

Key Issues:

- ASEAN vitalises interregional business activities through foreign direct investment.
- ASEAN has been refocused as an investment destination.
- ASEAN member states are expected to further advance the ASEAN Economic Community.
- ASEAN must deepen economic integration and narrow development gaps in the region.
- ASEAN is still an essential and integral part of global value chains.

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In writing this policy brief, the author learned a lot from the writings of Ryuich Ushiyama, Koichi Ishikawa, and Kazushi Shimizu. The author would like to extend special thanks to them.

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ASEAN as an FDI Attractor: How Do Multinationals Look at ASEAN?

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This policy brief presents an overview of the ASEAN economy in terms of its economic relationship with multinationals, particularly Japanese companies, that have long invested in this region. ASEAN has been an attractor of foreign direct investment (FDI). Business interest in ASEAN has increased again recently due to the (i) relatively low wage of ASEAN compared to China, (ii) establishment of the ASEAN Economic Community (AEC), (iii) economic partnership network with a core of ASEAN countries, (iv) large-scale market covered by ASEAN, and (v) rise of CLMV countries (Cambodia, Lao PDR, Myanmar, and Viet Nam). In these trends, ASEAN has established a reciprocal economic relationship with other countries and regions. To develop its economy, ASEAN member states are expected to further advance the AEC at a high level. Hence, ASEAN must address challenges such as deepening further economic integration and narrowing development gaps in the region. Most importantly, ASEAN still needs to increase the attractiveness of its 'whole region' as an essential and integral part of global value chains to draw further FDI.

Introduction

Since its establishment in 1967, ASEAN has opened its markets to both ASEAN member economies (AMEs) and to outside countries and regions to vitalise interregional business activities through foreign direct investment (FDI) of multinationals. Due to such an openness policy, ASEAN has successfully achieved rapid economic development and has acted as a 'growth centre' in the global economy, occupying a central position in the production networks that have been organised in East Asia.

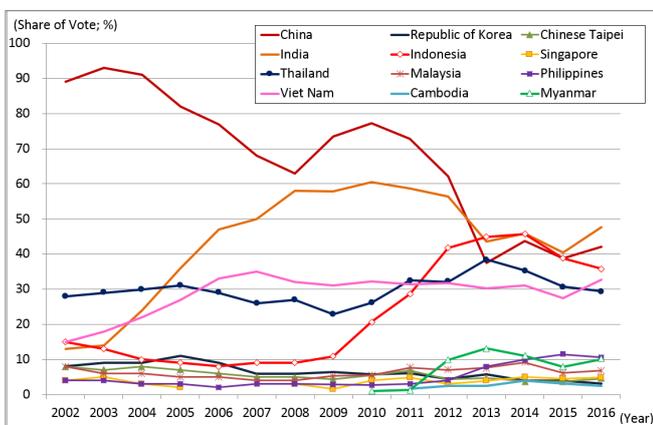
ASEAN has made modern economic history for over half a century in tandem with foreign economies. Japanese companies, like those of the United States and the European Union, are typical multinationals that have intensively invested in ASEAN to take most advantage of the production networks in the

region. Since this close economic relationship between ASEAN and Japan has been long established since World War II, it would be helpful to view the ASEAN economy through the lens of Japanese companies. This examination can provide a useful indication to derive hints on the future challenges of ASEAN which intends to maintain fruitful involvement with multinationals.

In the 1960s, the economic relationship between AMEs and Japan was intensified through the production bases of Japanese companies built in Malaysia and Thailand to develop the automobile and the home appliance industries, for example. The Plaza Agreement of 1985 that brought about the significant appreciation of the yen accelerated the relocation of industries from Japan to these two countries. This relationship reached a turning point in the 1990s when China entered the global market with its reformed economic system. Japanese investors, finding China's economy more attractive, increased FDIs in China during this period and inevitably started to lose interest in the ASEAN market. The severe shock that ASEAN experienced caused by the 1997 Asian financial crisis further aggravated such investors' disinterest.

Notably enough, however, we see from the following survey data that Japanese companies have rediscovered the attractiveness of the ASEAN market since the 2010s. This seems to be one reason for the efforts to build the ASEAN Economic Community (AEC).

