The 1997 Asian Financial Crisis and Foreign Direct Investment (FDI) Inflows to ASEAN Member Countries, 1995-2005

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Abstract
In the late 1990s, ASEAN countries started to find it more and more difficult to lure foreign investors. While ASEAN was capturing about 8% of foreign direct investments (FDI) until the mid-1990s, this share dropped to only about 3% from the late 1990s until mid-2000s. This paper traced the trends and patterns of FDI flows to ASEAN during the years 1995-2005, a period that included the Asian financial crisis that started in July 1997, the years immediately preceding the crisis and the recovery years. The study examined the effects of the crisis on FDI inflows to ASEAN countries and their response
to the crisis. A cursory assessment of the strengths and weaknesses of the individual ASEAN countries as well as the opportunities and threats they faced during the period was also done. It was found that the declining interests of global firms in ASEAN was the result not only of the prolonged stagnation in ASEAN countries triggered by the Asian financial crisis, but also of fundamental weaknesses in the ASEAN economies and external factors such as the increasing competition from other developing countries and transitional economies. The study also yielded some insights on how particular circumstances and policies could mitigate or aggravate the impact of similar crises in the future.

Keywords: foreign direct investments, ASEAN, 1997 Asian financial crisis

Introduction

Foreign Direct Investments (FDI) played an important part in the industrialization and growth experience of ASEAN countries. The growth in Gross Domestic Product (GDP) of the whole ASEAN region was strongly correlated with inflows of FDIs in the region. However, the share of ASEAN in global FDI inflows was disproportionately larger than its share in global GDP. During the period 1980-2005, about 5% of total world FDI went to ASEAN member countries while the region accounted for less than 2% of world GDP. This reflected 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.

In the late 1990s, ASEAN countries started to find it more and more difficult to lure foreign investors. While ASEAN was capturing about 8% of global FDIs until the mid-1990s, this share dropped to only about 3% from the late 1990s until mid-2000s. This paper traced the trends and patterns of FDI inflows to ASEAN in 1995-2005, during which a financial crisis disrupted the growth trajectory in ASEAN countries. The paper looked at the impact of the crisis on FDIs to ASEAN and the responses of the member countries. An analysis of the strengths and weaknesses of the individual ASEAN member countries and the ASEAN region as a whole as well as the opportunities and threats that they faced as FDI hosts was done to identify other contributory factors to the fluctuations of the FDI flows.

The approach employed in the paper was limited to descriptive analysis. Time series data for individual ASEAN countries were gathered from the United Nations Conference on Trade and

Development (UNCTAD) World Investment Report and the ASEAN Statistical Yearbook. The data were summarized and presented as growth rates and ratios or shares weaving a generally coherent story of the FDI and economic growth experience of the ASEAN member countries.

Trends and Patterns of FDI inflows to ASEAN

Growth. FDI inflows to ASEAN grew 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. Thus, it was only in 2005 that the 1997 peak level of US$34 trillion was surpassed.

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 went both ways. The size and potential growth of the ASEAN market, as reflected in its GDP, drew FDIs. FDIs, on the other hand, raised 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.

