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# **Foreign direct investment(FDI) inflows to ASEAN member countries: Problems and prospects**

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## **. Introduction**

FDI has played an important part in the industrialization and growth experience of ASEAN countries. The growth in Gross Domestic Product (GDP) of ASEAN as a whole is strongly correlated with inflows of FDIs in the region. The share of ASEAN in global FDI inflows is disproportionately larger than its share in global GDP. About 5% of total world FDI went to ASEAN member countries during the period 1980-2005 while the region accounted for less than 2% of world GDP. This reflects the perceived attractiveness of ASEAN member countries as FDI hosts.

Global firms were initially attracted by favorable conditions for export production (e.g.: low costs of labor and raw materials, investment incentives) in ASEAN countries. The export-oriented FDIs in the 1980s increased incomes in the ASEAN countries and their market potential began to be recognized by the international business community. In the 1990s, both export- and domestic market-oriented FDIs flooded ASEAN countries.

Though still having comparative advantage over other developing countries, ASEAN countries are finding it more and more difficult to lure foreign investors. Up to the mid-nineties, ASEAN was capturing about 8% of global FDIs. This share dropped to only about 3% from the late 1990s until mid-2000s. This is explained by a number of factors: the prolonged stagnation in ASEAN countries triggered by the Asian financial crisis,

increasing competition from other developing countries and transitional economies, worldwide economic slow-down, and fundamental weaknesses of the ASEAN economies.

As growth in ASEAN has been fuelled to a considerable extent by FDIs and in the face of the continuing severity in the competition for FDIs, what can ASEAN member countries individually and as a group do to stay on the growth track and remain a key FDI host region?

This paper first looks at the trends and patterns of FDI flows to the whole of ASEAN, and then at the individual ASEAN countries' experience. From the past performance of the individual countries and of the ASEAN as a whole, the prospects and problems are assessed and future trends are projected. The paper ends with some recommendations on specific courses of action.

## **. FDI inflows to ASEAN**

### **1. General trends and patterns**

#### **1) Growth**

FDI inflows to ASEAN have grown thirteen-fold from only US\$2.8 trillion in 1980 to over US\$37 trillion in 2005 (Figure 1). The region sustained a generally fast-paced growth in FDI inflows from 1986 to 1997, during which FDI increased at an average annual rate of 27%. In the late 1980s until the early 1990s, the world's investors, especially from Japan, only viewed ASEAN as a suitable area for their export production. But from the early to the mid-1990s, ASEAN attracted FDIs not only as an export plant location but also as a promising market. There were massive inflows of FDI to ASEAN during this period but this trend was abruptly interrupted by the on-set of a financial crisis in Asia in 1997. The crisis threw cold water on investors' enthusiasm, resulting in sharp decreases in FDI inflows to ASEAN from 1998 to 2002. Signs of recovery began to

appear in 2002 but it was only in 2003 that the downward trend was reversed. The recovery was brought about by reinvestments of earnings of foreign firms in the region. It was also believed to be an offshoot of positive developments on the ASEAN Free Trade Area (Asian Economic News, 18 February 2003). Slowing growth of the world economy and mounting competition from China and other developing countries, however, offered much hurdle to ASEAN that it was only in 2005 that the 1997 peak level of US\$34 trillion was surpassed. Nevertheless, the upward trend is expected to continue. Preliminary data indicate a big increase of about 90% for the first quarter of 2006 (Asian Economic News, 28 August 2006).

FDI inflows to ASEAN closely tracked GDP growth in the region. The ten years before the 1997 Asian crisis during which FDIs surged into ASEAN were characterized by record high ASEAN GDP growth rates. Conversely, the economic recession in many ASEAN countries in the late 1990s was accompanied by reduced inflows of FDIs. With the ASEAN back on the growth path by 2002, FDI inflows were again on the rise from 2003.

The causal relationship goes both ways. The size and potential growth of the ASEAN market as reflected in its GDP draws FDIs. FDIs, on the other hand, raises production capacity and efficiency and hence, GDP. The much wider fluctuations in FDI flows relative to GDP, however, indicates that while ASEAN economic performance was heavily fuelled by FDIs, other growth factors were at play.

## **2) Sources**

A third of FDIs in ASEAN for the ten-year period 1995-2004 came from the European Union (EU), the bulk of which, 28%, were from the EU-15 countries namely United Kingdom, Germany, Italy, France, Netherlands, Belgium, Denmark, Sweden, Finland, Austria, Spain, Portugal, Ireland, Luxemburg and Greece (Figure 2). The single biggest country source of ASEAN FDIs, however, was the United States (US), accounting for 18% of the total. The US was trailed by Japan with a 14% share. The

decade long recession in Japan in the 1990s had put a stop to the massive outflow of capital from Japan which fuelled the rapid growth in many ASEAN countries in the 1980s. The share of intra-ASEAN FDI in total ASEAN FDI was just less than 1% point short of FDI from Japan. The shares of the other neighboring and industrialized Asian countries of Taiwan, Hong Kong and South Korea pale in comparison to Japan. Expectedly, Taiwanese and Hong Kong firms would prefer China over Southeast Asia. Finally, South Korea was not as cash awash as Japan and there was no pressure for Korea to move its export production to other countries such as the ASEAN to circumvent protective policies in the US and the EU as well as to penetrate the ASEAN markets.

### **3) Sectoral shares**

More than a third of FDIs in ASEAN in 1999-2005 went to the manufacturing sector. The financial sector ranked second with a 23% share. Facing a severe drop in FDI inflows after the 1997 Asian crisis and with FDI incentives in the manufacturing sector already at its limits, many ASEAN countries endeavored to lure FDIs by liberalizing their financial sector.<sup>1</sup>

Other segments of the tertiary sector also captured considerable portions of FDI inflows—trade and commerce got 13%, services 6%, and real estate 5%. Only one extractive industry in the ASEAN remained to be lucrative for foreign investors—mining and quarrying which took in a reasonably substantial 7% of total FDIs in the region. With the agriculture, fishery and forest-based extractive FDIs saturated in the 1970s and early 1980s in Malaysia, Thailand and the Philippines, the miniscule 1% share of the sector

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<sup>1</sup> Indonesia removed all restrictions of the establishment of new banks and on opening new branches. Thailand lifted foreign shareholding limits on banks for a period of ten years from November 1997. The Philippines, in May 2000, allowed full foreign ownership of banks for a 7-year window. And Singapore, prompted by global competitive pressures and rising consumer demands, embarked on a gradual liberalization scheme for the retail banking sector in 1999 (Chua 2003).

was accounted for by Vietnam mainly, and Indonesia, Lao and Myanmar, as well (Figure 3).

#### **4) Distribution among ASEAN member countries**

Figure 4 shows the wide disparities in the FDI intake of individual ASEAN member countries. Only one—Singapore—of ten member countries captured half of the total inflows in 1995-2005. A far second to Singapore was Malaysia (16% share) which in turn was closely trailed by Thailand (13%). Vietnam, which only recently embraced market principles and opened its economy, albeit sufficiently aggressive in doing so, had overtaken old players in the FDI game, namely, the Philippines and Indonesia whose shares in total ASEAN inward investments were only slightly above the share of the new and much smaller ASEAN member—Brunei. Finally, the small-sized economies of Myanmar, Cambodia and Lao PDR and the still fragile political and economic situation in these new ASEAN members explain the negligible shares of these countries.

The uneven distribution of FDIs among ASEAN members countries are reflected more clearly in the data presented in Table 1. While Singapore accounted for just about 14% of ASEAN GDP, it had half of FDI flows to the region. FDI inflows to Singapore amounted to a substantial 14% of its GDP. Apart from Singapore, Malaysia, Vietnam and Brunei were the only other countries with a substantially greater share in ASEAN FDI than in ASEAN GDP. Old players, Indonesia and the Philippines, were far behind new comer Vietnam. The two recorded the lowest FDI to GDP ratio in the past decade. Thailand, the forerunner in the ASEAN FDI race in the 1980s, although slowing down, remained strong relative to its contemporaries, Indonesia and the Philippines.

<Table 1> Member country shares in ASEAN FDI and GDP, 1995-2005 Cumulative

Country	% share in ASEAN FDI	ASEAN GDP	FDI to GDP ratio
Singapore	50.30	14.02	14.00
Malaysia	15.64	14.49	4.21
Thailand	13.00	21.49	2.54
Vietnam	6.38	4.97	5.41
Philippines	4.73	11.88	1.59
Indonesia	4.30	30.28	0.26
Brunei	3.23	0.72	18.02
Darussalam			
Myanmar	1.48	1.28	4.74
Cambodia	0.74	0.59	5.03
Lao PDR	0.18	0.28	2.82

'Source of data: UNCTAD World Investment Report 2006 for FDI and UN Statistic Division for GDP'

## 2. Trends and patterns in ASEAN member countries

### 1) Singapore

Singapore managed to grow in 1995-2005 at an average of more than 5% per year in real terms. In nominal terms, this was translated into an annual growth rate of 4% reflecting deflationary trends in the crisis years. Despite swings in FDI flows, average annual growth was positive at 17%. In the three years 2003-2005, FDI growth stabilized at rates hovering around 40% and FDI inflows in 2005 reached a level double that of 1995 (Figure 5a).

Two-thirds of FDI inflows in Singapore in 1995-2005 came from the western part of the globe. EU brought in 43%. The biggest investing country, however, was the US with a 22% share. Asia's major investor Japan had a 10% share, less than half of the US. ASEAN investors made up 6% (Figure 5b).

The financial sector received the biggest chunk, 39%, of FDI to Singapore in 1995-2005. Singapore, together with Hong Kong, had long attracted financial sector FDI from western countries. Asian headquarters of major banking institutions in the US and Europe are located mainly in these two countries.

Manufacturing's 35% share ranked only second to the financial sector. Another major recipient of FDI was trade and commerce with a 13% share. The other tertiary sectors, namely, real estate, construction and services obtained minor shares of 5% or less (Figure 5c).

There are three things that concern foreign investors in Singapore. One is the twin problem of shortage of skilled labor and high cost of living. Two is excessive government participation (e.g.: a number of private companies are partly held by the government) and intervention in economic activities. And three is the overcapacity in manufacturing, financial intermediation, and trade and commerce brought about by massive FDI inflows in these sectors.

## **2) Malaysia**

Like Singapore, the Malaysian economy showed resilience in the face of the Asian financial crisis. Though the economy contracted by 7% in real terms in 1998, the year after the onset of the crisis, it immediately rebounded in subsequent years, thereby, recording a 5% average annual growth in both real and current terms in 1995-2005. FDI inflows, however, fluctuated wildly during the period such that even if FDI inflows posted an average annual increase of 44%, FDI inflows in 2005 was even lower its 1995 level. FDI inflows to Malaysia plunged to bottom low levels in several years during the period as much of foreign investors' interests and optimism about the Malaysian economy in the decades of the eighties waned with the emergence of underlying structural problems in the nineties (Figure 6a).



Figure 6b shows the origin of FDI flows to Malaysia. The biggest source of FDI inflows to Malaysia was the US with a 28% share. The US share even exceeded the combined share of EU15 (25%). The ASEAN share of 19% was mainly from Singapore (15%). Investment flows between Malaysia and Singapore has always dominated intra-ASEAN FDI flows. With the slow-down of the Japanese economy and its investment activities overseas, Japan's share dwindled to 14%.

Manufacturing FDI's accounted for the biggest chunk, 35%, of inflows to Malaysia in 1995-2005. Except for Singapore, Malaysia had the most advanced technology and infrastructure among ASEAN countries and hence, the country was the top choice in the region for export production location of foreign firms. The financial sector ranked only second to manufacturing with a much lower 16% share. Foreign investors had some reservations in penetrating Malaysia's tightly regulated financial sector. Financial sector stability in Malaysia during the Asian crisis years was achieved largely through government control of interest rates, exchange rates and capital flows, and there was much concern about how long the situation could prevail (ADB 2004). Generally, the services sectors in Malaysia were also heavily protected and reforms were still needed to make them globally competitive. Nevertheless, investments from Japan and the US, two of the country's major foreign investors, were directed in these sectors (Abidin 2002). Thus, trade and commerce gathered a quite substantial 13% share while construction, real estate and services each had a 6% share (Figure 6c).

Malaysia has industrialized and advanced technologically faster than other ASEAN countries. However, research and development has not been adequate to enable its industries to fully adopt the new technologies introduced by foreign firms. Much of the growth in Malaysia has been brought about by increases in capital and labor, not by higher productivity. Improving the fundamental technological base of its workforce has not been prioritized and thus, industrial productivity has remained below world standards. Further, there is a growing shortage of highly skilled labor which increases labor costs.

The other major concern of foreign investors in Malaysia is the dominating presence of government in business. The country's major economic sectors are dominated by so called government-linked companies (GLCs) to which some investments supposedly for infrastructure projects and the development of other sectors are channeled. There is likewise heavy government intervention in the financial and services sectors. While most of the ASEAN countries liberalized their FDI regulations in the banking sector after the 1997 crisis, Malaysia refused to follow suit and maintained most of its pre-crisis restrictions on foreign participation in the sector (Chua 2003).

### **3) Thailand**

Thailand and Indonesia were the two ASEAN countries hardest hit by the Asian financial crisis. The crisis drew blood in Thailand. Real GDP contracted by 1% in 1997 and 11% in 1998. It took the economy five years to return to pre-crisis levels due to inadequate financial regulations, and weak governance of both public and private sectors (Brimble 2002). As a result of the prolonged slump in the economy, FDI inflows was on a steep downward trend from 1998 to 2002 (Figure 7a).

The largest investor in Thailand remained to be Japan, accounting for a substantial 31% of Thailand's inward investments in 1995-2005. Japanese capital fueled much of the double-digit growth in Thailand from the late eighties to the early nineties. Investments done after the onset of the crisis were just part of commitments and plans made earlier. Having so much stake in Thailand, Japanese businesses might have decided to stay on (Figure 7b).

Two other major investors in Thailand, but with shares much lower than Japan's, were the US (19%) and Singapore (15%). Singapore made up the bulk (94%) of FDIs from ASEAN. All other ASEAN countries contributed only 1%. This heavy dependence on Singaporean investments caused concern in 2002 when the global electronics market, one of Singapore's main economic drivers, weakened (Brimble 2002).

The entire EU15 accounted for 22% of FDI flows to Thailand and this share was contributed by several countries. There was no major EU investing country in Thailand. The biggest two EU investors, namely, United Kingdom and Germany, had shares of only 6% and 4%, respectively. Hong Kong investors even had a higher share of 7%.

Half of FDI in Thailand went to the manufacturing sector. About a fourth went to trade and commerce and the remaining fourth were in the tertiary sectors of finance, real estate and services (Figure 7c).

The influx of manufacturing FDI in Thailand in the eighties and early nineties resulted in shortages of skilled labor and in labor costs higher than its competitors. Consequently, labor-intensive manufacturing FDI are now diverted away from Thailand and toward its Asian competitors, particularly, China and India. Thai's economic growth has been accompanied by moderate increases in over-all productivity but, as in the case of Malaysia, there are very little improvements in technological capabilities and comparative advantage due to deficient research and development initiatives and poor education system.

#### **4) Vietnam**

Vietnam's rapid economic growth of more than 7% per annum in real terms in the last decade brought in waves of FDI. Vietnam successfully sustained its growth momentum in the midst of the Asian crisis and hence was able to keep foreign investors' interests. Thus, the drops in inward FDI in the aftermath of the crisis were not steep compared to the rest of ASEAN. And FDI inflows to Vietnam returned to a steep upward trend from 2002 (Figure 8a).

Two-thirds of FDI inflows to Vietnam in 1995-2005 were from neighboring Asian countries. Although the biggest investing country was Japan with a 15% share, the other industrialized economies in Asia likewise invested heavily in Vietnam: Taiwan (12%), Singapore (10%), South Korea (10%) and Hong Kong (8%). ASEAN countries less

Singapore accounted for 8%. The largest EU investor was Netherlands with a 10% share. The rest of EU had a combined share of 12%. The low US participation was of course the legacy of the past. As Vietnam remained on the growth path in spite of the Asian crisis, investments from the western countries were generally on an upward trend during the period, and this cushioned the reduced inflows from the crisis-distressed Asian investors (Figure 8b).