Figure 1. Promising Countries/Regions for Japanese Business Deployment in the Medium Term (around 3 years)



Source: Japan Bank for International Cooperation (JBIC), Survey Report on Overseas Business Operations by Japanese Manufacturing Companies.

Figure 1 and Table 1 both illustrate the results of the survey report that asked Japanese companies which countries or regions are promising to conduct business in the medium term, around 3 years. The presence of AMEs, especially Indonesia, has been recently comparable to China and India (the order of the ranking in 2016 is India, China, and Indonesia), while Thailand has been in the decreasing trend in the last few years. In 2016, all AMEs, except Brunei Darussalam and Lao PDR, got into the top-20 ranking as a whole; intriguingly Cambodia and Myanmar have begun to join this ranking since 2010s.

Table 1. Promising Countries/Regions for Japanese Business Deployment in the Medium Term (around 3 years): 2016 Results

Ranking	Country
1	India
2	China
3	Indonesia
4	Viet Nam
5	Thailand
6	Mexico
7	United States
8	Philippines
9	Myanmar
10	Brazil
11	Malaysia
12	Singapore
13	Chinese Taipei
14	Germany
15	Russia
16	Republic of Korea
17	Cambodia
17	Turkey
19	Australia
20	Iran

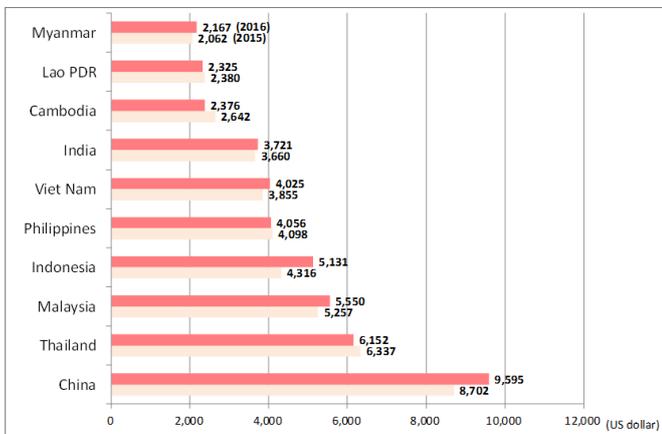
Source: Japan Bank for International Cooperation (JBIC), Survey Report on Overseas Business Operations by Japanese Manufacturing Companies.

Some significant factors seem to encourage investors to refocus on ASEAN. These factors can be divided into (i) the relatively low wage of ASEAN compared to China, (ii) the establishment of the AEC, (iii) the economic partnership network with a core of ASEAN countries, (iv) the large-scale market covered by ASEAN, and (v) the rise of CLMV countries – Cambodia, Lao PDR, Myanmar, and Viet Nam (Ushiyama, 2015)¹. Hereafter, I will deepen the debate based primarily on his framework.

¹ Ushiyama (2015) points to 'CLM' countries, but I include Viet Nam in this category as an important emerging economy in the Mekong region.

With respect to the first factor, rapid wage growth in China is becoming much more crucial for multinationals that are exposed to fierce competition in the global market. As Ushiyama also presents, Figure 2 illustrates the estimated annual total cost per worker of Japanese manufacturing companies in fiscal years 2015 and 2016. From this we can observe that China records a prominently high wage in 2016 (US\$9,595), about twofold that in Indonesia (US\$5,131) and still higher than Thailand (US\$6,152) and Malaysia (US\$5,550). These statistics show that the wage level of AMEs (especially CLMV countries) remains lower than that of China.

Figure 2. Annual Total Cost Per Worker of Japanese Manufacturing Companies (2015, 2016)



Note: The total cost includes base salary, bonus, various benefits, social security, and others.
 Source: Japan External Trade Organization (JETRO), Survey Report on Business Operations of Japanese Companies in Asia and Oceania.