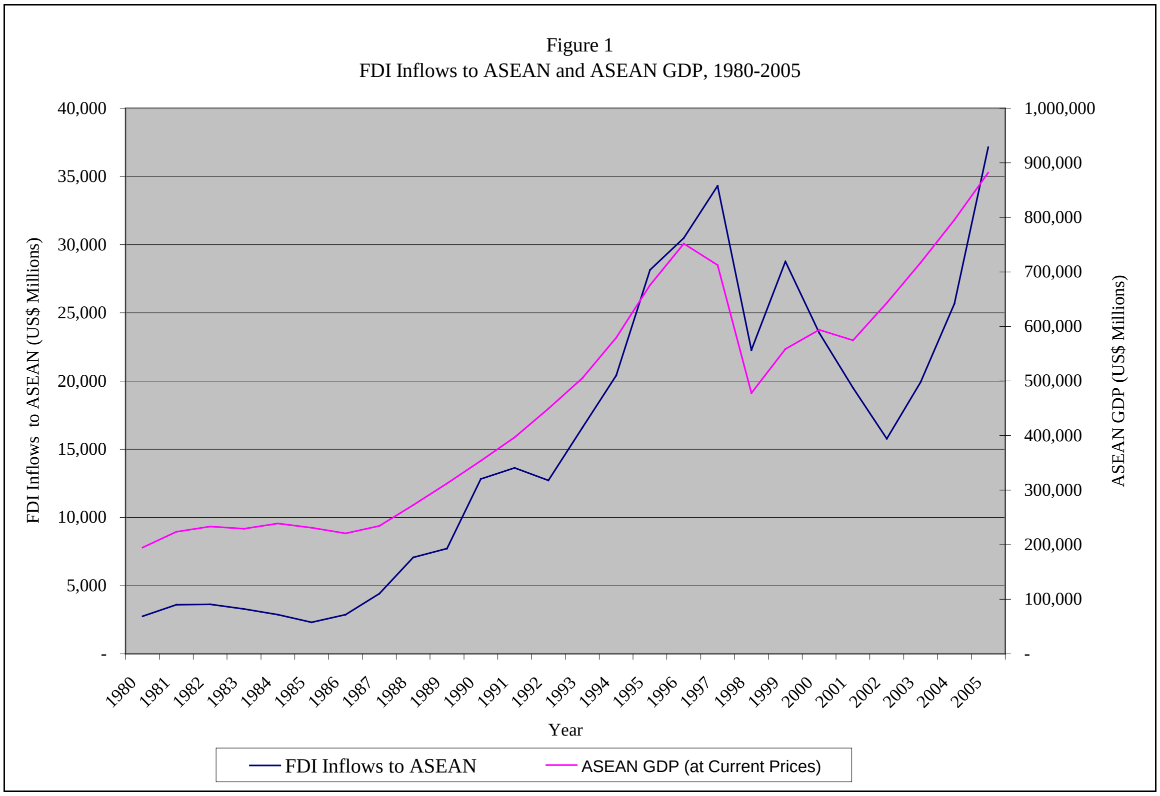
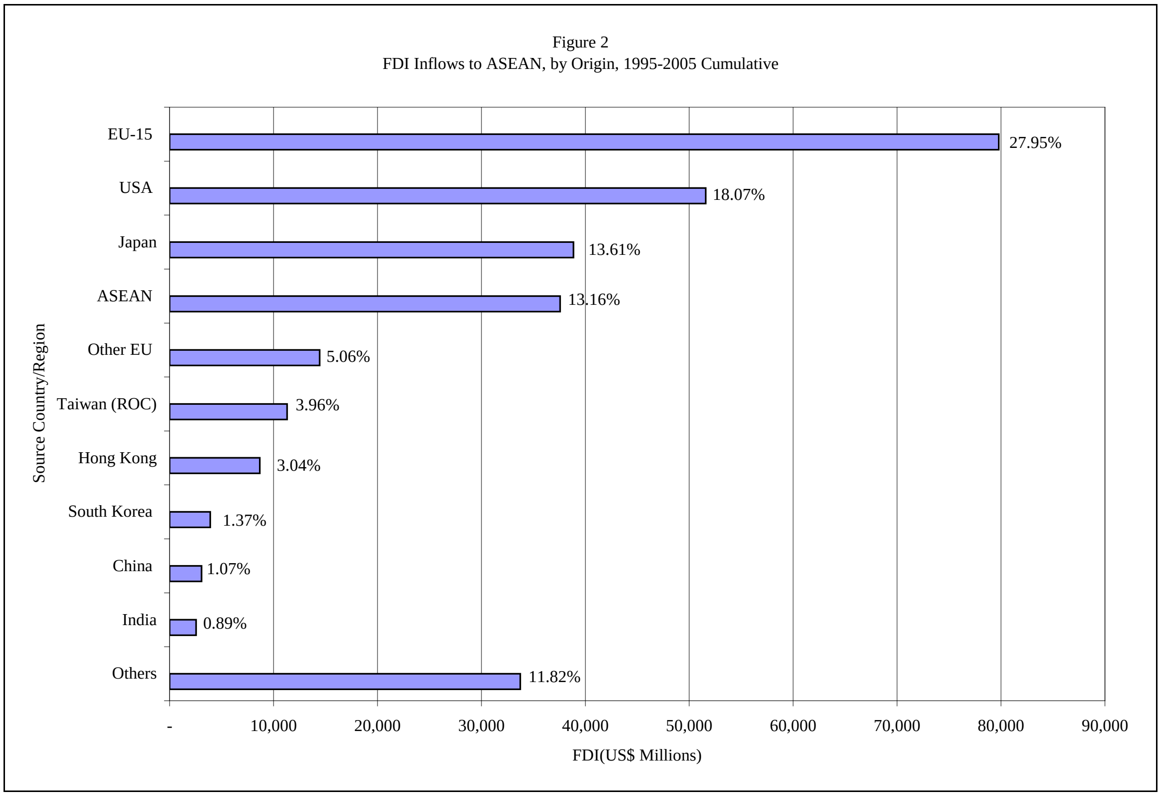


