax incentives.

Due to the existence of global and regional production networks, nontraditional FDI factors, such as, but is not limited to, locational cost advantages, labor cost, business cost, corruption cost, quality of infrastructure, availability of skilled labor, political stability, and volatility of exchange rate, have gained prominence vis-à-vis conventional FDI determinants as an indicator of demand and economies of scale (*United Nations Conference on Trade and Development [UNCTAD]*, 1996 as cited in Nunnenkamp, 2002). This finding still warrants further investigation, as various studies such as that of Hood and Young (1987), as cited in Tayyebi and Hortamani (2007); Noorbakhsh, Paloni, and Youssef (2001); and Nunnenkamp (2002) found inconclusive outcomes on the transference in significance of FDI determinants from classical to contemporary factors. Ultimately, whether MNE investments abroad are motivated by proximity to markets, lower cost, or any other factors, the competition for transnational capital remain with the intraregional facet gaining increased distinction as a central element of the sustained growth and integration of ASEAN.

Table 1. *Inward and Outward FDI Stock (In Million USD)*

Year	1985	1990	1995	2000	2005	2006	2007	2008	2009	2010
Brunei Darussalam	21.78	33.12	641.77	3,867.13	9,426.69	9,860.20	10,120.38	10,359.58	10,729.24	11,224.96
Cambodia	37.75	37.75	355.93	1,579.92	2471	2,954.21	3,821.50	4,636.68	5,175.79	5,958.39
Indonesia*	5,739.45	8,732.45	20,626.45	25,060.45	41,187	54,534	79,927	72,227	108,223	121,526.70
Lao PDR	0.55	12.55	211.45	588.35	680.85	868.25	1,191.76	1,419.52	1,738.14	2088.14
Malaysia	7,388.42	10,318	28,730.60	52,747.49	44,459.52	53,709.76	75,762.65	73,601.33	78,894.73	101,339.10
Myanmar	5.49	281.10	1,209.70	3,211.04	4,714.87	5,247.40	5,962.22	6,937.78	7,516.37	8,272.69
the Philippines	1,839.19	4,528.19	10,148.19	18,156.19	14,978	16,914	20,463	21,746	23,180	24,893
Singapore	10,619.80	30,468.04	65,644.24	110,570.3	194,580.7	241,569.7	322,977.80	326,789.80	343,598.70	469,871.30
Thailand	1,999.49	8,242.25	17,684.44	29,915	60,408	76,950	94,112.24	93,499.90	109,628.60	127,257.20
Viet Nam	1,447.44	1,649.59	7,149.95	20,595.62	31,136.32	33,536.32	40,275.33	49,854.33	57,454.33	65,627.66
the USA	219,996	539,601	1,005,726	2,783,235	2,817,970	3,293,053	3,551,307	2,486,446	3,026,781	3,451,405
EU	274,409.40	760,207.60	1,151,794	2,322,264	4,718,712	5,546,527	7,515,798	6,490,775	7,296,079	6,890,387
World	698,951.50	987,618.40	2,081,299	3,392,763	7,445,637	11,539,452	13,833,355	17,849,168	15,294,653	17,950,498

* Includes East Timor until 2005

Source: United Nations Conference on Trade and Development (UNCTAD)

Table 2. *Inward and Outward FDI Flows (In Million USD)*

Year	1985	1990	1995	2000	2005	2006	2007	2008	2009	2010
Brunei Darussalam	3.67	7	582.7606	549.16	288.5	433.5	260.1924	239.2	369.66	495.72
Cambodia	0	0	150.7	148.504	381.18	483.209	867.289	815.18	539.113	782.597
Indonesia*	308	1092	4419	-4495	8336	4914	6928	9318	4877.369	13303.65
Lao PDR	-1.62	6	95.1	33.89	27.7	187.4	323.5134	227.7564	318.6181	350
Malaysia	694.71	2611	5815	3787.632	4065.311	6060.253	8594.666	7171.978	1429.91	9102.974
Myanmar	0	225.1	317.6	208	235.8	427.787	714.82	975.56	578.59	756.323
the Philippines	105	550	1459	2240	1854	2921	2916	1544	1963	1713
Singapore	1046.75	5574.749	11535.31	16484.49	15459.63	29347.93	37032.98	8588.2	15278.62	38638.07
Thailand	159.994	2575	2070	3410.119	8066.551	9516.983	11355.03	8448.106	4975.93	5812.976
Viet Nam	-0.08	180	1780.4	1289	2021	2400	6739.008	9578.997	7600	8173.333
the USA	20490	48422	58772	313997.2	104809.3	237136	215952	306366	152892	228249
EU	16076.55	97309.31	132003.4	698279.4	496074.6	581718.9	850528.3	487968.4	346531	304689.2
World	55866.1	207454.7	342391.4	1402680	982593.4	1461863	1970940	1744101	1185030	1243671