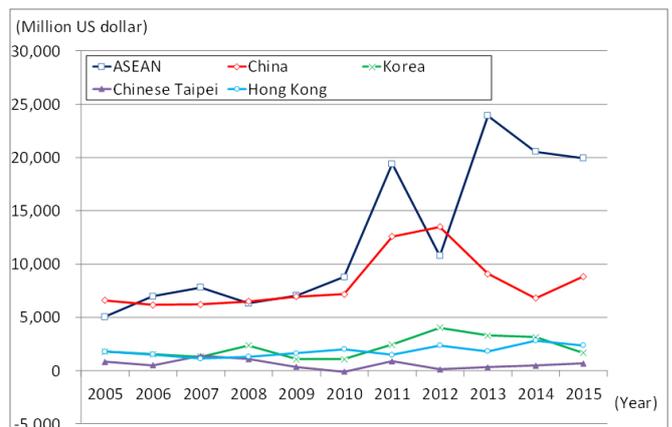
Let us consider the second and third factors collectively. Although the AEC was officially established with two other communities at the end of 2015, the substantial movement to economic integration in the region started a long time before (the AEC was established ahead of the initial schedule, 2020). This is exemplified by the fact that developed AMEs eliminated almost all tariffs by 1 January 2015. CLMV countries also did, with some exceptions under the ASEAN Trade in Goods Agreement (ATIGA), which increased the ratio of 0 percent tariff lines to 96 percent in the whole ASEAN. Moreover, various economic reforms have been in progress, such as the improvement in the rules of origin;

the ASEAN Single Window programme; the liberalisation of investments, services, and movements of natural persons, and others.

On top of these, an economic partnership network centring on ASEAN has been created with the following Asia-Pacific countries: China, Korea, Japan, India, Australia, and New Zealand. Additionally, individual AEMs have established bilateral free trade agreements (FTAs) with developed countries outside the region. For example, Singapore, Malaysia, Thailand, Brunei Darussalam, Indonesia, and Viet Nam concluded FTAs with Japan. The AEC and the FTA networks have largely benefited Japanese companies that deploy their business activities in ASEAN, thereby encouraging them to develop their production and export linkages globally within and beyond ASEAN. Overall, these foreign policies enable ASEAN to maintain the significant position of an FDI attractor in the global economy.

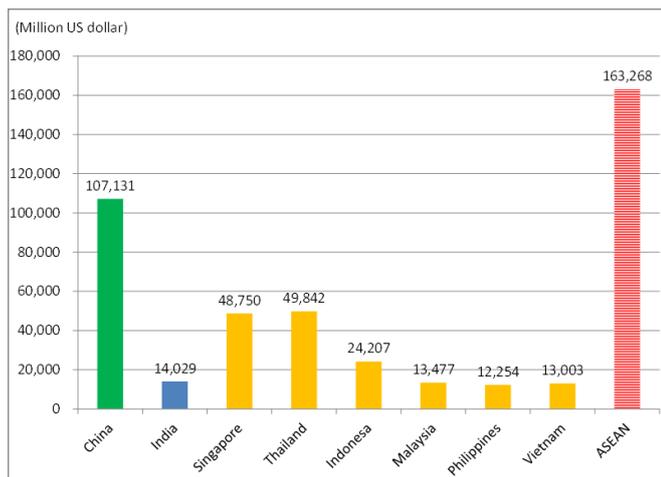
Figures 3 and 4 show that both FDIs from Japan to ASEAN and trade values between them have increased compared to the past. Although exports and imports are affected by the downturn in the world economy in these years, the trend of FDIs into ASEAN is strong and rather stable from around US\$20,000 million to US\$25,000 million. These statistics demonstrate that economic relationships between ASEAN and Japan have become reciprocal.

Figure 3. Foreign Direct Investment of Japan



Note: The figures are transformed from Japanese yen to US dollar based on Principal Global Indicators.
 Source: Ministry of Finance, International Balance of Payments.