Figure 1
FDI Inflows to ASEAN and ASEAN GDP, 1980-2005

Source of Data: United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2006 for FDI data, and United Nations (UN) Statistics Division 2007 for GDP data

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, There was also no pressure for Korea to move its export production to other countries to circumvent protective policies in the US and the EU and to penetrate the ASEAN markets.

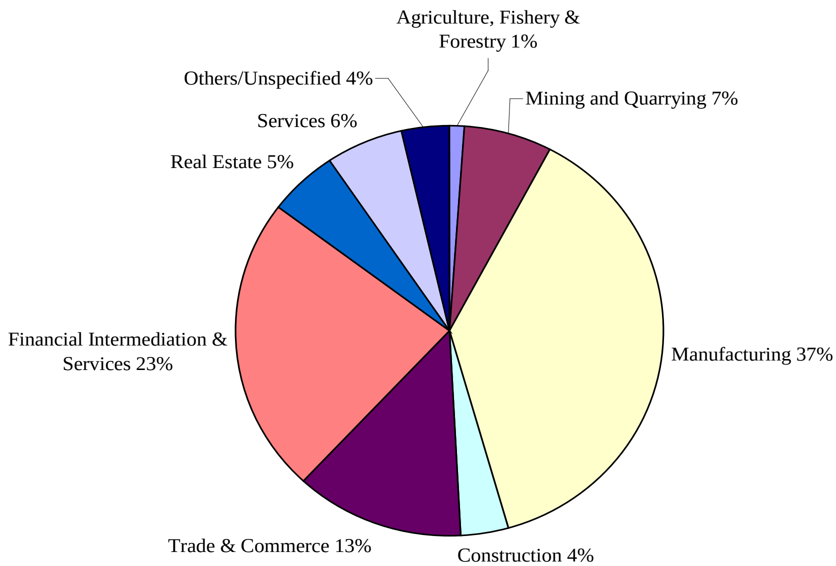


Source of data: ASEAN Statistical Pocketbook 2006

Sectoral shares. More than a third of FDIs in ASEAN in 1995-2005 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. 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 2005).