* Includes East Timor until 2005

Source: United Nations Conference on Trade and Development (UNCTAD)

Table 3. *Top 10 FDI Inflow into ASEAN (In Million USD)*

Country/Region	2008	2009	2010
EU	7,010	9,113	16,984
ASEAN	9,449	5,223	12,108
the USA	3,518	4,087	8,578
Japan	4,129	3,763	8,386
Republic of Korea (ROK)	1,596	1,472	3,769
Cayman Islands	4,673	-693	3,089
PRC	1,874	3,926	2,701
India	547	827	2,584
Australia	787	776	1,765
Canada	661	504	1,641
Rest of the World (ROW)	12,831	8,886	14,152
Total	47,076	37,881	75,758

Source: United Nations Conference on Trade and Development (UNCTAD)

INVESTMENT FACILITATION MEASURES IN ASEAN

Macroeconomic policies and institutional and regulatory frameworks play an essential role in investment facilitation in an economy. The study of Fung, Herrero, and Ng (2011) surveyed the data, literature, and tools of emerging countries that can enhance the feasibility and the successful implementation of cross-border infrastructure projects. Results showed that government involvement in transnational infrastructure projects is vital, as there are clear external benefits, which will otherwise not be reaped, and a need for coordination for projects to be successful. Meanwhile, according to Arbatli (2011), lowering corporate tax rates and trade tariffs, adopting managed exchange rate policies, and lowering FDI-related capital controls facilitate FDI inflows to emerging economies. Moreover, Arbatli (2011) emphasized that domestic conflict events and political instability are found to have significant negative effects on FDI. This emphasizes the role of inclusive policies to encourage growth and avoid abrupt interruptions of FDI inflows. Meanwhile, according to Poulsen and Hufbauer (2011), in times of crises, administrative and political constraints will hamper extensive reforms of FDI regimes; hence, there is a need to target the most binding constraints for sustainable FDI promotion—all of which are country and sector specific.

Poulsen and Hufbauer (2011) emphasized that if trade negotiations are equitable, it can generate the greatest benefits for an economy and scarce resources would be best spent investing in domestic legal expertise. Meanwhile, deeper linkages between foreign investors and domestic firms would require the provision of technical support to potential domestic suppliers. Lastly, foreign investors who take advantage of the corrupt state institutions also need to be targeted. However, these would require considerable expertise and institutional capacity—features that emerging markets lack. Furthermore, multilateral organizations, aid donors, and nongovernmental organizations (NGOs) will have imperative roles to play.

In addition, according to the study of He, Rui, and Zha (2011) on the inflow of FDIs in PRC, the more developed the regional economy is, the more attractive it is to foreign capital, even after considering the round-tripping FDI issue. On the other hand, He et al. (2011) also found a very weak statistical relationship between economic growth and FDI across Chinese regions implying that high-growth provinces and cities are unlikely to attract greater FDI inflows. However, based on the study of Prasad, Rajan, and Subramanian (2007), low-growth groups of countries received more significant amounts of foreign capital. Such findings are inconsistent with the standard neoclassical capital-follows-growth theory, although results are compatible in part with the findings of Madariaga and Poncet (2007), wherein FDI promotes economic growth. Hence, it can be construed that economic growth may be the consequence, but may not be the cause, of FDI.