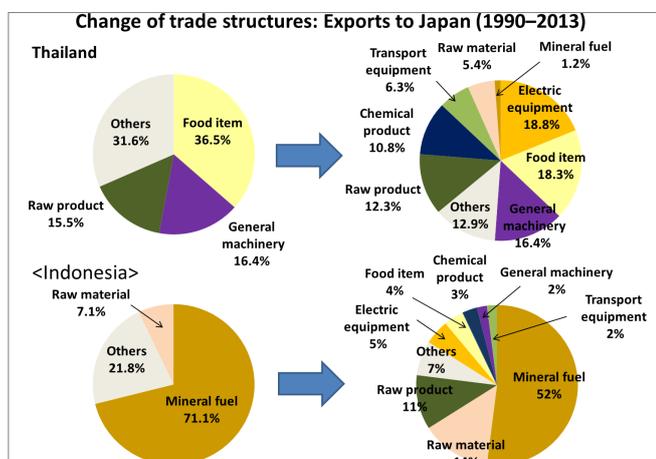
Figure 4. Trade Values of Japan and ASEAN



Source: CEIC Data.

Data on exports to Japan from ASEAN reveals the change in the trade structure as well. In Figure 5, Thailand exported mostly machinery to Japan in 2013 compared to food items in 1990. Indonesia's exports consisted largely of mineral fuel and raw material in 2013, but at the same time had diversified into electric equipment and other manufacturing products. Hence, we also need to be aware that the trade and investment structure between ASEAN and Japan has been shifting from 'vertical' to 'horizontal' specialisation (Ishikawa and Shimizu, 2015). This change of trade structures implies that some AMEs have been steadily or gradually achieving their industrial advances and that useful production networks between ASEAN and Japan have been established.

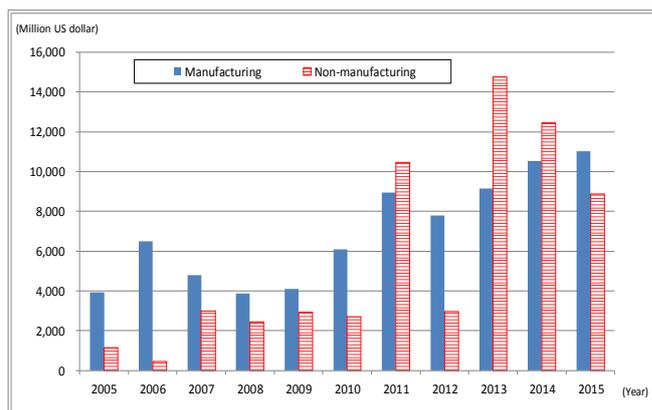
Figure 5. Change of Trade Structures: Exports to Japan (1990–2013)



Source: ASEAN-Japan Center, ASEAN Information Map.

Fourth, wealthy and middle-income classes rise in tandem with abundant younger generations, which leads the ASEAN economy to a large-scale consumption market. Multinationals find that demand for services, such as for food, retail, and tourism, are rapidly growing. Figure 6 clearly shows that FDIs of Japanese non-manufacturing industries (including service industries) in ASEAN are currently comparable to those of manufacturing industries. Table 2 further illustrates that non-manufacturing sectors seem to have increased more employment than before in response to Japanese investments in local shareholding companies of AMEs. (Data for Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam is available.) Accordingly, the lesson from this observation is that to attract more FDIs, AMEs need to further improve the 'business environments' of service industries by reducing barriers to investment and eliminating unnecessary regulations.

Figure 6. Japanese Foreign Direct Investment in ASEAN



Note: The figures are transformed from Japanese yen to US dollar based on Principal Global Indicators. Source: Bank of Japan, Balance of Payment Statistics.

Table 2. Employment Created through Foreign Direct Investment in Non-manufacturing Industries

	2000	2014
Indonesia	19,495 (7.0%)	61,919 (15.1%)
Malaysia	21,977 (8.6%)	38,305 (21.4%)
Philippines	10,481 (7.4%)	44,584 (20.1%)
Singapore	22,385 (30.1%)	50,293 (56.8%)
Thailand	30,771 (9.3%)	95,200 (13.6%)
Viet Nam	2,729 (7.5%)	32,122 (8.7%)