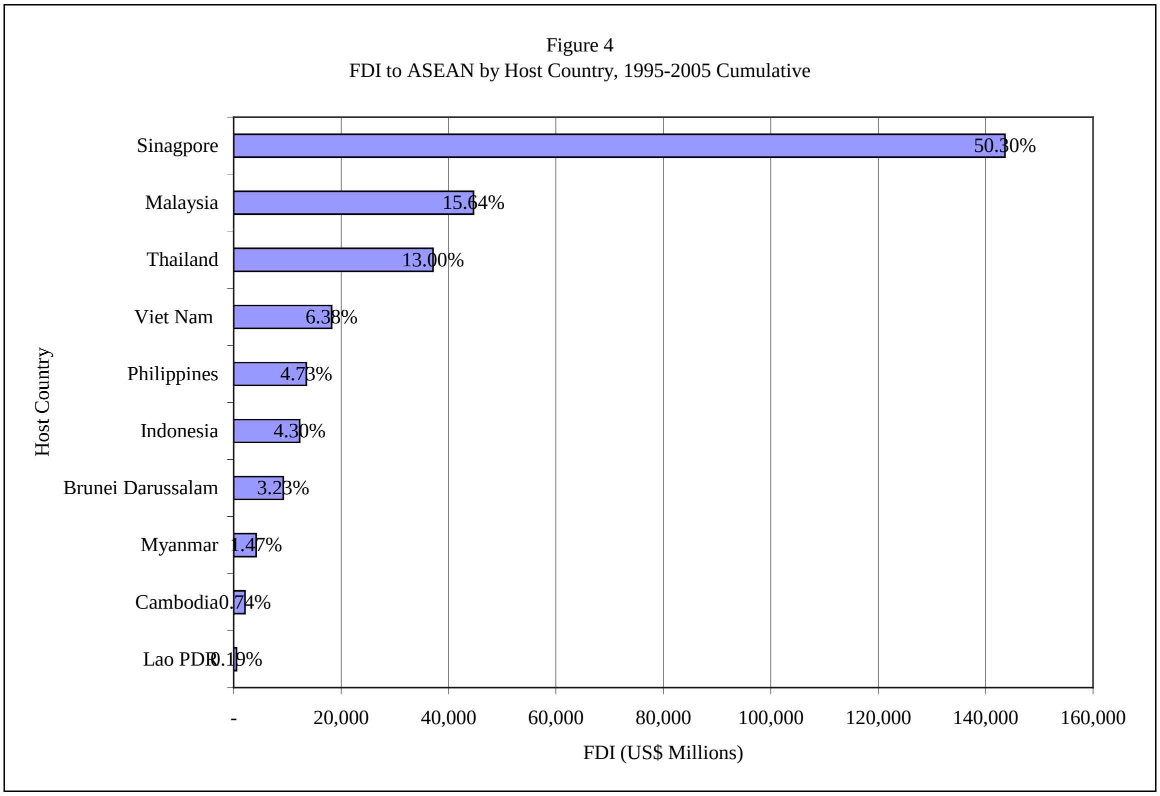
Other segments of the tertiary sector also captured considerable portions of FDI inflows—trade and commerce got 13%, services 6%, and real estate 5%. Only one extractive industry in the ASEAN remained to be lucrative for foreign investors—mining and quarrying which took in a reasonably substantial 7% of total FDIs in the region. Agriculture, fishery and forest-based extractive FDIs were already saturated in Malaysia, Thailand, and the Philippines in the 1970s and early 1980s. Hence, the miniscule 1% share of the sector was accounted for by Vietnam, Indonesia, Lao, and Myanmar (Figure 3).

Figure 3
ASEAN FDI Inflows by Sector, 1995-2005 Cumulative



Source of data: ASEAN Statistical Yearbook 2005

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 then 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 explained the negligible shares of these countries.



Source of data: UNCTAD World Investment Report 2006

The uneven distribution of FDIs among ASEAN members countries during 1995-2005 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. Older players, Indonesia and the Philippines, were far behind newcomer 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		FDI to GDP ratio
	ASEAN FDI	ASEAN GDP	
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 Darussalam	3.23	0.72	18.02
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

FDI Issues in ASEAN member countries

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.

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%.

The financial sector received the biggest chunk, 39%, of FDIs to Singapore in 1995-2005. Singapore, together with Hong Kong, had long attracted financial sector FDIs from western countries. Asian headquarters of major banking institutions in the US and Europe were located mainly in these two countries. Manufacturing's 35% share ranked only second to the financial sector. Another major recipient of FDIs 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.