In the 1990s, in the face of the growing shortage of labor and increasing wages in Malaysia, Thailand and the Philippines, foreign investors began to consider locating their production plants to Vietnam, then starting to open its doors to foreign capital and trade. Hence, about 29% of FDI inflows to Vietnam in 1995-2005 were in manufacturing. Global manufacturing firms were attracted by the country's low wages, improving business climate and its government's programs to lure foreign investments (Figure 8c).

On the other hand, having just recently espoused some elements of capitalism and welcomed foreign businesses, Vietnam, unlike its predecessors—Malaysia, Thailand and Philippines, still has a lot of resource-based investment opportunities to offer. Hence, nearly a fourth of FDIs in Vietnam were in the extractive sectors—17% in mining and quarrying and another 7% in agriculture, fishery and forestry.

With Vietnam's export-oriented development strategy, trade and commerce accounted for 15% of FDIs, and services, 10%. Further, infrastructure building and land development which accompanied Vietnam's rapid economic growth attracted 10% of FDIs into the construction industry and another 8% in real estate.

Financial sector's share was a measly 3%, a reflection of the government's dominating presence in the sector which crowded out both local and foreign private investments and its continuing reluctance to liberalize the financial market.

Like all the other ASEAN countries, there are constraints to the continuous influx of FDIs in Vietnam. One is the heavy state intervention in economic activities. One

particular case is in the financial sector. In the wake of the 1997 crisis, financial market activities such as commercial lending and portfolio flows, which played important supporting roles in attracting FDI inflows, reached very low levels. With much government support, financial activities picked up again. In 2000, for example, the government opened the first stock market in Vietnam. Efforts such as this had successfully maintained the increasing inflows of FDI during the period. But they had also led the international business community to doubt the sustainability of the economic development in Vietnam as so much of it was government-aided (Freeman 2002).

Corollary to the above, there is some skepticism about the prospect of continuing economic reforms as government persists to impose a number of business restrictions. In the equity market, for instance, foreign ownership is limited and foreign institutional investors are not allowed to participate.

Another major hurdle in further increasing FDI inflows is the lack of coordination among various FDI-licensing government agencies. As FDI licensing is assigned to different agencies, it happens that a license given to a particular FDI project by one government agency is revoked by another agency during project implementation.

## **5) Philippines**

Macroeconomic fundamentals in the Philippines began to improve before the Asian financial crisis and the Philippine economy did not nose-dive like Thailand and Indonesia. Throughout 1995-2005, real GDP growth which averaged 4% per year was in general stable. Despite this positive development and indications that it would continue, foreign investors kept a cautious stance in sending FDI (ADB 2005). FDI inflows were on a downward trend until 2003 during which it reached a level comparable only to FDI inflows in Cambodia and Lao. There were increased flows in 2004 and 2005 but the levels in absolute terms remained low and far behind FDI flows to Thailand, Vietnam and Indonesia (Figure 9a).

The two major investing countries in the Philippines were Japan (27%) and the US (24%). About a fifth of FDIs came from its neighboring East Asian countries, half of which (11%) from ASEAN. Taiwan and Hong Kong, which invested in the Philippines more heavily in the seventies and eighties, redirected their capital into mainland China and registered much reduced shares in Philippine inward investments from the mid-nineties (Figure 9b).

Inward FDIs in the Philippines in 1995-2005 were heavily concentrated in the manufacturing sector which had a share of 74%. The other sectors that received FDIs were services (7%), mining and quarrying (6%) and financial sector (6%) (Figure 9c).

The continuing lack of foreign investor's confidence and interest in the Philippines could be attributed to a number of factors (ADB 2005). One is the uncertainty about the sustainability of recent economic gains. Political scandals keep cropping up every now and then, which perpetually shakes political and economic stability. Two, public sector debt remains to be substantial. Despite improvements in its revenue collection and expenditures, government continues to absorb the debts of government-owned corporations. Three is the country's poor infrastructure, particularly transportation and power. Cargo handling is very costly due to poor roads and maritime transport. Four is the corruption-prone bureaucratic red-tape—numerous requirements for setting up a business, long waiting times for license and permit applications, long procedures at the Bureau of Customs (said to be the longest in Asia), etc. Finally, minimum wages in the Philippines are higher compared to other Asian countries (e.g.: China and Vietnam) and regulations on hiring and firing of workers are keeping firms from maintaining optimal employment levels.

## **6) Indonesia**

FDI inflows in Indonesia declined the year the Asian financial crisis set in. From 1998 to 2003, there were net outflows of FDIs. Not only were new investments not coming, foreign firms divested out of Indonesia. Worst hit by the Asian financial crisis,

Indonesia's gross domestic product dipped in 1997 and 1998 and remained stagnant until 2001. Though the Indonesian economy posed for an upward trend in 2001, the decentralization program of the Indonesian government that was initiated in January 2001 prevented the revival of FDI inflows (Gray 2002). The autonomy given to sub-national governments through the decentralization program resulted in some local regulations and restrictions that were not favorable to foreign businesses (e.g.: higher minimum wages).

More than a third of FDIs in Indonesia during 1995-2005 were from the EU, with United Kingdom as the largest single investing country. The other third of FDIs came from the ASEAN and Singapore was the largest ASEAN investor. Japan, which heavily invested in Indonesia from the eighties until the first half of the nineties and was then top investor, divested from 1998 until 2003 and hence reduced its share to only 9% (Figure 10b).

Endowed with oil and other minerals, mining and quarrying received the largest share, amounting to 34% in 1995-2005, of FDIs. Compared to mining, the share of agriculture, fishery and forestry was a measly 6% Figure 10c).

Manufacturing ranked second only to manufacturing with a 32% share. Much of these manufacturing FDIs were concentrated in Java. The lion's share of manufacturing in Java had contributed to unequal developments among the country's sectors and regions (Nugroho 2006).

Indonesia has abundant natural resources in different regions of the country that may be explored and efficiently utilized through FDIs. Due to low levels of FDIs and as the large share of the little FDIs that come go to the manufacturing sector, there have not been sufficient investments in resource-based sectors (Nugroho 2006). This underscores the big need to attract foreign investments.

However, several factors prevent the return of FDIs to Indonesia. Foremost of which are the economic and political factors. Added to its long history of conflict and high

incidence of human rights violations are the confusion over private property rights and the loss in confidence in its legal and judicial system<sup>2</sup> brought about by the decentralization program. Disagreements between national and provincial governments further diminish government's credibility.

Apart from economic and political stability concerns, there are other deterrents to FDI in Indonesia (Nugroho 2006).

One is poor infrastructure. Power outages, transport failures and inadequate water supply are prevalent in provinces and this has stalled many business operations. Telecommunications and electricity connections have also been difficult to acquire (ADB 2005).

Two is the unsound financial position of the government. In 2002, interest payments for the huge public sector debt were about 5% of GDP (Gray 2002). Further, the Indonesian government still controls more than three-fourths of the total assets of the commercial banks and much of the corporate debt in the country remains unstructured.

Three, the planned privatization program of the government to fix its fiscal finances is not making headway. It has been way behind schedule thus breeding suspicion among foreign investors about the sincerity and preparedness of Indonesia authorities to undertake economic reforms.

Finally, among the ASEAN member nations, Indonesia has the most prohibitive investment list. Although the government recently opened up a few sectors such as telecommunications, power generation, transmission and distribution, shipping, drinking

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<sup>2</sup> There were instances of local governments filing cases to claim ownership over foreign businesses with courts ruling in favor of the provincial governments and the local governments taking over the operations of the foreign firms (Gray 2002).



water supply and atomic power generation, foreign investments in such sectors still require the investors to tie up with local partners.

### **7) Brunei Darussalam**

Brunei's GDP grew modestly in 1995-2005, averaging 2% in real terms. Except in 1998, real GDP growth rate was positive, ranging from 1 to 4%, with the maximum rate occurring in 2003. From 1995 to 2001, FDI inflows were modest but stable, amounting to just over US\$500 million. FDI inflows doubled to US\$1 billion in 2002 before it ballooned to US\$3 billion, the year the highest GDP growth rate was recorded. After 2003, FDI inflows slowed-down to below US\$300 million (Figure 11a).

The United Kingdom, being the source of almost two-thirds of the investment influx in 2003, was the biggest country investor in Brunei in 1995-2005 with an over-all 43% share. Netherlands, consistently topping the list until 2002, had a 24% share. Singapore's 13% share dominated the 16% total ASEAN share. Other countries, including Japan, contributed only minor portions (Figure 11b).

Most of FDIs in Brunei go to the gas and petroleum sectors. Hence, mining and quarrying had the lion's share—69% of total FDI inflows from 1995-2005 (Figure 11c).

Brunei embarked on an aggressive FDI promotion program and diversified investments options by opening up the manufacturing and services sectors to foreign investors in addition to the usual gas and petroleum sectors. This resulted in the surge of FDI in 2002 and 2003 which has not been sustained due to a number of factors (Nezu 2005).

One is the lack of data and information needed by foreign investors to assess their risks and expected returns in investing in Brunei. The government rarely gives out reports on its key economic statistics. With this information asymmetry, risk-hedging foreign investors are forced to limit their investments in Brunei or are altogether

discouraged to invest in the country. Two is the lack of transparency in the government (e.g.: regulations on foreign investments are often changed without consultation). Three is the dominance of government in business. Majority of the firms are government-owned. Although its government is considerably financially stable, the high dependence on the public sector is nonetheless a concern (Nezu 2005).

### **8) Myanmar**

In the 1990s, Myanmar enjoyed relatively larger FDI inflows compared to its neighboring Cambodia. The country's proximity to India, Pakistan, China and Thailand and its natural resources encouraged the said FDI inflows. However, the country's repressive political regime had brought down the country's economy. Political repression in Myanmar had resulted to economic sanctions from the international community. In 2004, for instance, Myanmar suffered a drop in international trade as a result of a sanction.

The leading investing country in Myanmar in 1995-2005 was United Kingdom with a 30% share. Two other major western investing countries were France (15%) and the US (11%). The share of the ASEAN countries totaled 28%, the bulk of which came from Singapore (20%) (Figure 12b).

Manufacturing got the largest share (42%) of FDIs, followed by mining and quarrying (23%), and then services (12%) and real estate (11%) (Figure 12c).

Apart from the repressive political regime, poor domestic economic conditions deter FDI flows to Myanmar. The economy suffers from inefficient state enterprises (which are given special privileges), large budget deficits and an unbridled inflation scenario (Hsieh 2005).

Other problems include inadequate legal infrastructure and weak enforceability, poor physical infrastructure, weak banking and financial markets, inadequate property right protection, and currency controls.

Myanmar is also facing stiff competition from transitional economies especially those from the former Soviet Union and those of Eastern Europe. The said transitional economies have been more attractive to FDI as they are relatively closer to both China and Europe.

### **9) Cambodia**

Political order was restored in Cambodia in 1998. The improvement in the political arena brought about economic growth which reached double digit levels in 2004 and 2005 (Figure 13a).

Up to the year 2000, most or all of FDI in Cambodia came from multilateral institutions (e.g.: United Nations, World Bank and International Monetary Fund). Private investors from various countries started to pour in only in 2001. From 2001 to 2004, private capital accounted for the bulk (93%) of FDI. In 2005, multilateral institutions extended an unprecedented US\$300 million worth of FDI and once again dominated Cambodia's inward investments while level of FDI inflows from private firms remained more or less the same. Over-all, 78% of FDI in Cambodia in 1995-2005 were from multilateral institutions, and the remaining 22% were accounted for by China (7%), Taiwan (4%), South Korea (3%), ASEAN (6%), and North America (2%) (Figure 13b).

Multilateral FDI were mainly used for infrastructure development, including cultural heritage restoration, rehabilitation and preservation (67% of total FDI). Private FDI were distributed among manufacturing, construction, services, and agriculture, fishery and forestry (Figure 13c). Manufacturing FDI which accounted for 7% of total FDI were concentrated in the garment and textile sectors in which the country has a comparative advantage. The said sectors are the biggest contributors to the country's exports earning as well as to its GDP (Hsieh 2005).

The continuous flow of private FDIs to Cambodia rests on two things. One is its government's commitment to pushing macroeconomic stability through various reforms such as infrastructure building/improvement, good fiscal management and investment in human capital. The other is the sustainability of the country's economic expansion. As these developments in Cambodia are very recent, there is definitely much uncertainty about their continuity and hence, many investors are still on a 'wait and see' position (Hsieh 2005).

Over-all, not much FDIs are expected to pour into Cambodia as the country together with its neighbor Lao PDR is viewed by the international business community as having very little influence in the global community despite its membership in various multilateral organizations such as the ASEAN. Such a perception has brought potential FDI flows to Cambodia elsewhere, mostly in other ASEAN countries particularly Thailand, Vietnam and Indonesia.

To attract more foreign investments, Cambodia has resorted to the strategy of providing tax incentives and holidays to foreign investors, as practiced by its neighbors. With a fiscal position that is in bad shape, however, it may not be capable of withstanding tax breaks.

#### **10) Lao PDR**

Lao PDR, having the smallest GDP among ASEAN countries, had the lowest levels of FDI inflows (Figure 14a). The low and even waning investment interests in Lao could be attributed further to centralized planning and control, defunct state-owned enterprises and an economy that is driven mainly by subsistence agriculture (Hsieh 2005).

More than half of FDIs in Lao in 1995-2005 came from ASEAN countries, and half of the ASEAN FDIs were from Thailand, the biggest country investor. Another major investor from Asia was South Korea. Its share of 21% in Lao's inward investments was

second only to Thailand's. Investments from western countries were minimal (Figure 14b).

FDI opportunities in Lao are quite limited. There is only one major growth sector—hydropower and FDI inflows are concentrated in the sector. The level of FDI flows is a largely a function of hydropower project developments. Flows increase when hydropower projects are approved and implemented while a lack of hydropower projects translates to a dearth of FDI inflows. Thus, a substantial 67% of total FDIs in Lao in 1995-2005 was accounted for by the electricity sector. The remaining one-third was distributed in trickles among all the other sectors (Figure 14c).

Prospects of increasing FDI inflows to Lao are low. The country's communist regime is not been keen on expanding the private sector and on building-up a strong export base to stimulate the economy and attract FDIs (Hsieh 2005). Foreign capital arrives in the country mainly in the form of official development assistance. The government has very limited experience in handling private capital and is not yet equipped to take on the task of attracting, retaining and managing FDIs. Approvals coming from the Lao government for FDI projects are noticeably slow and project implementation is even slower.

## **. Prospects and problems**

### **1. Opportunities**

Recovery from the prolonged slump in FDI flows to ASEAN resulting from the 1997 Asian financial crisis started in 2003. In 2005, the previous 1997 peak level of FDI inflows to ASEAN was surpassed. The recovery was said to be brought about by considerable reinvestments of earnings of transnational corporations already in ASEAN and there are indications that the upward trend would continue. Asian Economic News reported that FDI flows to ASEAN increased by about 90% just for the first quarter of 2006. The recent robustness of FDI inflows to ASEAN is seen as the positive impact of

efforts toward regional integration. A fully operational ASEAN Free Trade Area (AFTA) means that ASEAN is a single market. All ASEAN countries together make up a huge dynamic market with a population 40% that of China, 50% of China's GDP, and 150% of China's exports (Lim 2003). Relative to India, ASEAN GDP is 20% more and its exports ten times as large.

One particular growth driver for ASEAN FDI's in the near and medium term is the restructured and revitalized Japanese economy. After ten years of recession, Japanese firms are now posting record high operating income and record low interest-bearing debt to cash flow ratio. Japanese firms are now with excess cash flows that are waiting to be invested domestically and internationally (Kobayashi 2005). With the long-standing economic relationship between Japan and ASEAN countries, some of this excess cash may find its way into ASEAN.

## **2. Threats**

ASEAN countries have been faced with more intense competition for FDI's in recent years.

Global firms invest in developing countries like ASEAN countries mainly to establish plants for their export goods and to gain access to the developing countries' markets. Global firms have become more selective in choosing an export plant location as more alternative host countries, such as China and countries in Central and Eastern Europe, have emerged with the end of the cold war. Although ASEAN member countries are still presently getting relatively good evaluation in terms of business environment and incentives to foreign investors (Mizra), they have no absolute advantage. New FDI host countries have been making substantial progress in luring FDI's and ASEAN countries may lose its comparative advantage if needed reforms and continuing improvements are not made.