ASEAN implemented measures to facilitate the inflow of FDIs into the region and amongst member countries. Precedent measures implemented by ASEAN were the Investment Guarantee Area (IGA) in 1987, which addressed investment guarantees concentrating on protection and promotion, and the ASEAN Investment Area (AIA) in 1998, which aimed to achieve national treatment by 2020. These paved the way for the implementation of the ASEAN Comprehensive Investment Area (ACIA) in 2009, which targeted comprehensive integration in ASEAN by 2015.

The ACIA, as reported by Ing (2011), aims to provide intra-ASEAN investments via the following: (1) liberalization, (2) protection, (3) facilitation, and (4) promotion and awareness. Liberalization within the ACIA would entail the reduction and removal of regulations that hinder investments from entering ASEAN. Moreover, liberalization of the ACIA provided flexibility in securing sensitive industries through a reservation list. With respect to protection, the ACIA provides national treatment, Most Favored Nation (MFN), expropriation, compensation of losses, and dispute settlements. In the ACIA, facilitation of investments is brought about by consistent, transparent regulations, policies, and procedures. Lastly, with respect to promotion and awareness, the ACIA promotes ASEAN as an integrated investment area and production network. This facilitates the promotion of small and medium enterprises (SMEs) and new growth areas in the region. These provisions aim to increase the flow of investments in ASEAN and treat all ASEAN and non-ASEAN investors as nationals. Moreover, the ACIA covers industries such as manufacturing, agriculture, mining, fisheries, forestry, and services.

The ACIA is advantageous to ASEAN as it simplifies investment application and approval procedures as well as provides clear and conducive regulations. These will deliver superior protection and increased ease of conducting business within the region. Furthermore, these will facilitate the growth and development of SMEs and MNEs, which is one of the apparent drivers of economic growth within ASEAN.

The inherent need to provide avenues to facilitate the inflow of FDIs to the ASEAN region is founded on the basis that the inflow of such investment can shape the an economy's architecture (Ing, 2011). Hence, the role of investment to ASEAN is for the creation of employment and the investment spillover. The inflow of investments allows for the creation of jobs in the different industries covered by the ACIA. With the entry of FDIs, labor-intensive industries can provide more jobs to less skilled workers. In line with the investment spillover, the entry of FDIs will allow the knowledge transfer from the inbound investors to domestic industries. Moreover, old technology can be transferred to the emerging countries, by way of the Flying Geese Model (FGM). Likewise, these technologies will enable emerging member countries to develop alongside their neighboring industrialized ASEAN countries.

Given these existing investment channels present, there are other means that can be considered to further the facilitation of FDIs in ASEAN. The purpose of these reforms is regional and global integration. For instance, Singapore can be identified as the benchmark country in ASEAN. Following are reform proposals that are geared towards ASEAN investment integration.

By virtue of Singapore's gross domestic product (GDP) and its economic position in the region, there is enough evidence to say that it is the most advanced economy in ASEAN. Moreover, it can also serve as the benchmark in ASEAN for various social services, specifically education and health care. Hence, we can assume that Singapore can highly influence the maneuvers of the other ASEAN member countries, which technically can be considered a "hegemon." By definition, a *hegemon* is a country that has influence on the decisions that other countries make but does not have actual decision-making powers. In ASEAN, Singapore is just that. It can also be construed that Singapore has the highest score in terms of investment facilitation, being considered the "best practice" as reported by Intal et al. (2011). Given these, Singapore can be considered as the hegemon in ASEAN, as the other member countries aspire to achieve the openness that Singapore has.

Hegemony can be a viable means to facilitate investment integration because of the ability to harmonize investment incentives within the ASEAN region. Such investment incentives are (1) tax holidays, (2) tax and duty exemptions, (3) equal treatment, and (4) VAT refunds. By these means, ASEAN can attract FDIs in various industries without compromising the ease of doing business in the ASEAN member countries. Needless to say, having Singapore as the hegemon of ASEAN will allow even the emerging member countries to use Singapore's example as a benchmark for implementing local investment policies. This will constitute, however, the amendment of the ASEAN Charter because a hegemon is technically not allowed to exist.