There were three things that concerned foreign investors in Singapore during the period. One was the twin problem of shortage of skilled labor and high cost of living. Two was excessive government participation (e.g.: a number of private companies were partly held by the government) and intervention in economic activities (ADB, 2000a). And three was the overcapacity in manufacturing, financial intermediation, and trade and commerce brought about by massive FDI inflows in these sectors (ADB, 2000b)

Malaysia. Like Singapore, the Malaysian economy showed resilience in the face of the Asian financial crisis. Though the economy contracted by 7% in real times 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 for several years during the period. 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.

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 had 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 FDIs 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. There was much concern about how long the situation could prevail (ADB, 2004). The service 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.

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

The other major concern of foreign investors in Malaysia was the dominating presence of government in business. The country's major economic sectors were dominated by so-called government-linked companies (GLCs) to which some investments supposedly for infrastructure projects and the development of other sectors were channeled. There was 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. It maintained most of its pre-crisis restrictions on foreign participation in the sector (Chua, 2005).

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.

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.

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 FDIs 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.

The influx of manufacturing FDIs in Thailand in the eighties and early nineties resulted in shortages of skilled labor and labor costs higher than its competitors (ADB, 2002). Consequently, labor-intensive manufacturing FDIs were diverted away from Thailand and toward its Asian competitors, particularly, China and India. Thailand's economic growth was accompanied by moderate increases in over-all productivity. However, as in the case of Malaysia, there were very little improvements in technological capabilities and comparative advantage due to deficient research and development initiatives and poor education system.

Vietnam. Vietnam's rapid economic growth of more than 7% per annum in real terms in the last decade brought in waves of FDIs. 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 FDIs 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.

Two-thirds of FDIs inflows to Vietnam in 1995-2005 were from neighboring Asian countries. The biggest investing country was Japan with a 15% share. 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. This cushioned the reduced inflows from the crisis-distressed Asian investors.

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. 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 had 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 (Freeman, 2002a).

Like all the other ASEAN countries, there were constraints to the continuous influx of FDIs in Vietnam. One was the heavy state intervention in economic activities, such as 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, 2002b). Corollary to the above, there was some skepticism about the prospect of continuing economic reforms as the government persisted to impose a number of business restrictions. In the equity market, for instance, foreign ownership was limited and foreign institutional investors were not allowed to participate. Another major hurdle in further increasing FDI inflows was the lack of coordination among various FDI-licensing government agencies. As FDI licensing was assigned to different agencies, a license given to a particular FDI project by one government agency could be revoked by another agency during project implementation.

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, 2005a). 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.

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. 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%).

The continuing lack of foreign investor's confidence and interest in the Philippines could be attributed to a number of factors (ADB, 2005c). One was the uncertainty about the sustainability of recent economic gains. Political scandals kept cropping up, and this perpetually shaked political and economic stability. Two, public sector debt remained to be substantial. Despite improvements in its revenue collection and expenditures, government continued to absorb the debts of government-owned corporations. Three was the country's poor infrastructure, particularly transportation and power. Cargo handling was very costly due to poor roads and maritime transport. Four was 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 were higher compared to other Asian countries (e.g.: China and Vietnam) and regulations on hiring and firing of workers were keeping firms from maintaining optimal employment levels.

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 also 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 reduced its share to only 9%.

As Indonesia was 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%. 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, 2005). Indonesia has abundant natural resources in different regions of the country that could be explored and efficiently utilized through FDIs. Due to low levels of FDIs and as the large share of the little FDIs that came went to the manufacturing sector, there had not been sufficient investments in resource-based sectors (Nugroho, 2005).

Several factors prevented the return of FDIs to Indonesia, most important of which were economic and political factors. Added to its long history of conflict and a high incidence of human rights violations were the confusion over private property rights and the loss of confidence in its legal and judicial system brought about by the decentralization program. There were instances of local governments filing cases to claim ownership over foreign businesses with court's ruling in favor of the provincial governments and the local governments taking over the operations of the foreign firms (Gray 2002). Disagreements between national and provincial governments further diminished government's credibility.