Regional blocs and free trade agreements (FTAs) involving other developing countries also threaten to divert FDI flows away from ASEAN (Huang and Yeung 2004). For instance, with the North American Free Trade Agreement (NAFTA) and the expansion of the EU, global firms are now finding the developing countries in these regional economic blocs increasingly more attractive as FDI hosts. The recently concluded economic partnership agreement (EPA) between Japan and Mexico likewise can be expected to increase FDI inflows to Mexico, particularly from Japan.

China is said to be the biggest threat to ASEAN. China began to open its doors to foreign investors in 1979. With its extremely low cost labor and abundant natural resources, profit maximizing global firms would naturally look to China as sites for their export firms. But it was not until the early 1990s that China was able to provide a sufficiently friendly business environment and was considered a suitable location for export production that big waves of foreign capital arrived at its shores (Palanca-Tan 2001). With the subsequent phenomenal growth of its economy, global firms began to view China as a promising market as well in the mid-nineties. Thus, from just 1.5%, China's share in global FDIs ballooned to 20% in 2005. Whether this phenomenal growth of FDIs in China was achieved at the expense of ASEAN or not, it is clear that China has risen as the most promising market in the world and as such, has lured much of the global capital to its shores. Further, when Japan is the target market of foreign investors, China and the ASEAN countries will be in stiff competition with each other.

### **3. Strengths**

All ASEAN countries together make up a huge dynamic market that can match the gigantic economies of China and India.

As the ASEAN countries had earlier opened their doors to foreign capital, they had earlier set-up the environment required by foreign investors. Most ASEAN countries have attractive fiscal incentive schemes (consisting of preferential tax rates, investment allowances and subsidies) for foreign investors. Physical, commercial and legal

infrastructure is, until the present, generally better in ASEAN than in most developing countries including China.

Likewise, most ASEAN countries had earlier established business relationships with major investing countries. Firms from major investing countries are already in ASEAN and have accumulated tangible and intangibles assets in the region. Thus, it will only be in these investing countries' interests to see the region grow further and will therefore be in support of that growth. Japan, in particular, would like more foreign investments to come to the region with its huge stakes in the region's economies and its geographical and psychological proximity to it.

#### **4. Weaknesses**

Due to fiscal constraints and government corruption, some ASEAN countries (namely, Indonesia and Philippines) lag behind others (i.e., Singapore, Malaysia and Thailand) in putting up the infrastructure facilities required by foreign investors. Up to the present, the Philippines and Indonesia, are beset with poor roads system and heavy traffic, poor marine transport system and high shipping costs, and unreliable and expensive power supply.

One weakness that can be found even in the relatively more advanced ASEAN countries of Malaysia (Abidin 2002) and Thailand, is the lack of research and development (R&D) as well as human resources development programs. This results in the low absorptive capacity of ASEAN industries. Domestic firms and manpower are unable to fully absorb knowledge and adopt new technologies brought in by foreign firms. Support industries that can service and supply foreign firms with their input requirements are not able to develop. In the case of the Philippines, Indonesia, the newer ASEAN countries, and to a less degree, Thailand, the problem is also caused by irrelevant and inadequate science and engineering curricula in tertiary level education and the lack of facilities and equipment necessary for practical training of students. In these ASEAN countries, technology transfer even within the foreign firms (from the foreign to the local



staff) is hard to occur and long-run improvements in labor productivity and competitiveness are not realized.

Further, there is still much resistance to opening up the financial sector to foreign investors in some ASEAN countries and in fully liberalizing the sector in several others (e.g.: Malaysia). Government support and control of local banks do not allow a level playing field thus discouraging foreign investments in the sector. In so far as the financial sector performs an important support service to firms, an inefficient and unstable financial sector in the host countries can deter FDI inflows in the other sectors as well.

Finally, several ASEAN countries are still struggling to address a number of institutional weaknesses—corruption, unclear property rights laws, underdeveloped corporate governance, poor law enforcement, and state activism.

## **. What then needs to be done?**

### **1. Promote ASEAN integration**

The prospects of a complete ASEAN integration—a single market with no borders, no custom, and with a common currency—help revive FDIs to the region. Though this may be a very long-term endeavor, any concrete step towards this vision will send a positive signal to foreign investors.

One such step that pertains specifically to FDIs is the harmonization of FDI policies and in general of corporate laws and regulations that can enable global firms integrate their operations across ASEAN. This can be done by formulating an industrial policy for the region that includes a complementary ASEAN FDI incentives scheme. The ASEAN FDI incentives scheme must provide also for joint promotion of FDIs and for a region-wide data collection and reporting system.

## **2. Forge economic partnerships with investors' countries and their target market countries/regions**

The FDI-diverting effect of FTAs and EPAs can be used by ASEAN and member countries to their advantage by getting themselves involved in these agreements. ASEAN as a whole and member countries individually must actively explore possibilities for and seriously look into the benefits and costs of FTA/EPA with major trade and investment countries and regions in the world.

## **3. Complete financial sector reform and liberalization**

Financial sector FDIs in ASEAN had helped to stabilize the banking systems in ASEAN countries during the 1997 Asian crisis. Relative to local banks, foreign banks had lower non-performing loans and hence was able to serve as a buffer during the crisis (eg: Thailand). Foreign banks also made up for the credit crunch experienced by domestic banks due the withdrawal of inter-bank credit as in the case of Thailand and Singapore (Chua 2005).

An important aspect of an enabling environment for FDIs is a liberalized financial market. Financial liberalization can lead to increased efficiency, increased availability of funds for capital (expansion of loan portfolio), introduction of new banking products, and the stability and continuing development of ASEAN's financial sector. Foreign banks can serve as catalyst for change among local banks. In the presence of foreign banks, local banks are forced to cut costs, increase efficiency levels and adopt new technology. The family-controlled structure so prevalent among local banks in many ASEAN countries will break-down and decision-making process for loans will be improved, minimizing bank failures.

#### **4. Continuously improve the business environment**

Although ASEAN member countries had started welcoming FDIs earlier and have already established a business environment conducive to foreign businesses, the new host countries have been very fast in undertaking the necessary improvements and are catching up. China, for example, had substantially increased its infrastructure facilities. Its expressways had been expanded from 500 kms in 1990 to 29,700 km in 2003 (Kobayashi 2005). Thus, there is a need for ASEAN to continually improve the business environment or it may lose its comparative advantage.

Specific areas that require improvements are as follows.

(1) Physical infrastructure – road networks, sea and air port systems for smooth and inexpensive transport of goods; power supply systems that provide reliable and inexpensive electricity for industries.

(2) Institutional infrastructure – political and economic stability; predictability and transparency of laws and rules; elimination of corruption and bureaucratic red-tape.

(3) Support services for FDIs – provision of information (e.g.: database of suppliers); assistance in finding partner and contracts.

#### **5. Invest more in R&D, education, and human capital development**

The fundamental knowledge and technological competencies of ASEAN industries and workforce must be improved through research and development, education, and human capital development. Specific courses of actions are as follows. First, tertiary education curricula must be reviewed and facilities for practical training of students must be made available. Second, relevant government agencies must initiate and undertake R&D programs and/or support R&D activities of local firms and academic institutions. Third, government must promote and facilitate linkages between academic and research

institutions and firms in basic and applied research. Collaborative efforts among ASEAN member countries can also be promoted. Assistance of the investing firms and countries may also be sought. Foreign firms can provide training for their own staff and technical assistance to their local suppliers of raw materials and support services. Investing countries' government, on the other hand, can provide both financial and technical support.

### **. Concluding remarks**

ASEAN has shown other developing countries how to utilize FDIs to achieve economic growth. With growth, income levels in the region have increased and have eroded the initial comparative wage advantage of ASEAN over other developing countries. Thus, ASEAN can not really hope to retain its place as the developing region with the highest level or share of FDI. It can, however, hope and endeavor to evolve into a mature FDI host region, one that can keep old and new investors' interests and presence.

Many of the large investing companies from North America, Japan and Europe are already in ASEAN, and the main task therefore for ASEAN is to keep these firms in the region—prevent their departure and/or encourage re-investments. As China presently has a cost advantage over existing FDI operations in ASEAN, existing ASEAN FDI hosts will have to their raise productivity and/or they can relocate labor-intensive production processes to the newer ASEAN member countries with still lower wages. For the first strategy, investment in research and human resources development is the most important success factor. For the second, regional integration will be crucial.

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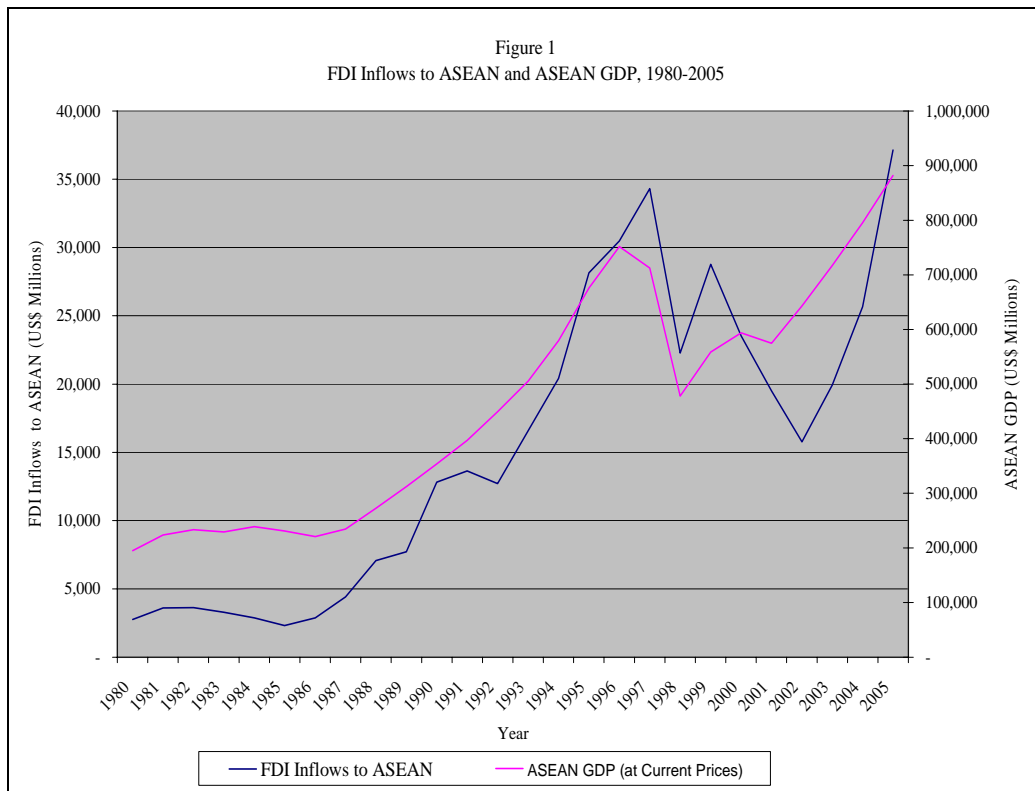
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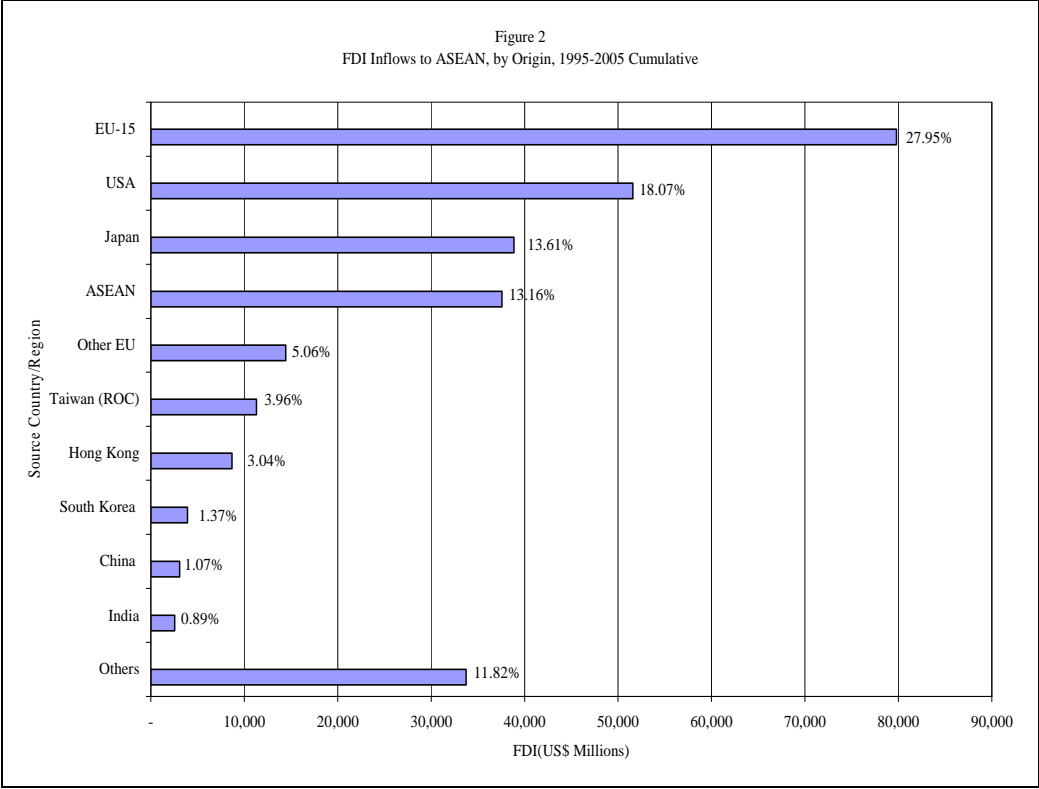
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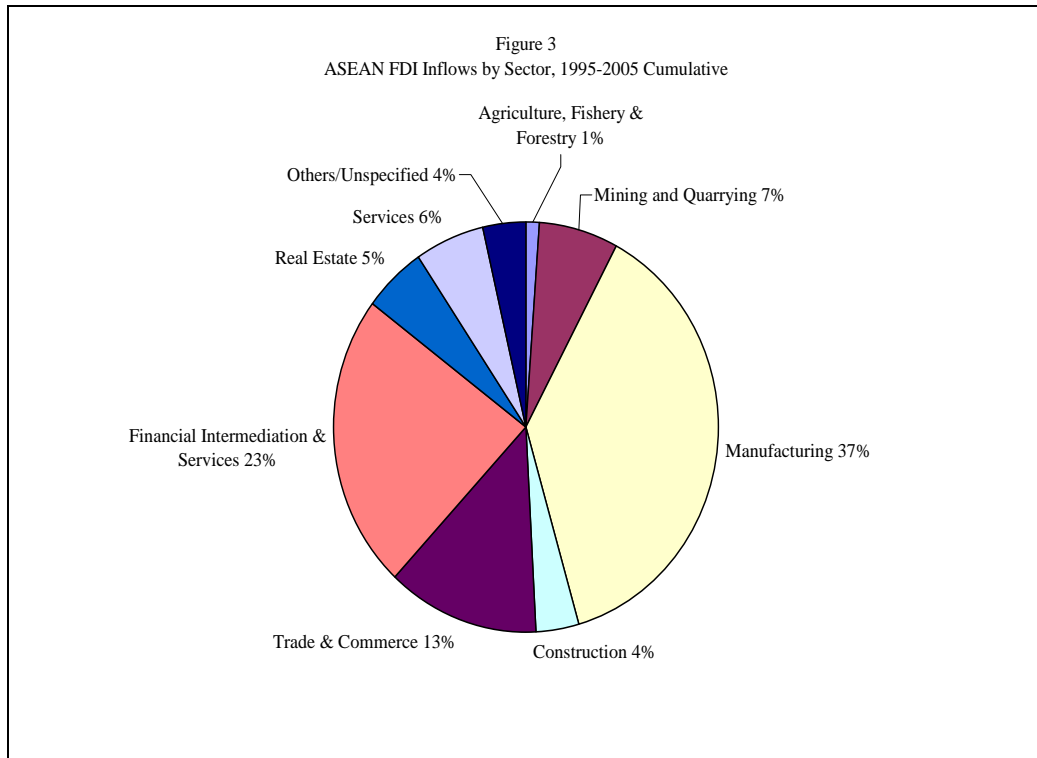
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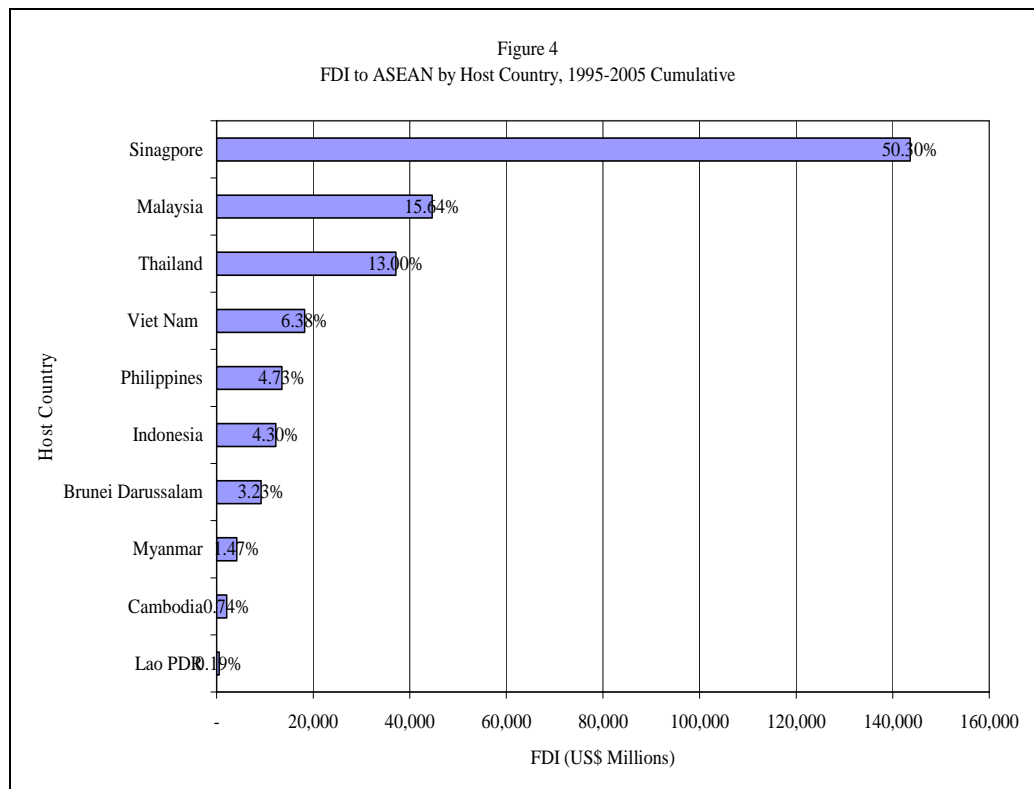
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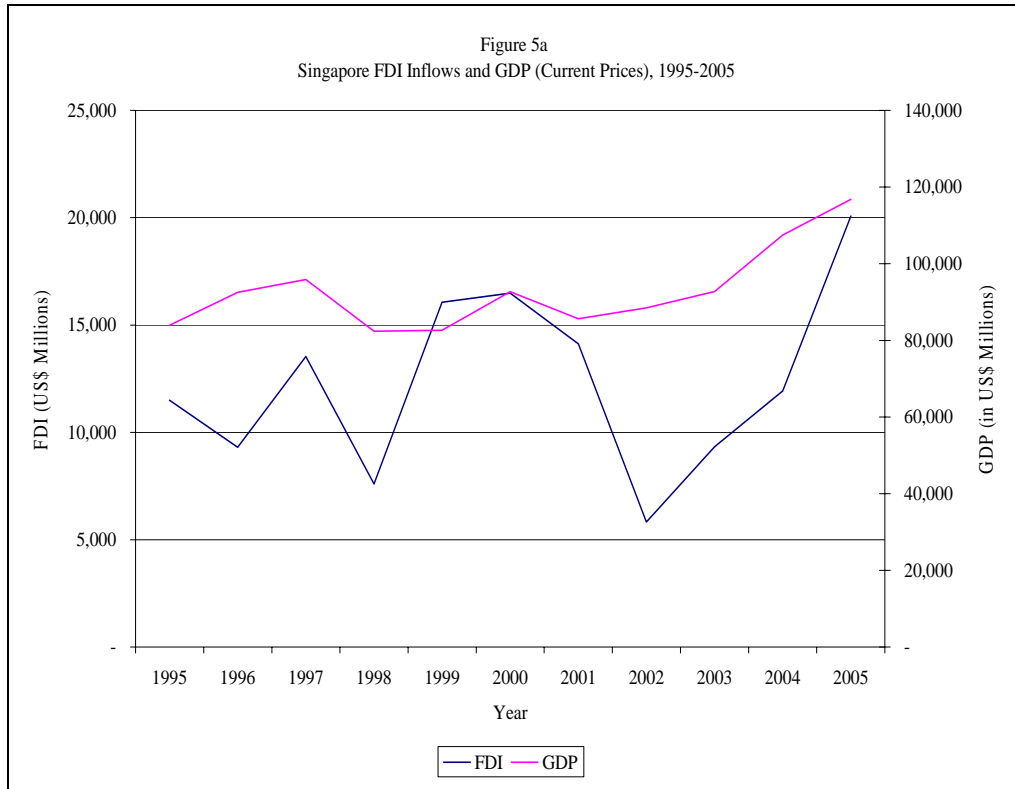
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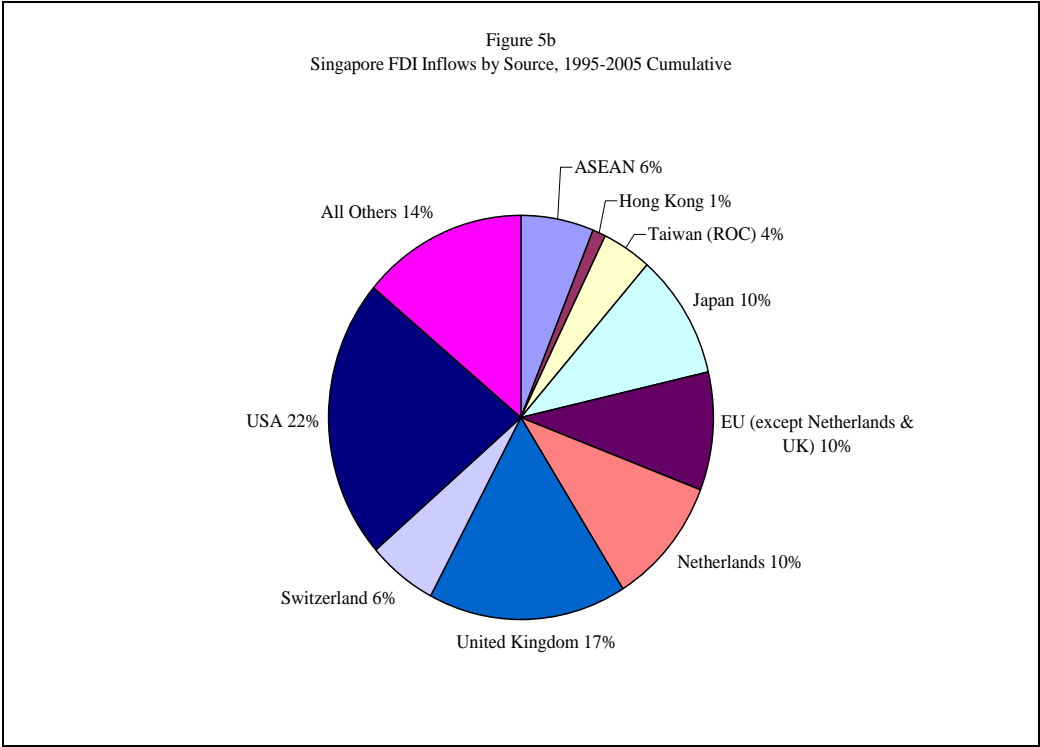