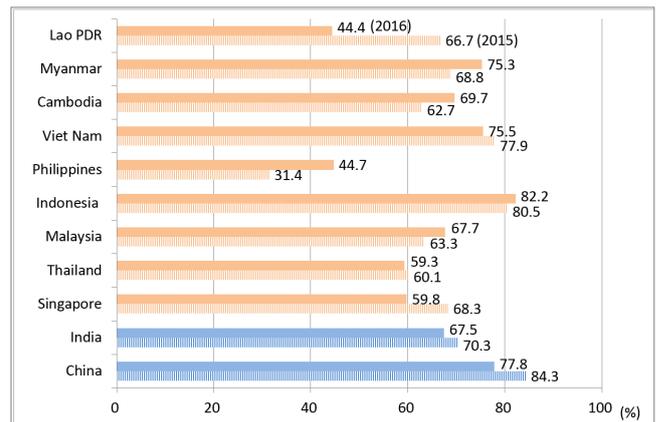
Notes: 1) The percentage means the ratio that accounts for total industries. 2) The figures include Japanese employment in local shareholding firms. Source: Ministry of Economy, Trade and Industry, Survey of Overseas Business Activity.

Lastly, the fifth factor has been markedly conspicuous in recent years. The rise of CLMV countries gets much attention from companies around the world. Indeed, Japanese companies in the apparel, automobile parts, and electric appliance industries, for example, move into the industrial estates of these countries. As can be seen in the second unbundling such as ‘Thailand+I’, supply chains are further deepened throughout ASEAN to the extent that the production networks of multinationals have penetrated CLMV countries.

From the above, assessing the ASEAN economy, we see that AMEs can promote domestic manufacturing industries and can increase exports of manufacturing products due to investments by multinationals, particularly Japanese companies. Thus, whereas Japanese firms have found more external business opportunities in ASEAN and have achieved economic globalisation by increasing export-oriented investments and cultivating consumption markets, ASEAN has achieved its economic development as a significant production base in the world (Ishikawa and Shimizu, 2015). This so-called ‘win-win’ relation has been enhanced through efforts based on the AEC and the FTAs centring on ASEAN, where the production networks realised by horizontal trade structure have been consolidated into the two economic entities.

However, to further increase the attractiveness of its economy to foreign investors, ASEAN needs to address the following challenges. Wages of local employees, which used to be a relatively strong factor of ASEAN compared with China’s, as explained in the first factor, have been progressively rising. Figure 7 points to wage rise as one critical managerial problem for Japanese companies, particularly those in Indonesia where 82.2 percent of Japanese companies raise this wage problem. AMEs might then find it difficult to attract FDIs soon solely through low wages. Consequently, among others, highly advanced industrialisation, which does not depend anymore on unskilled labour-intensive industries, is strongly required particularly for Indonesia, Malaysia, the Philippines, and Thailand. More precisely, there is a growing concern that these middle-income AMEs may suffer from the so-called ‘middle-income trap’ where their income levels stagnate at current levels before arriving at the high-income ones. To escape from such middle-income trap, AMEs need to nurture their competitiveness in the global economy through innovation.

Figure 7. Managerial Problems: Wage Rise in Employees



Source: Japan External Trade Organization (JETRO), Survey Report 2016 on Business Operations of Japanese Companies in Asia and Oceania.

What should ASEAN do next to achieve the aforementioned goals as also mentioned in *ASEAN 2025: Forging Ahead Together* (or AEC Blueprint 2025)? So far, considering the changing structure of trade and investment, a wage rise in ASEAN, and the current mood for protectionism, the answer is quite simple from the review: to realise the AEC at a high level. To achieve this, two long-standing issues must be addressed.