Apart from economic and political stability concerns, there were other deterrents to FDIs in Indonesia (Nugroho, 2005). One was poor infrastructure. Power outages, transport failures, and inadequate water supply were prevalent in provinces, and this had stalled many business operations. Telecommunications and electricity connections were difficult to acquire (ADB, 2005b). Two was the unsound financial position of the government. In 2002, interest payments on the huge public sector debt were about 5% of GDP (Gray, 2002). Further, the Indonesian government controlled more than three-fourths of the total assets of the commercial banks and much of the corporate debt in the country remained unrestructured. Three, the planned privatization program of the government to fix its fiscal finances did not make headway. Finally, among the ASEAN member nations, Indonesia had the most prohibitive investment list. Although the government recently opened up a few sectors such as telecommunications, power generation, transmission and distribution, shipping, drinking water supply and atomic power generation, foreign investments in such sectors still required the investors to tie up with local partners.

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 fell to less than US$300 million.

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 a share of 43%. 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. Most of FDIs in Brunei went to the gas and petroleum sectors. Hence, mining and quarrying had the lion's share—69% of total FDI inflows from 1995-2005.

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 was not sustained due to a number of factors (Nezu, 2005). One was the lack of data and information needed by foreign investors to assess their risks and expected returns. The government rarely gave out reports on its key economic statistics. With this information asymmetry, risk-hedging foreign investors were forced to limit their investments in Brunei or were altogether discouraged to invest in the country. Two was the lack of transparency in the government (e.g.: regulations on foreign investments are often changed without consultation). Three was the dominance of government in business. Majority of the firms were government-owned. Although its government was considerably financially stable, the high dependence on the public sector was nonetheless a concern (Nezu, 2005).

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 brought down the country's economy. Political repression in Myanmar resulted in 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%). Manufacturing got the largest share (42%) of FDIs, followed by mining and quarrying (23%), and then services (12%) and real estate (11%).

Apart from the repressive political regime, poor domestic economic conditions deterred FDI flows to Myanmar. The economy suffered from inefficient state enterprises (that were given special privileges), large budget deficits and an unbridled inflation scenario (Hsieh, 2005). Other problems included inadequate and weak legal infrastructure and enforceability, poor physical infrastructure, weak banking and financial markets, inadequate property right protection, and currency controls. Myanmar also faced stiff competition from transitional economies especially those from the former Soviet Union and those of Eastern Europe. The said transitional economies were more attractive to FDI as they were relatively closer to both China and Europe.

Cambodia. Political order was restored in Cambodia in 1998. The improvement in the political arena brought about economic growth that reached double-digit levels in 2004 and 2005.

Up to the year 2000, most or all of FDIs 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 FDIs. In 2005, multilateral institutions extended an unprecedented US$300 million worth of FDIs and once again dominated Cambodia's inward investments while level of FDI inflows from private firms remained more or less the same. The bulk (78%) of FDIs in Cambodia in 1995-2005 were from multilateral institutions. The remaining 22% were accounted for by China (7%), Taiwan (4%), South Korea (3%), ASEAN (6%), and North America (2%).

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

Lao PDR. Having the smallest GDP among ASEAN countries, Lao PDR had the lowest levels of FDI inflows. The low and even weakening 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.

FDI opportunities in Lao were quite limited. There was only one major growth sector—hydropower, and FDI inflows were concentrated in the sector. The level of FDI flows was largely a function of hydropower project developments. Flows increased when hydropower projects were approved and implemented while a lack of hydropower projects translated 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.

Prospects of increasing FDI inflows to Lao were low. The country's communist regime was 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 arrived in the country mainly in the form of official development assistance. The government had very limited experience in handling private capital and was not yet equipped to take on the task of attracting, retaining and managing FDIs. Approvals coming from the Lao government for FDI projects were noticeably slow, and project implementation was even slower.