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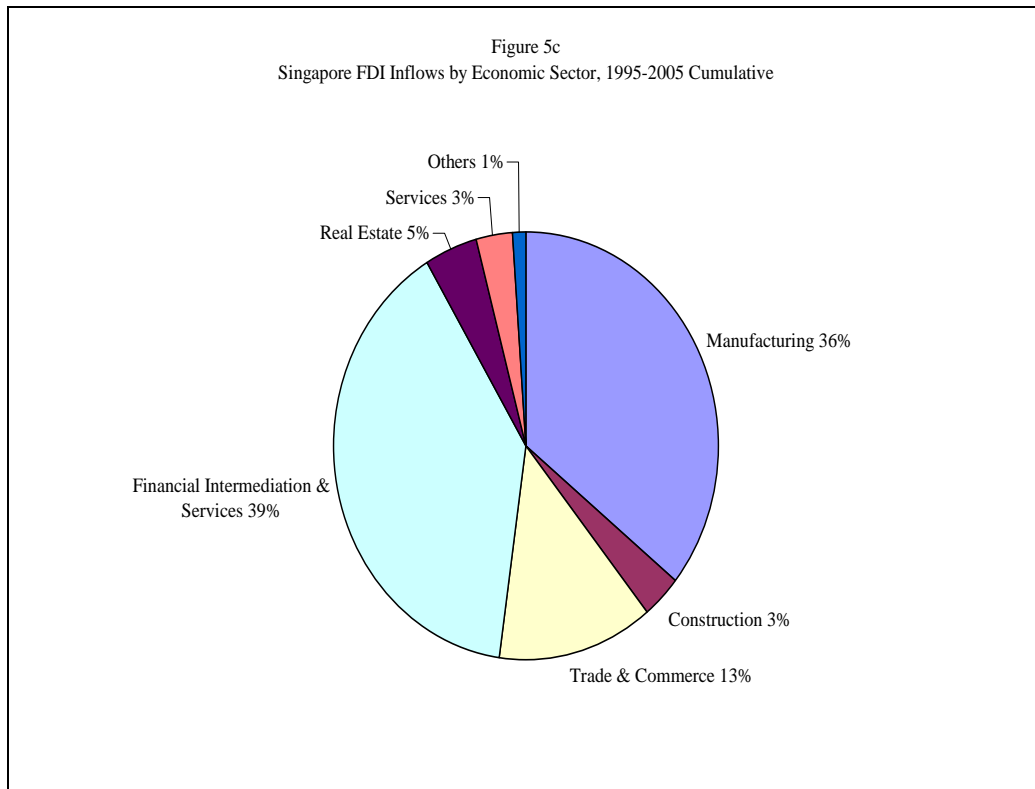


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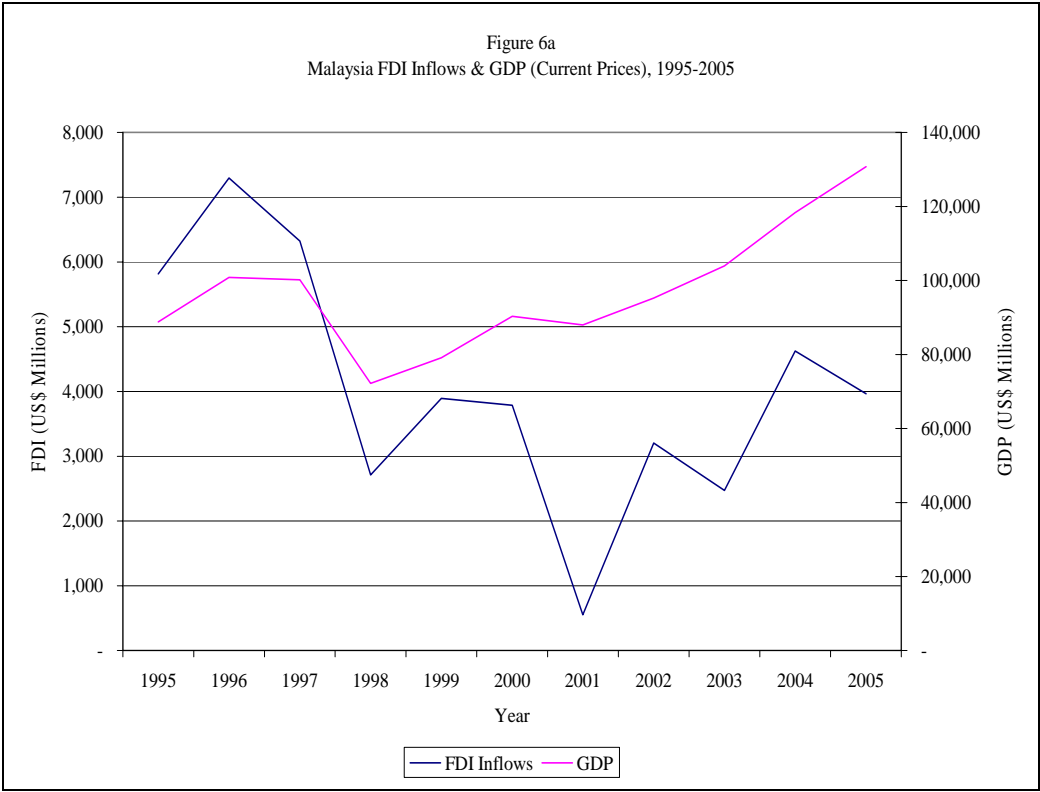


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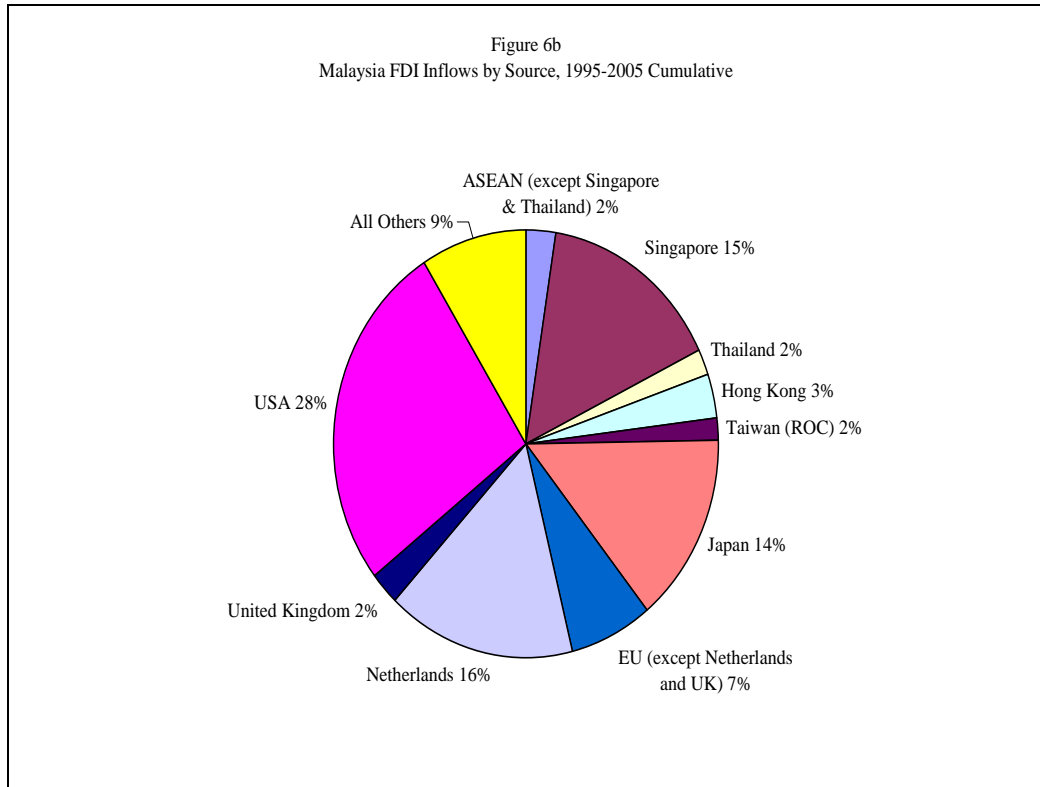