With the inflow of investments into ASEAN, there is an inherent need to establish intellectual property rights (IPR) protection. To complement the increasing number of unique FDIs that enters the member countries, an effective system of patents, trademarks, and copyrights must be established within ASEAN to ensure that all FDIs are protected as intellectual property. This has great value in ASEAN because it provides a comparative advantage to ASEAN member countries, with respect to different industries.

A highly debated reform that will be able to increase investments in ASEAN would be the establishment of the ASEAN single currency. Like its Euro counterpart, the ASEAN single currency would allow the free flow of goods, services, investments, and capital within the ASEAN member countries. However, given that the ASEAN is a two-tiered region, being ASEAN-6 and CLMV (Cambodia, Lao PDR, Myanmar, Vietnam), there would have to be a means by which the ASEAN single currency will be implemented without putting much pressure on CLMV. Thus, this single currency should be implemented first among the ASEAN-6, allowing CLMV to make adjustments for growth, and then eventually be extended to them.

These proposals would require certain amendments in the ASEAN Charter to support such reforms specifically in Article 7: ASEAN Summit and Chapter VII: Decision Making.

CONCLUSION

The challenges that have to be overcome with the implementation of the proposed reforms are to comply with the ACIA principles that are already in place within the ASEAN. There are accompanying challenges that such reforms will have to overcome to fully liberalize the flow of investments into the region. One of which is the evident cultural, religious, and economic heterogeneity of ASEAN. Due to these differences, there may be apprehensions against cooperation among member countries, which may ultimately lead to the ineffective implementation of such regional reforms.

The challenge that ASEAN has to face in implementing investment facilitation measures would be reducing trade and investment barriers to entry into the ASEAN member countries. As a matter of consideration, ASEAN has to harmonize investment policies and regulations to ease the manner of doing business within the region.

Moreover, there will be a need to reduce tariff and duties rates within the region, in which Singapore is already implementing zero-percent tariffs and duties. In addition, tax measures should incorporate provisions on tax holidays and corporate income tax incentives. In terms of labor, regulations must be established since the inflows of FDIs are accompanied by an increase in employment, of both domestic and foreign workers. Likewise, ASEAN has to work on closing the development gap through human capital formation, information and communication technology (ICT), and communication and transportation infrastructure. The investment in human capital formation would require the improvement in public education and the provision of training and development programs. ICT is considered as the prime mover of investment reorientation (Ing, 2011). In the context of ASEAN, the Master Plan on ASEAN Connectivity (MPAC) and the National Single Window (NSW) aim to connect the ASEAN member countries by a single communication system, which is the primary goal of regional investment integration. Lastly, the provision of communication and transportation infrastructures is an important incentive to have in an investment-receiving country.

Given the numerous constraints, barriers to entry, and investment incentives that may have to be implemented to complement the proposed investment reforms, it is integral that transparency is present in ASEAN. There would be a need to improve the processes by which the entire investment cycle operates. The elimination of red tape and the streamlining of overlapping processes would contribute to the degree of transparency that ASEAN has in terms of being able to track where information is coming from. As mentioned previously, the MPAC and NSW are geared towards transparency and accountability of the ASEAN processes. As such, monitoring and evaluation come into play if these reforms are implemented. There would be a need for ASEAN to establish monitoring and evaluation criteria by which ASEAN can properly monitor and assess existing investment policies. To further the evaluation process that would be needed, a dispute and settlement institution would have to be established to ensure that ASEAN can address any issues that may arise among the member countries.

Ultimately, the challenge that the ASEAN will have to face in terms of implementation of the various investment reforms is the amendment of the ASEAN Charter. The ASEAN Charter emphasizes on ASEAN centrality and regional cooperation (Purnajaya, 2011). As such, the need to amend the Charter would facilitate the implementation of the aforementioned investment reforms. As the governing constitution among the ASEAN member countries, the amendment of the ASEAN Charter will permit for the influence of one country over the other member countries and the revision of decision-making powers within the ASEAN. However, the amendment of the ASEAN Charter will entail certain costs that the ASEAN must shoulder and would translate into increased pressure for the member countries to comply, particularly CLMV. Though there would be accompanying costs to this, the amendment of the ASEAN Charter may be a consideration for the choice of an appropriate driver for regional integration and economic growth.

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