SWOT Analysis

Strengths. 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 had earlier offered attractive fiscal incentive schemes (consisting of preferential tax rates, investment allowances, and subsidies) for foreign investors. Physical, commercial and legal infrastructure was 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 were already in ASEAN and had accumulated tangible and intangibles assets in the region. It would only be in these investing countries' interests to see the region grow further and would, 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 the region.

Weaknesses. Due to fiscal constraints and government corruption, some ASEAN countries (namely, Indonesia and Philippines) lagged behind others (i.e., Singapore, Malaysia and Thailand) in putting up the infrastructure facilities required by foreign investors. The Philippines and Indonesia had poor roads system and heavy traffic, poor marine transport system and high shipping costs, and unreliable and expensive power supply. One weakness, that could be found even in the relatively more advanced ASEAN countries of Malaysia (Abidin, 2002) and Thailand, was insufficient research and development (R&D). Deficient human resources development programs also resulted in the low absorptive capacity of ASEAN industries. Domestic firms and manpower were unable to fully absorb and adopt new technologies brought in by foreign firms. Support industries that could service and supply foreign firms with their input requirements were not able to develop. In the case of the Philippines, Indonesia, the newer ASEAN countries, and to a less degree, Thailand, the problem was 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) was hard to occur, and long-run improvements in labor productivity and competitiveness were not realized (Lee and Tan, 2006). Further, there was 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 did not allow a level playing field thus discouraging foreign investments in the sector. Finally, several ASEAN countries were struggling to address a number of institutional weaknesses—corruption, unclear property rights laws, underdeveloped corporate governance, poor law enforcement, and state activism.

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 were 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 robustness of the recovery was seen as the positive impact of efforts toward regional integration. All ASEAN countries together would 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 was 20% more and its exports ten times as large.

A particular growth driver for ASEAN FDIs was the restructured and revitalized Japanese economy. After ten years of recession, Japanese firms were again posting record-high operating income and record low interest-bearing debt to cash flow ratio (JETRO, 2007). Japanese firms were with excess cash flows that were waiting to be invested domestically and internationally (Kobayashi, 2005).

Threats. ASEAN countries have been faced with more intense competition for FDIs in recent years. Global firms invested 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 had become more selective in choosing an export plant location as more alternative host countries, such as China and countries in Central and Eastern Europe, had emerged with the end of the cold war. Although ASEAN member countries were getting relatively good evaluation in terms of the business environment and incentives to foreign investors (Mirza, 2002), they had no absolute advantage. Regional blocs and free trade agreements (FTAs) involving other developing countries also threatened to divert FDI flows away from ASEAN (Huang, Morck and Yeung, 2004). For instance, with the North American Free Trade Agreement (NAFTA) and the expansion of the EU, developing countries in these regional economic blocs became increasingly more attractive as FDI hosts.

China was the biggest threat to ASEAN. China began to open its doors to foreign investors in 1979. China had extremely low-cost labor and abundant natural resources that attracted the profit maximizing export-oriented global firms. In the early 1990s, China started to provide a sufficiently friendly business environment and 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 was clear that China had risen as the most promising market in the world. As such, China had lured much of the global capital to its shores.

Concluding Remarks

ASEAN had shown other developing countries how to utilize FDIs to achieve economic growth. With growth, income levels in the region increased and the initial comparative wage advantage of ASEAN over other developing countries was diminished. The waning interests of global firms in ASEAN was the result not only of the prolonged stagnation in ASEAN countries triggered by the Asian financial crisis. There was a host of other factors, namely, increasing competition from other developing countries and transitional economies, worldwide economic slow-down, and fundamental weaknesses of the ASEAN economies.

Factors that could boost resilience of FDI ASEAN member countries to external shocks would include: (1) ASEAN integration, particularly the harmonization of FDI policies and corporate laws and regulations that could enable global firms to integrate their operations across ASEAN; (2) financial sector reform and liberalization; (3) improvement in the business environment—physical infrastructure such as road networks, sea and airport systems, and institutional infrastructure such as transparency of laws and rules, elimination of corruption and bureaucratic red-tape; and (4) more investments in R&D, education, and human capital development.

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