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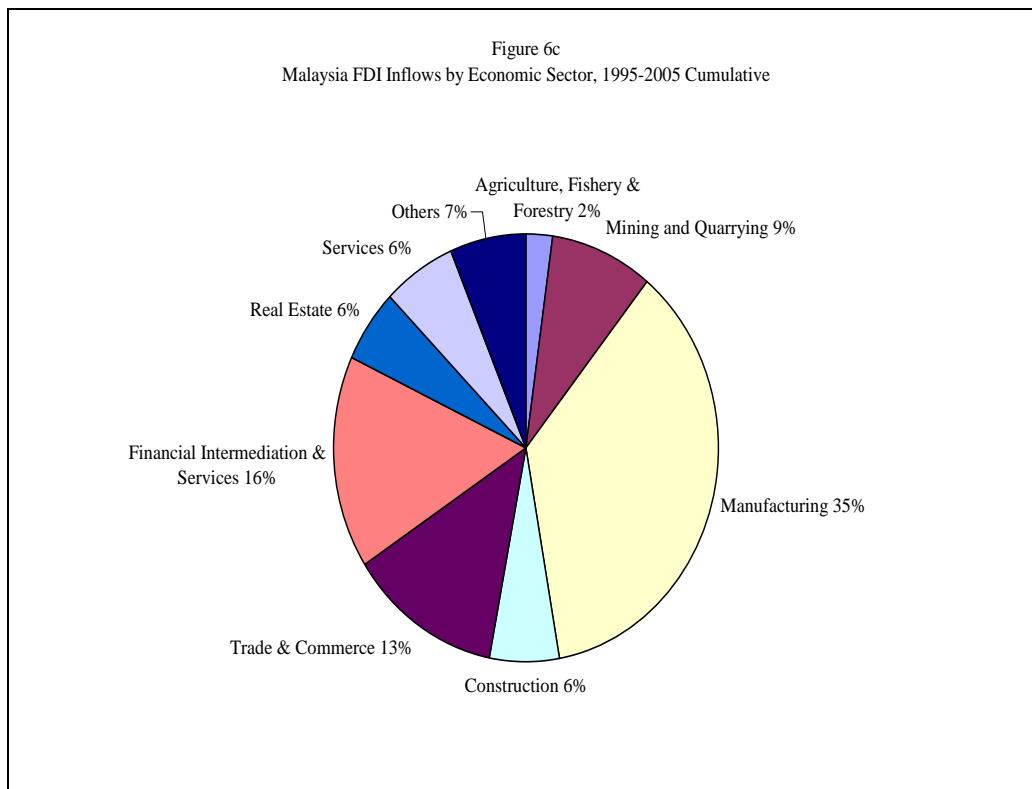
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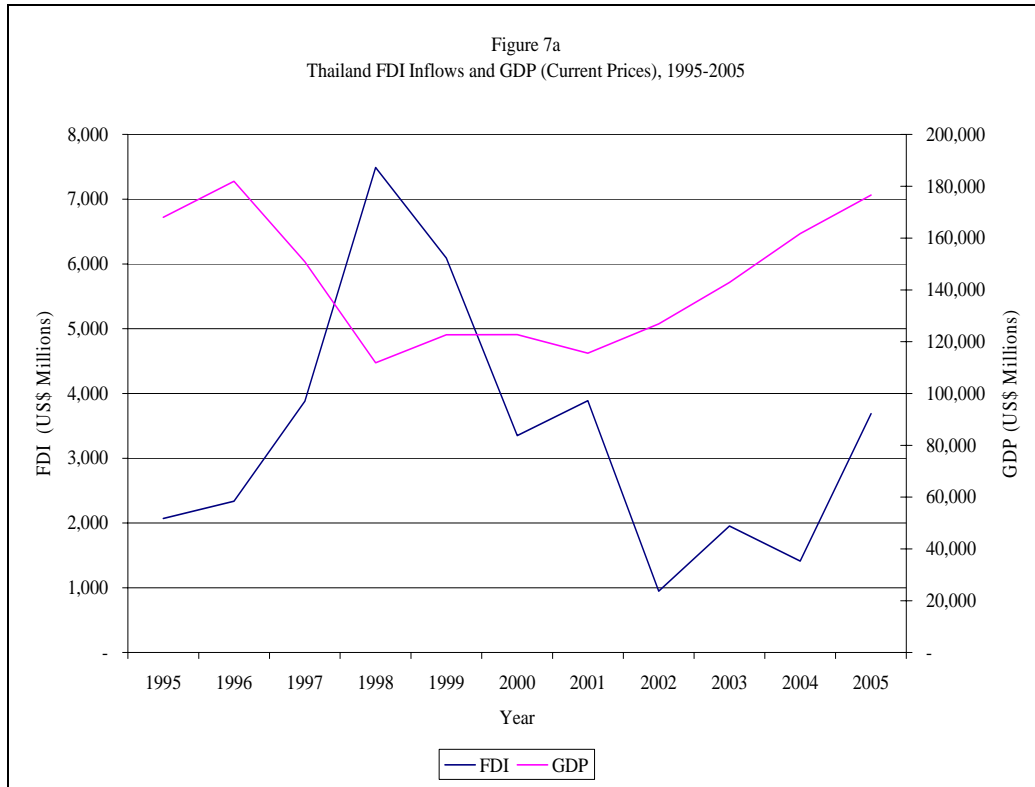
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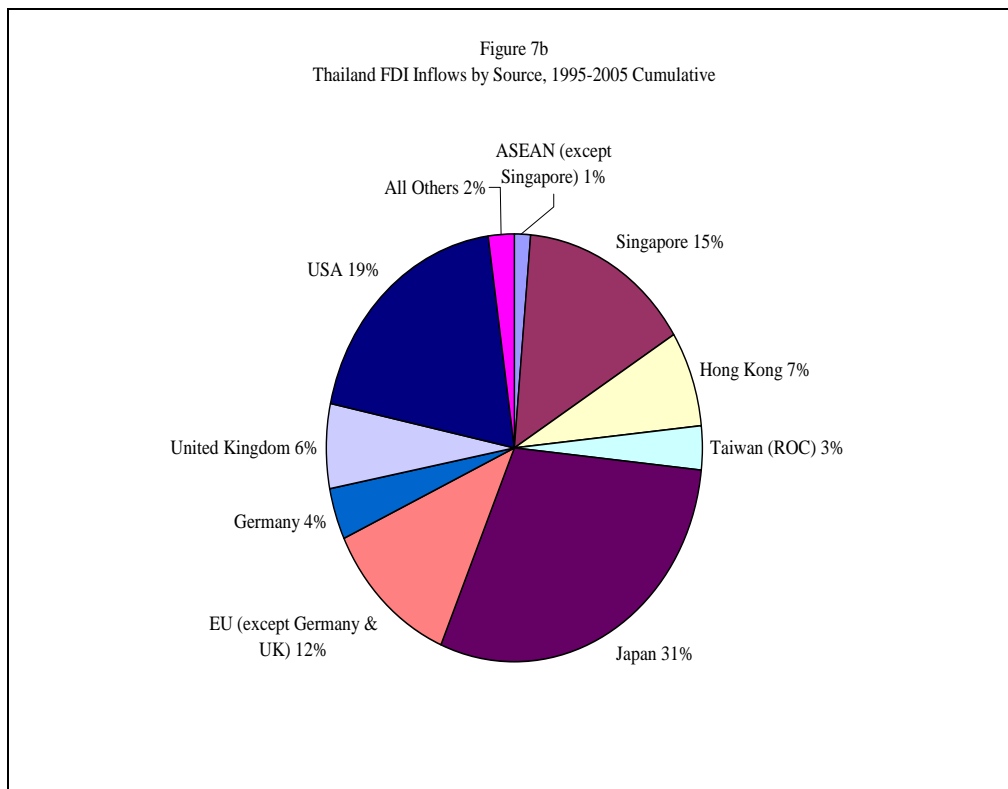


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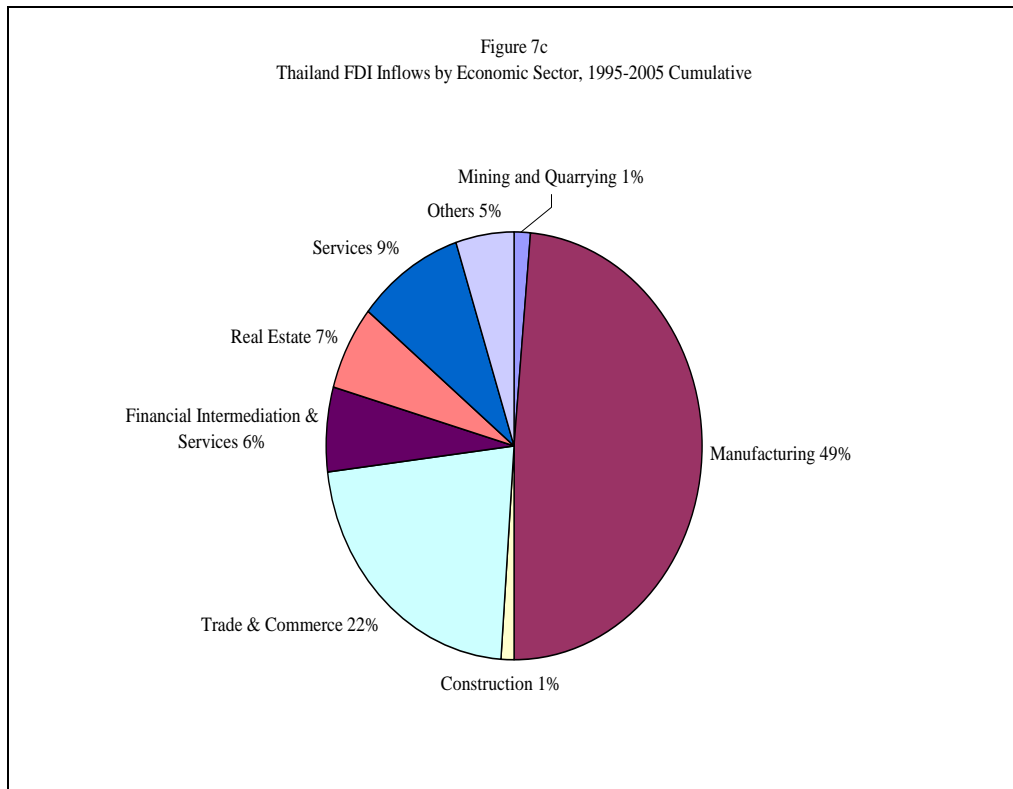


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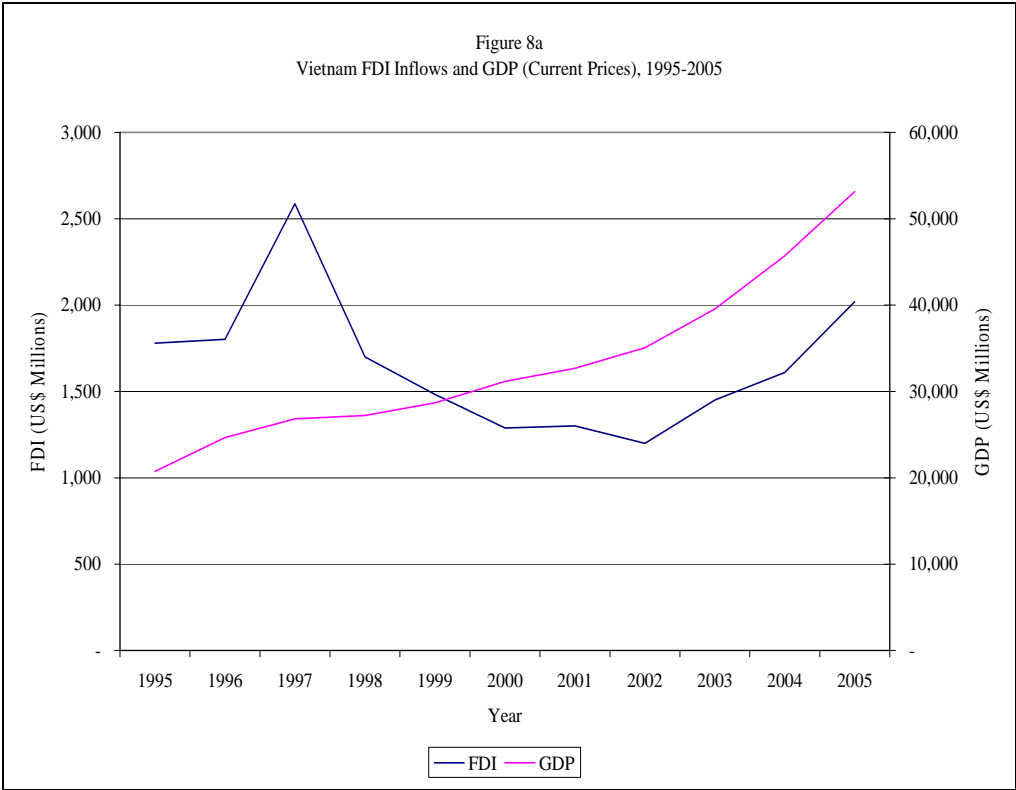


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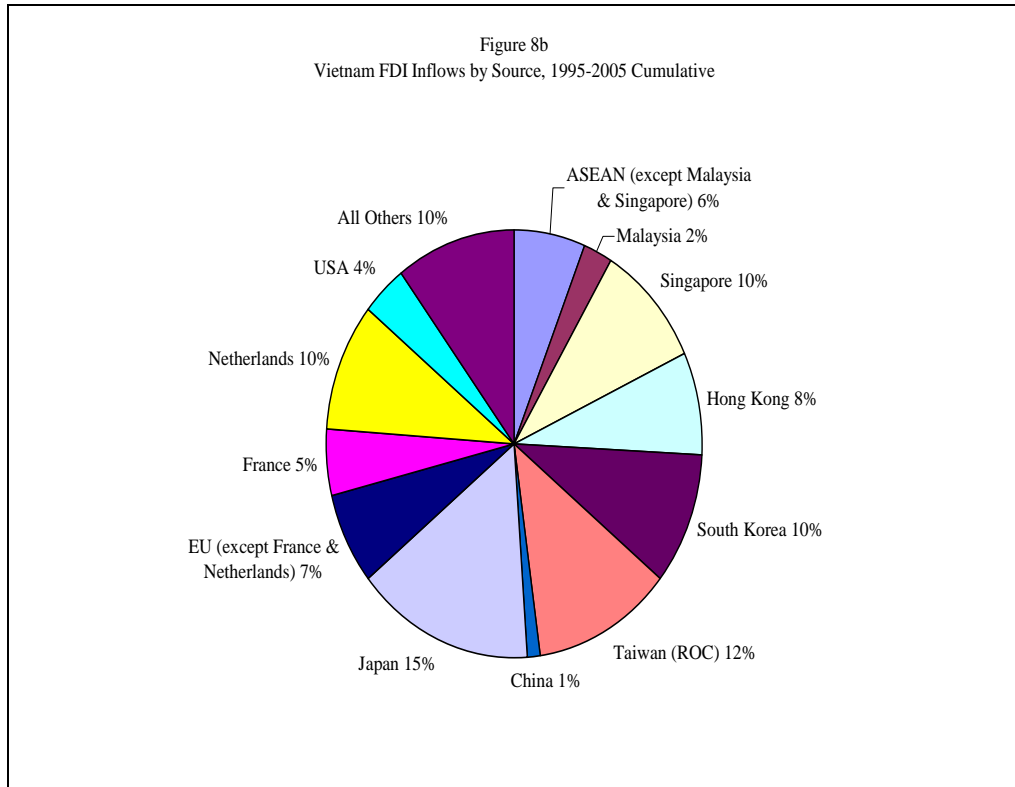