First, it is imperative to further economic integration to attract FDIs. AMEs will benefit from the mega FTAs that connect them to broader global value chains (GVCs). In addition to the Trans-Pacific Partnership (TPP), the immediate conclusion of the Regional Comprehensive Economic Partnership (RCEP) is also important for regional multinationals. This is because only RCEP can integrate fully the markets in the Asia-Pacific region, including Japan, China, India, Korea, Australia, and New Zealand. In other words, although ASEAN+I FTAs connect ASEAN and its economic partners on a ‘one-on-one’ basis, only when RCEP is concluded can we consolidate the Asia-Pacific region as an enormous integrated market in terms of goods trade, service liberalisation, and so on (Fukunaga and Isono, 2013). In a nutshell, driving RCEP should be considered efforts to further consolidate the AEC. Presently, RCEP negotiations are said to be facing difficulties in agreeing with high-level liberalisation among the 16 countries. As Kimura and Chen (2016) recommend, the possible direction ASEAN could take without discouraging some countries is a pragmatic and systematic approach that can be certainly

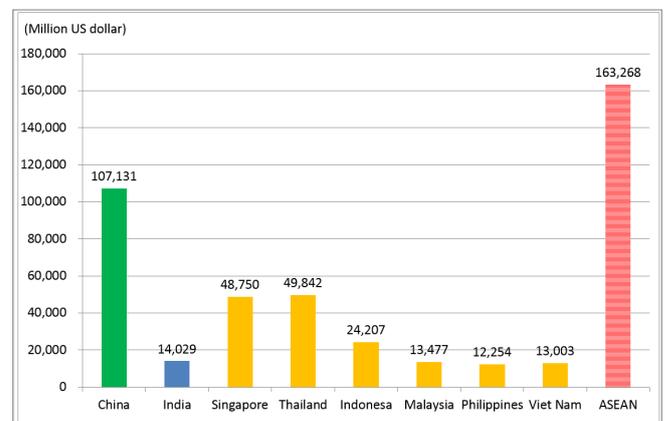
concluded by RCEP members, and subsequently upgrade RCEP to incorporate the disciplines of TPP and other mega FTAs.

Furthermore, ASEAN needs to do much regarding economic integration. AMEs should further pursue economic connectivity considering both hard and soft infrastructure. To reinforce connectivity, AMEs should improve the efficiency of hard infrastructure by focusing on its quality in addition to quantity, contributing to sustainable economic development in ASEAN. With respect to soft infrastructure, for example, many problematic non-tariff measures (NTMs) could exist in the region. Relying on the most comprehensive NTMs database, Ing et al. (2016) assert that it is important to embed dynamic disciplines, in which we break up NTMs to national issues aimed at driving better regulations. For ASEAN to continue to attract FDIs, liberalisation should not only be explored; transparent regulation standards applied to multinationals should also be disseminated across all AMEs. While I do not intend to raise all necessary measures along with this discussion because of space constraints, it is significant for ASEAN to recognise and deal with problems that hinder smooth flow of investment.

Second, ASEAN needs to keep its focus on narrowing development gaps between and within the regions to obtain ‘thicker’ ASEAN domestic consumption markets. Rich consumers are emerging with the rise of wealthy middle income household. To this end, developed AMEs and other economic partners, including Japan, need to lead in infrastructure development, technology cooperation, capacity building of small and medium-sized enterprises, nurturing of local supporting industries, etc., especially for CLMV countries. Enlarging the ASEAN market also benefits local companies that aim to enter other AMEs.

Before I conclude, I would like to call attention to the actual status of ASEAN. Figure 8 indicates that whereas the FDI stock by Japan in individual AMEs is much less than in China (US\$107,131 million), the total investment stock in ASEAN (US\$163,268 million) is much greater than in China. We should note that this shows what the ASEAN economy is like: each AME has relatively small economic scale compared to China, yet, these AMEs, as a group, constitute a considerable scale. Thus, AMEs still face the risk of falling into economic marginalisation. Figure 8 suggests that ASEAN needs to increase the attractiveness of its ‘whole region’ as an investment destination of multinationals by participating in and playing an essential and integral part of GVCs to become a major economic power in the global market.

Figure 8. Stock of Direct Investment by Japan (2015)



Note: The figures are transformed from Japanese yen to US dollar based on Principal Global Indicators.

Source: Bank of Japan, Balance of Payment Statistics.

Therefore, economic integration by all AMEs, which might be rephrased as ‘ASEAN centrality’, is significant for the region’s development. One solution for ASEAN to survive global competition could be to maintain and enhance regional economic integration, but not to behave individually as small ‘pieces’ in the world. □

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