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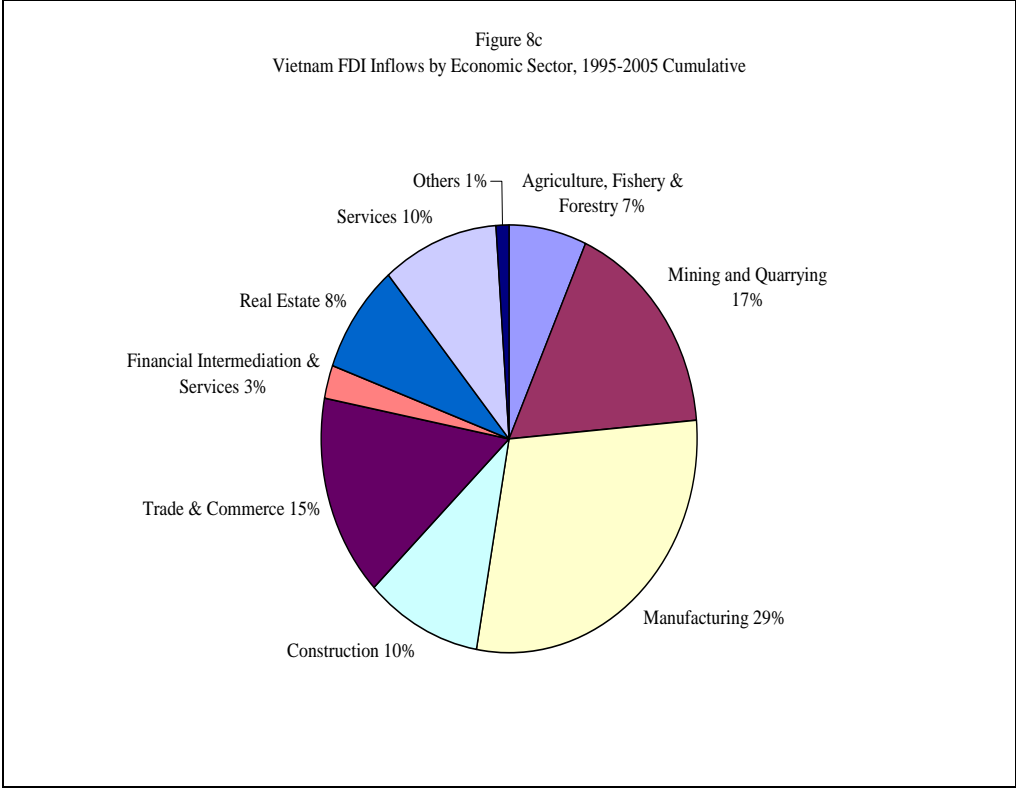


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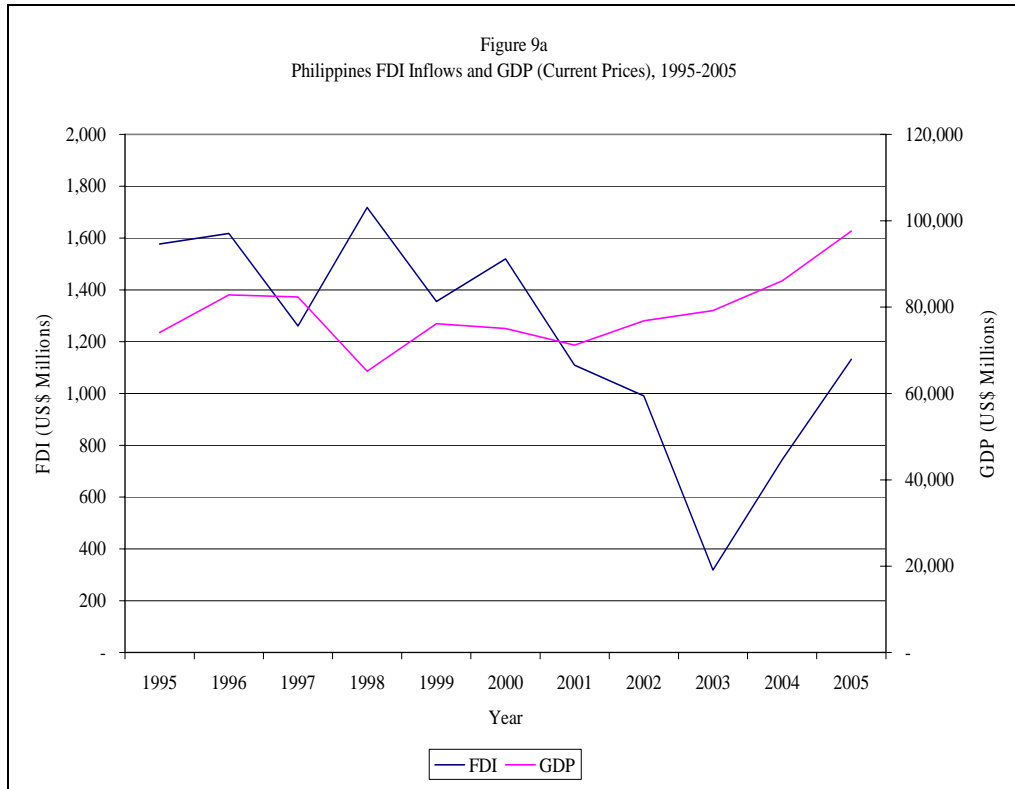


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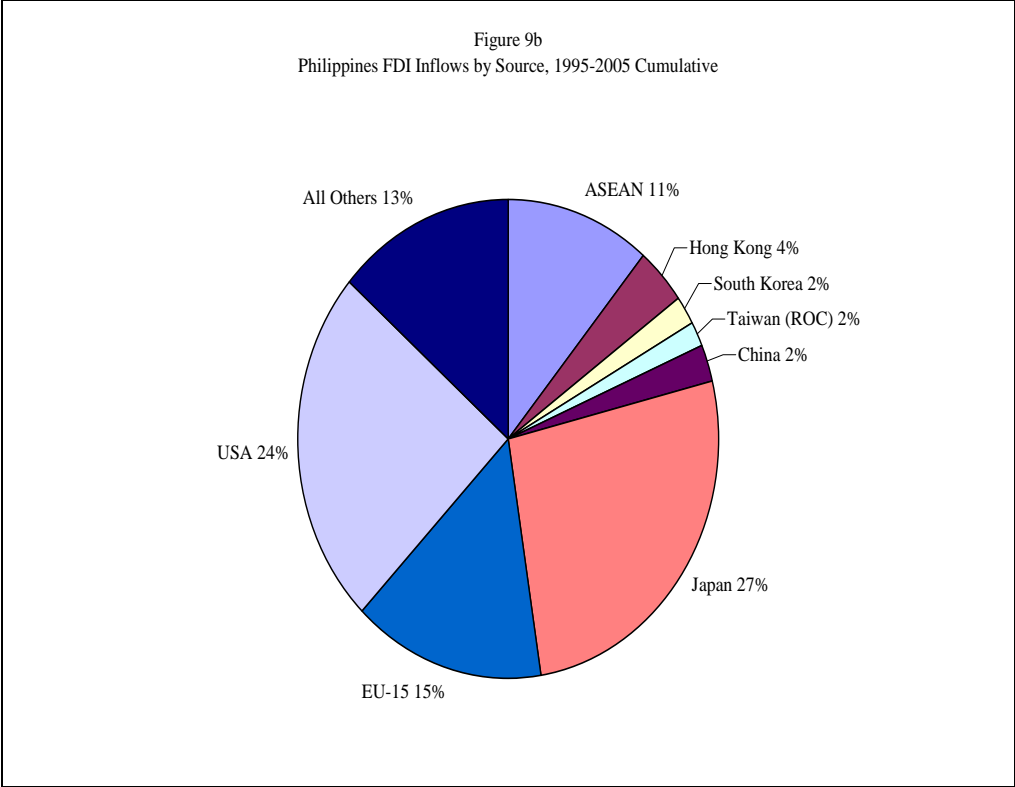
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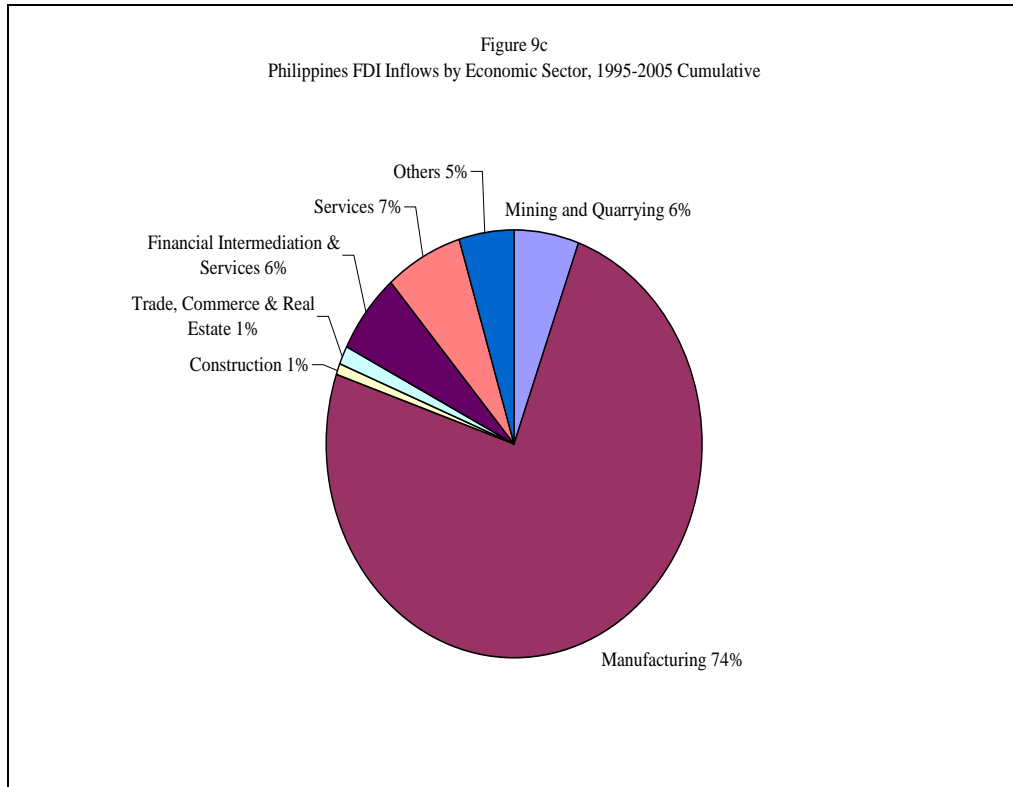
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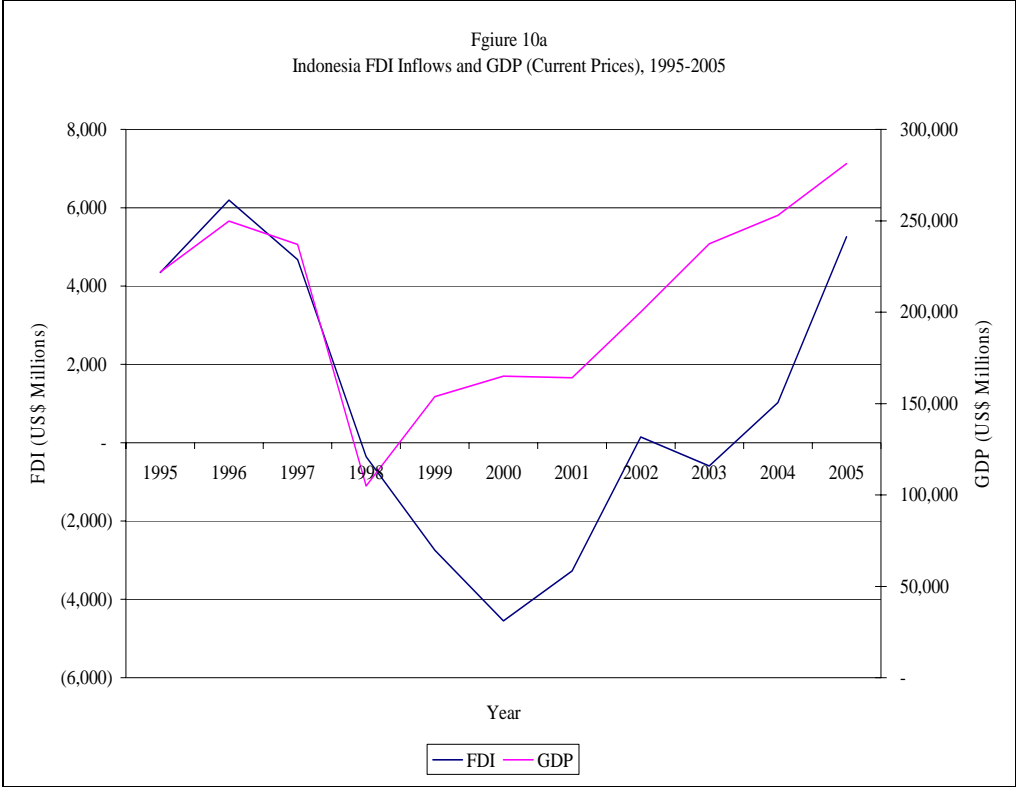


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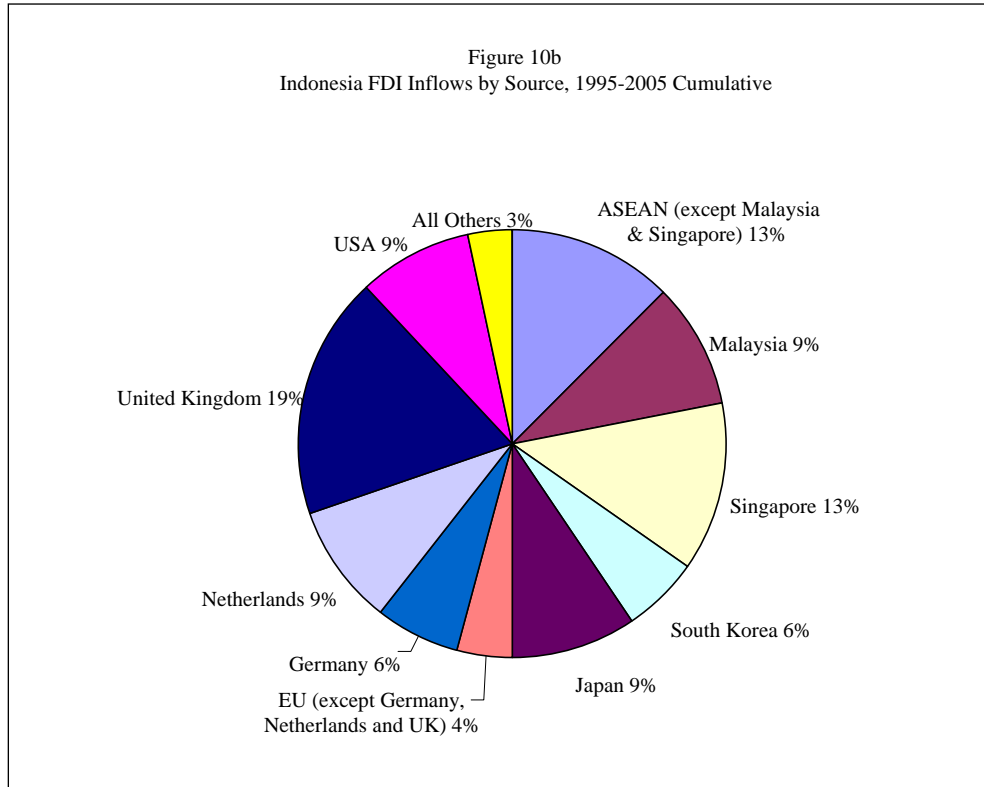


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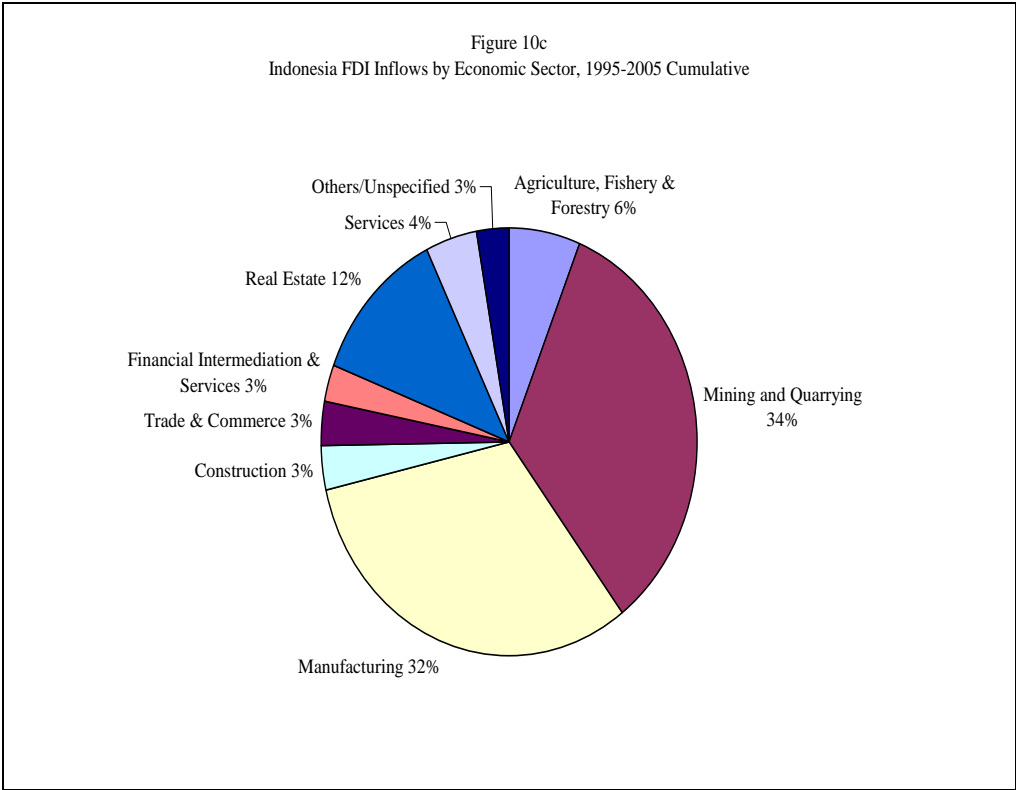


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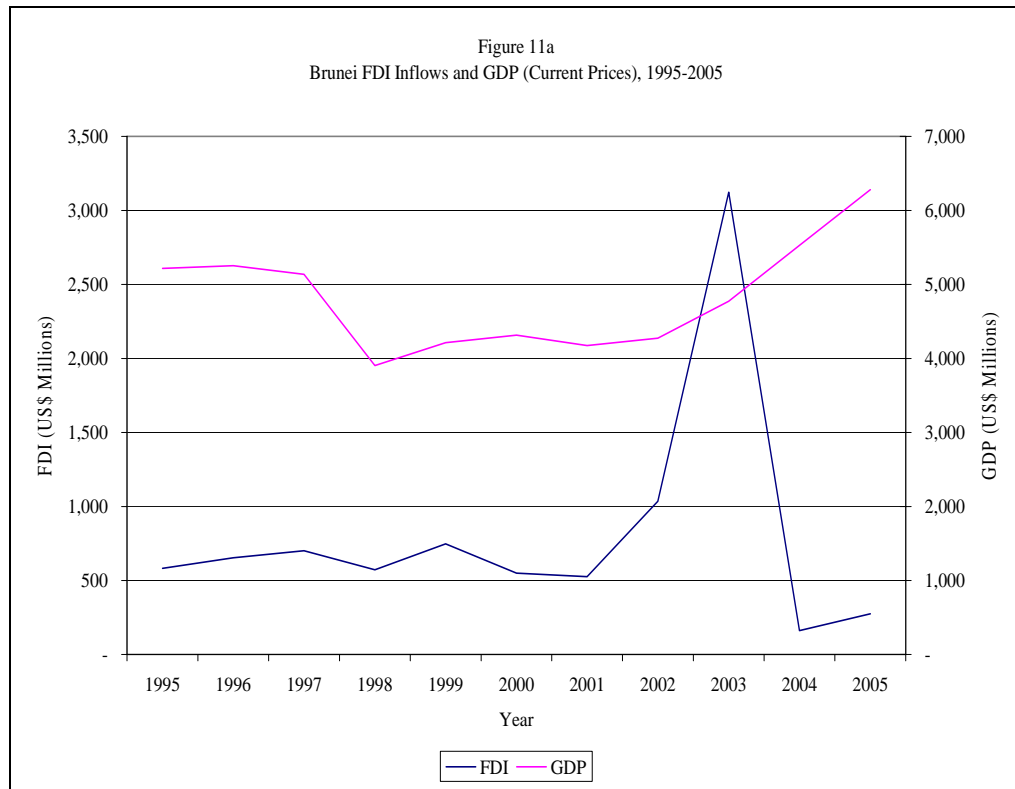


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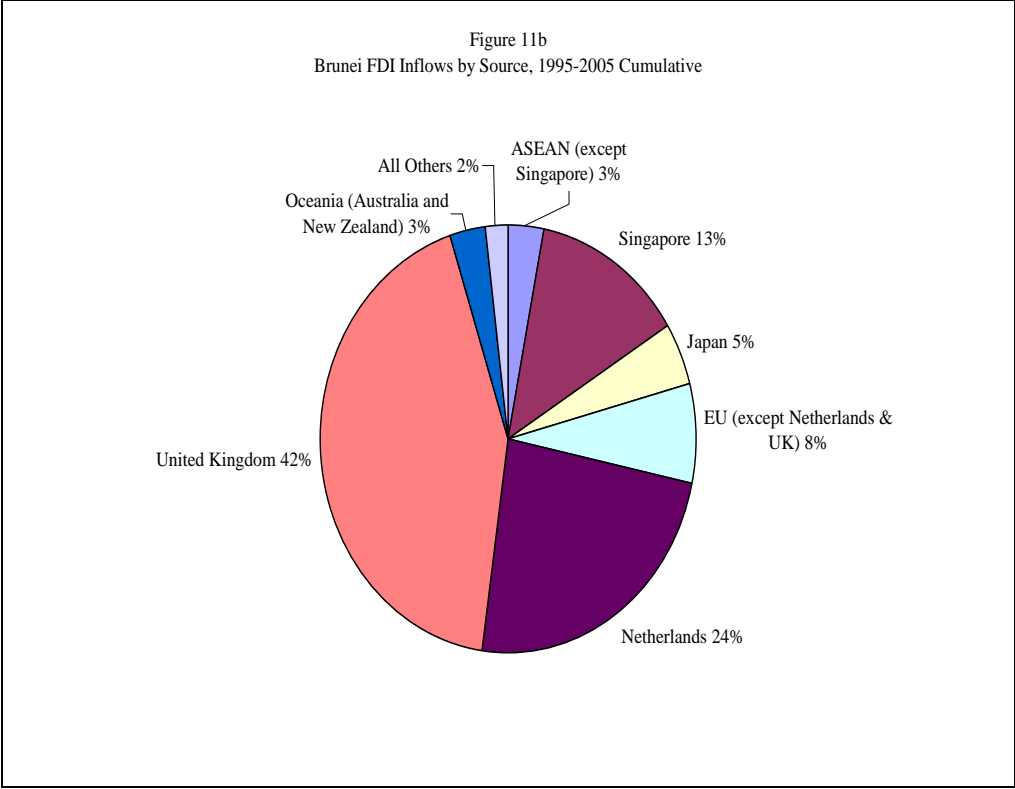


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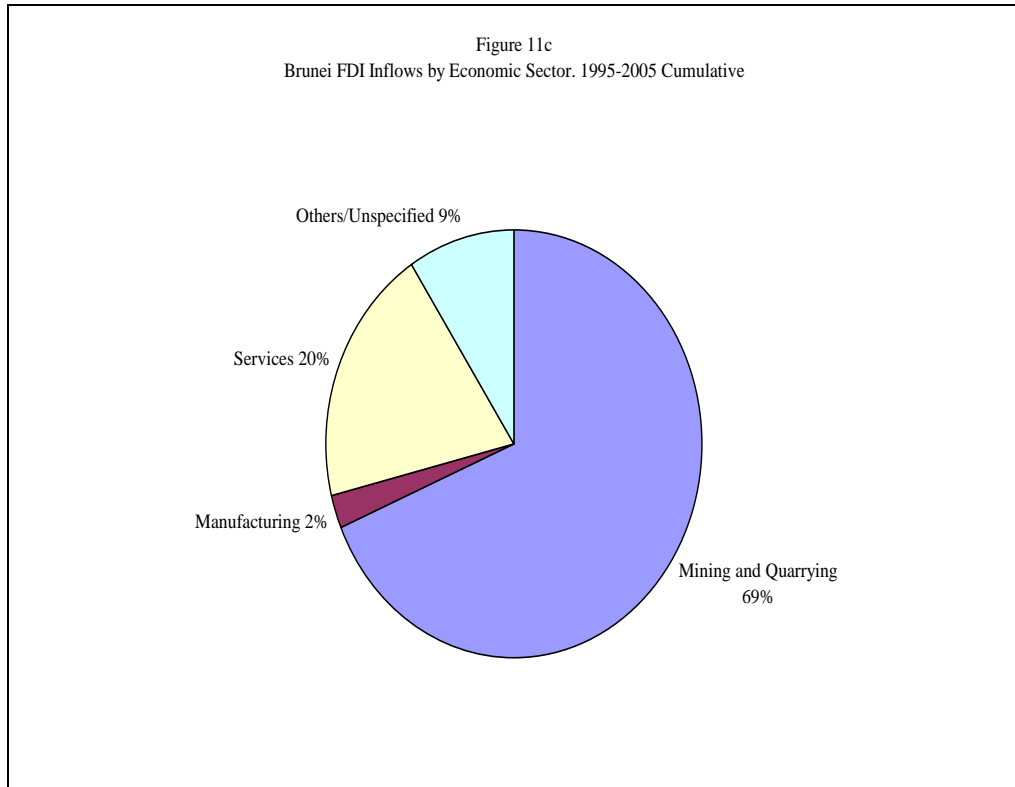


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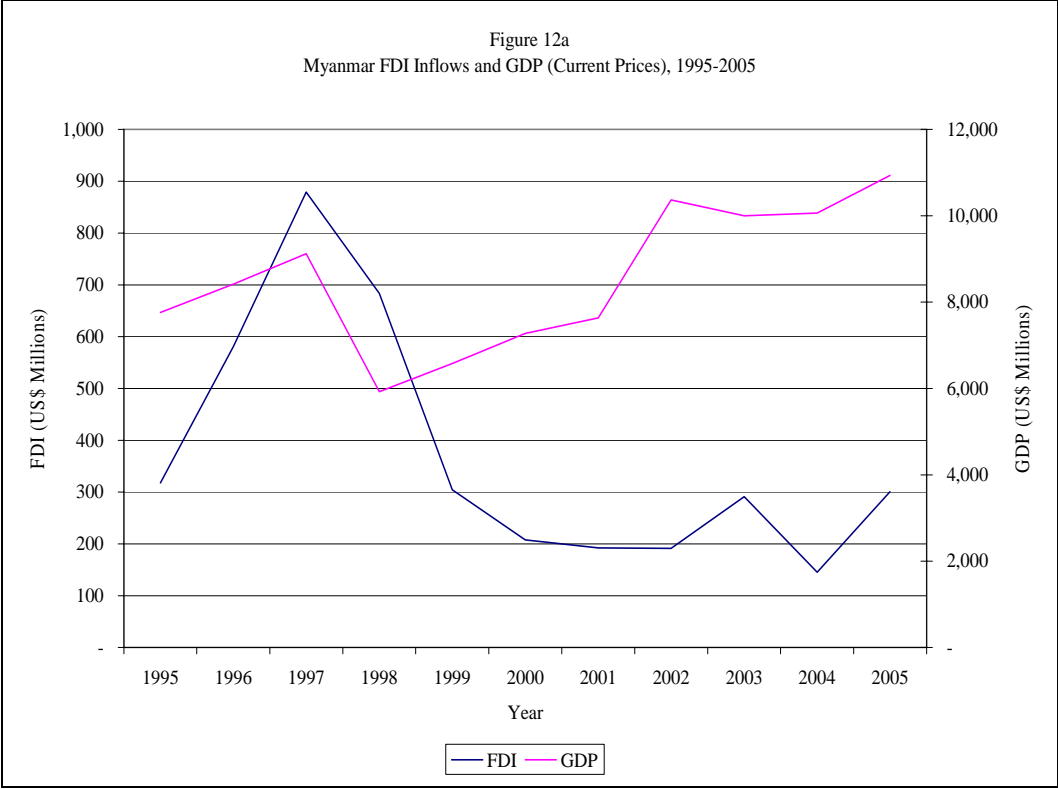
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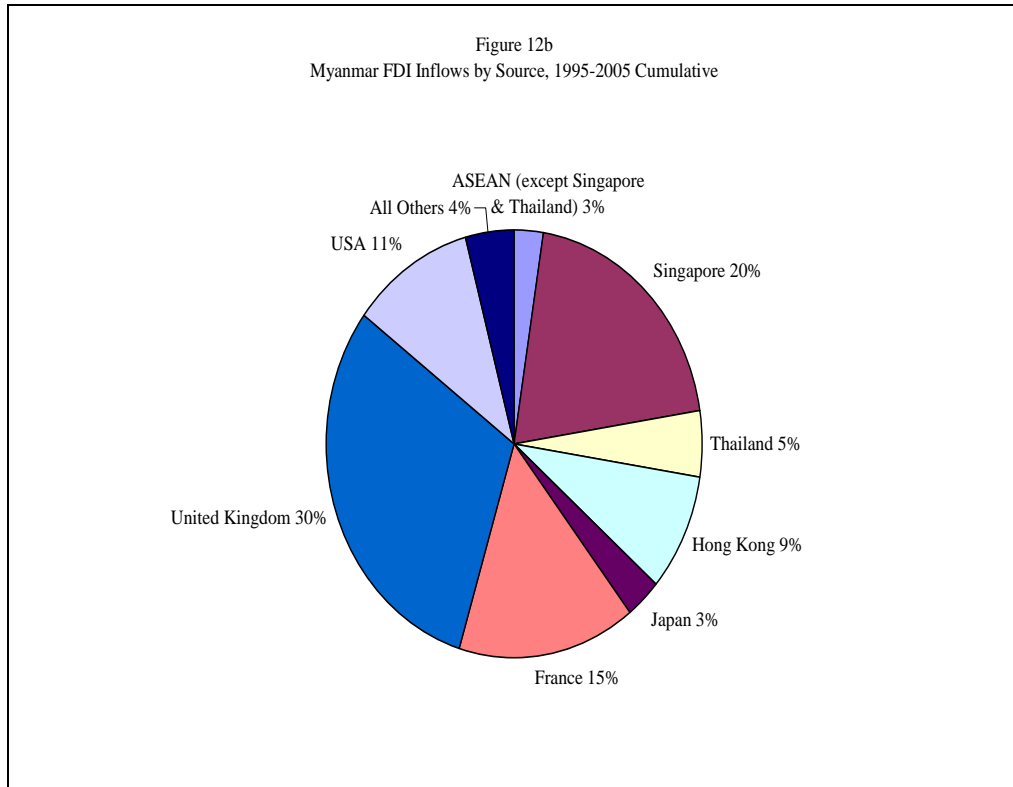
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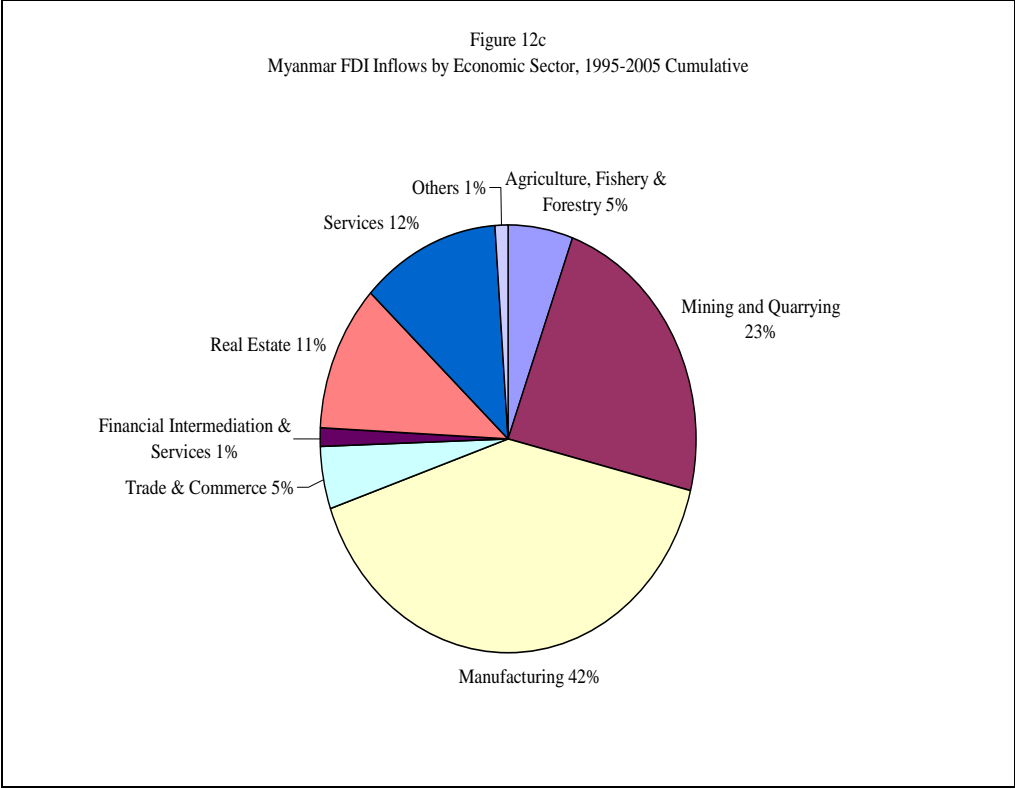


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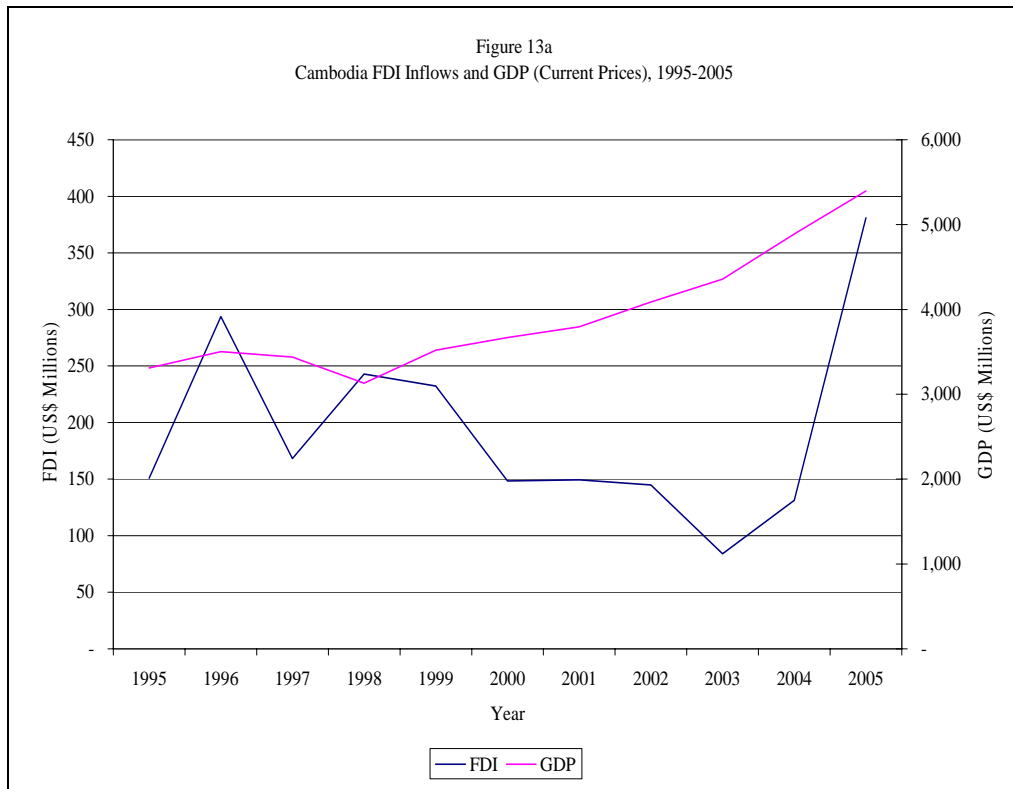


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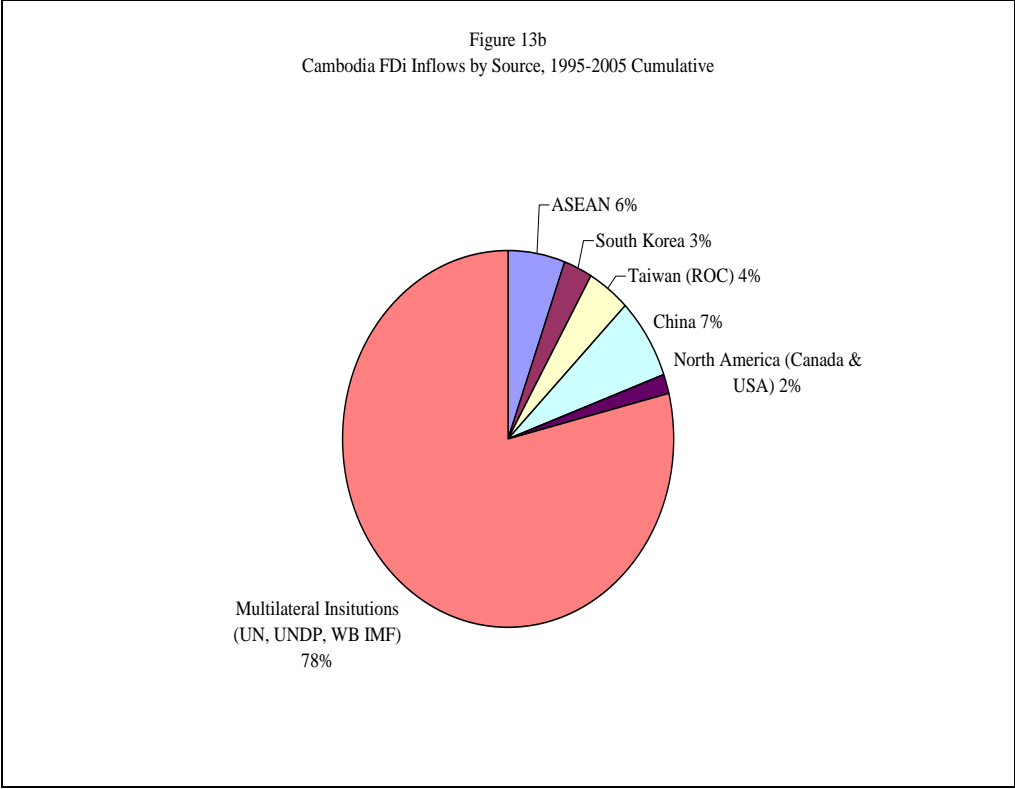


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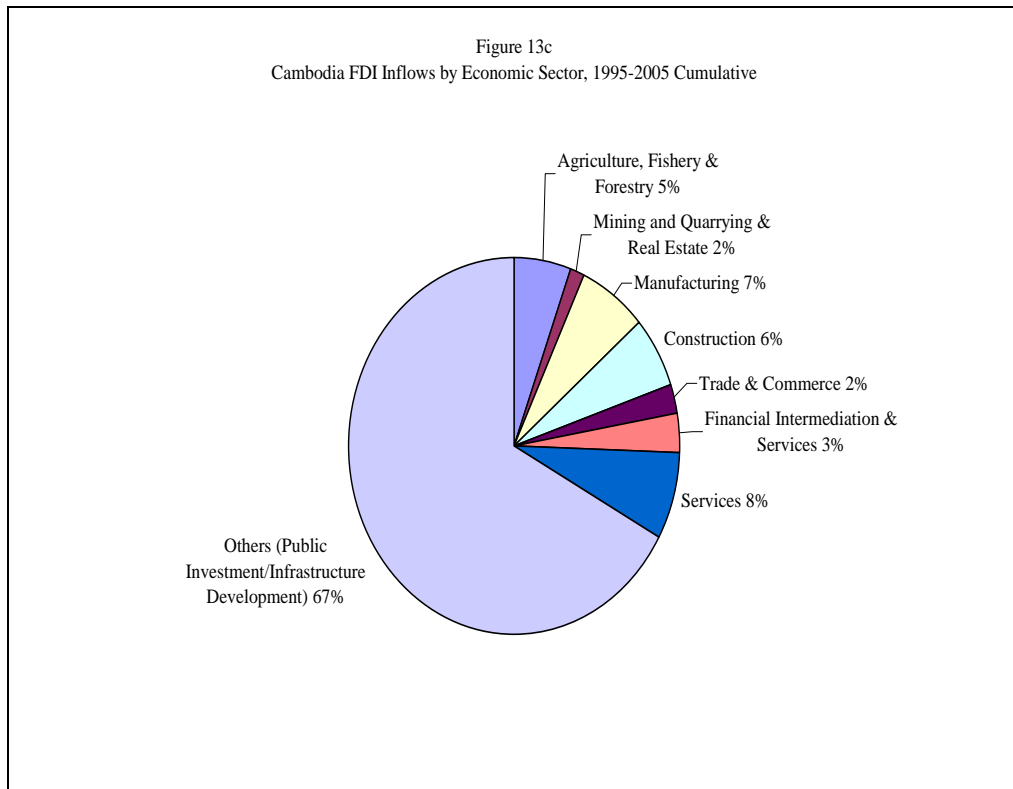


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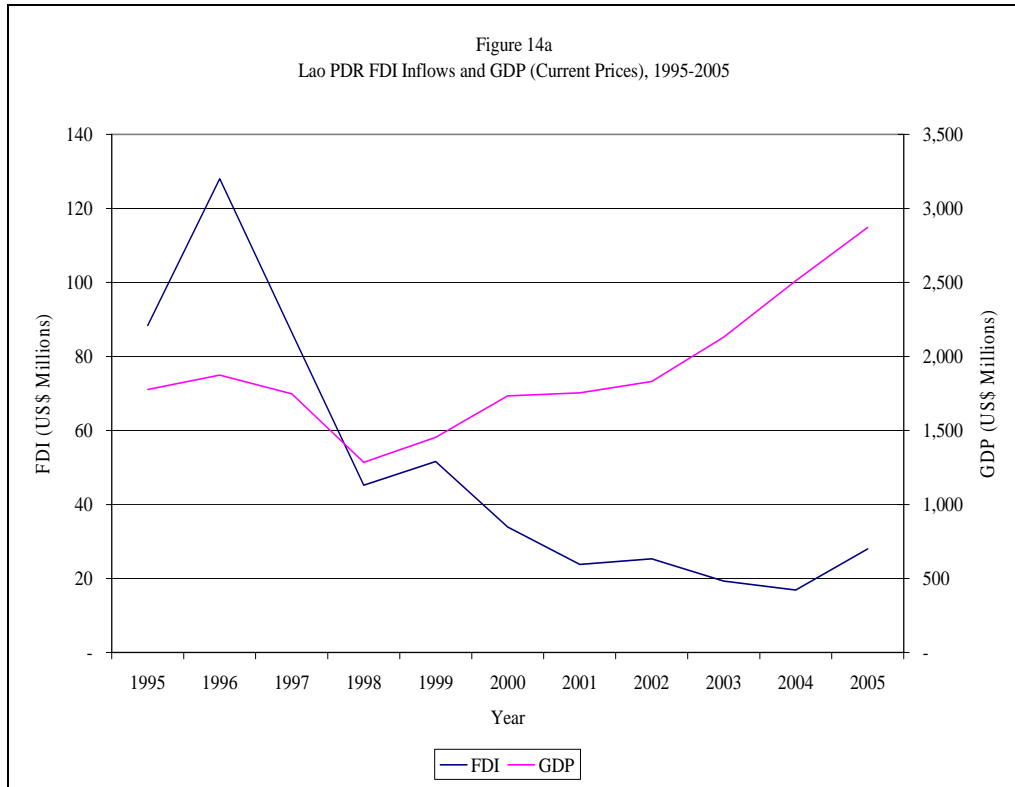


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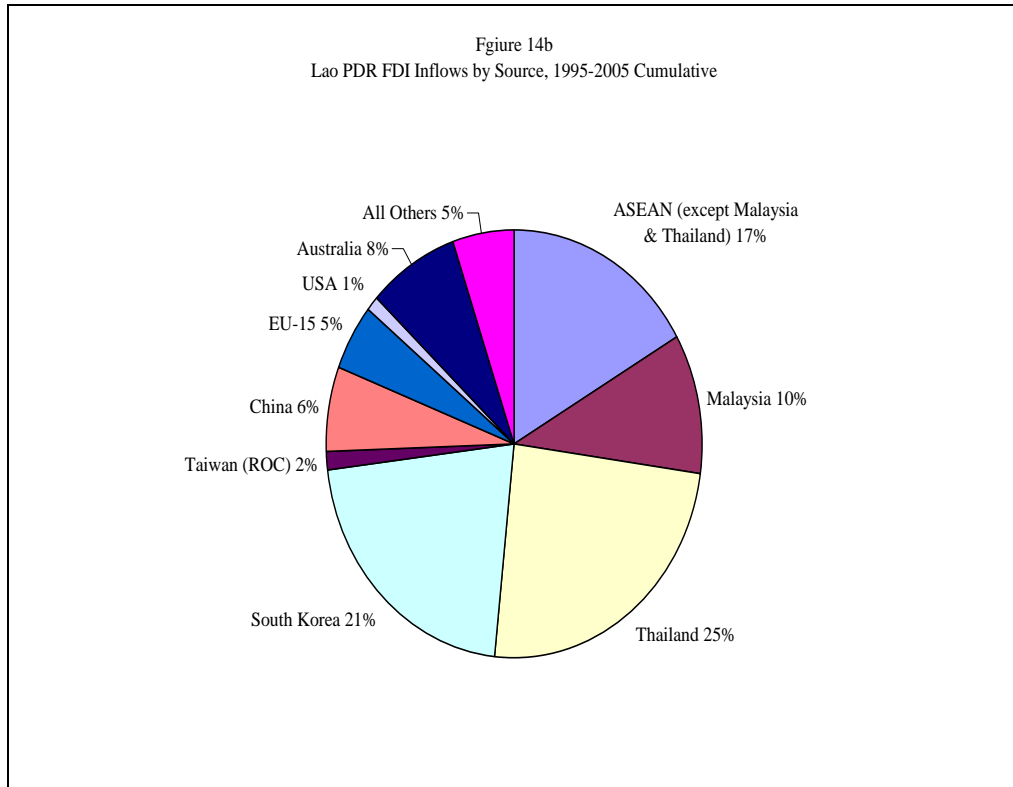


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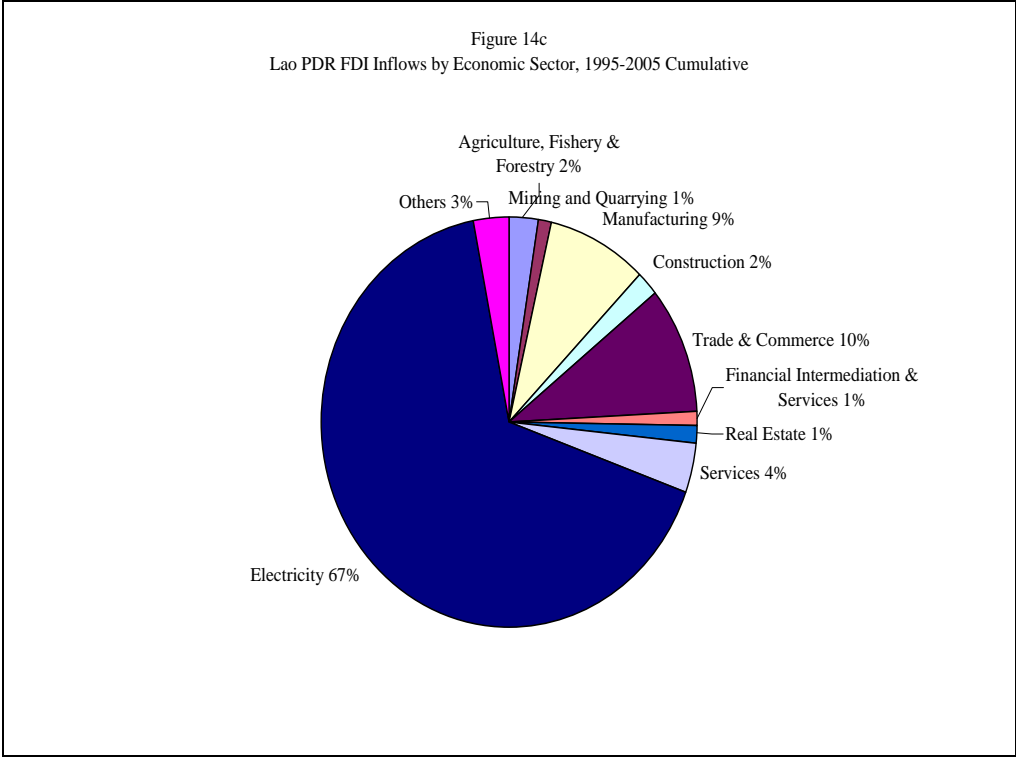
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