ASEAN
(ASSOCIATION OF SOUTHEAST ASIAN NATIONS)

and a

POSITIVE STRATEGY for FOREIGN INVESTMENT

Edited by: Lloyd R. Vasey
Pacific Forum

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(Association of Southeast Asian Nations)

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POSITIVE STRATEGY FOR FOREIGN INVESTMENT

Report and Papers of a Private Conference
organized by the Pacific Forum

Edited by: Lloyd R. Vasey

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PREFACE

Since its founding in 1975, the Pacific Forum has devoted a major portion of its efforts to the economic and political problems of the Southeast Asian countries and their inter-relationships with the more industrialized nations. This interest of the Pacific Forum reflects the increasing importance of Southeast Asia, and expecially the Association of Southeast Asian Nations (ASEAN) -- Indonesia, Malaysia, Philippines, Singapore and Thailand.

The ASEAN area is considered to have one of the largest growth potentials for economic development and progress over the next ten years. Its strategic position between two continents and athwart the approaches to the Indian and Pacific Oceans is of major importance. It is rich in natural resources which are still largely untapped, and has an impressive potential as a souce of food for Asia. It has a population of some 250 million with an abundant supply of industrious and lower cost labor. Economic projections indicate high rates of growth and development in the ASEAN area in the years ahead. The ASEAN states themselves have cultivated a close political rapport which provides a significant basis for economic cooperation and a more active collective role in the international community.

Foreign enterprise and direct investment will continue to play a major role in the efforts of the ASEAN countries as they expand their industrial and marketing structures. In the process, occasional policy issues and points of friction between foreign investors and the host countries are bound to arise. This is especially true as the countries now have a clearer picture of what they want to achieve economically. They are placing a greater emphasis on national self reliance and are increasingly sensitive to trade imbalances and external factors which might affect their internal social situations. But to the foreign investor who must risk time and money, it sometimes appears that the resultant investment rules and policies are unfair and onerous.

The Pacific Forum recently convened in Manila to focus on these major points of issue in light of the anticipated "policy climate" for foreign investment in the ASEAN region. The meeting was a planned outgrowth of earlier programs held in Honolulu and Singapore where the desire had been expressed for foreign private enterprise to play a more constructive role in contributing to the economic and social development needs of the developing countries of Pacific Asia.

The impressive array of talent and experience brought to bear on the issues by the conferees in the Manila forum is reflected in the papers included in the present volume. We are grateful to conference participant Professor Augustine H. H. Tan of the University of Singapore who agreed to assume the formidable task of distilling from the many fine papers presented and the thousands of words exchanged during the seminar, a succinct summary and analysis of the essential facts, principles and judgments. His analysis of the proceedings provides the basis for "a positive strategy for foreign investment", which was the theme of the Manila conference.

Malcolm MacNaughton
Chairman, Policy Council
Pacific Forum

Lloyd R. Vasey
Executive Director
Pacific Forum

Honolulu
November 1977

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The Pacific Forum wishes to express its gratitude to President Ferdinand E. Marcos, Republic of the Philippines for his kindness in hosting a plenary session of the Forum in Malacanang Palace and for his perceptive and candid remarks on that occasion on the role of foreign investment in the ASEAN region.

* * *

The Pacific Forum meeting in Manila was made possible by the initiatives and generous support of Mr. Sixto Roxas, President of the Bancom Development Corporation of the Philippines, who was active in the planning and logistics of the conference including the provision of an outstanding Secretariat from the staff of Bancom.

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A special acknowledgement is due the Honorable Alejandro Melchor of Manila who in his private capacity, gave freely of his time and invaluable counsel and helped in many ways to make this conference a success.

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Appreciation is expressed to Dr. Jesus Estanislao, Executive Director of the Center for Research and Communications of Manila and his staff for the conference background paper "The ASEAN as an Investment Area: Dimensions of Industrial Growth" included in this volume.

* * *

A highlight of the meeting was the two field trips, one to the Bancom Development Corporation's integrated area development project (Sab-A Basin) located in the northeastern section of Letye, and the other to Castle & Cooke's Dole Philippines, Inc., plantations in the Mt. Mututum area of Mindanao. The Pacific Forum is grateful to the staffs of these organizations for their professional briefings and the tours of the projects.

* * *

Appreciation is expressed to the following for their kindness in "hosting" certain functions:

Ayala Corporation
Castle & Cooke/Dole Philippines, Inc.
Far East Bank and Trust Company
Herdis Management and Investment Corporation
Private Development Corporation of the Philippines
The Honorable Benjamin Romualdez, Governor of Leyte

* * *

The Pacific Forum acknowledges the important role of the speakers who gave so freely of their time in research and in the preparation and presentation of their papers.

* * *

And finally, in the preparation of this report for publication, Mrs. Kathy Wehmeir performed invaluable service.

EDITOR'S NOTE

In lieu of including the details of the discussions of the Open Forum, the major points raised therein are summarized in the paper written by Professor Augustine H. H. Tan.

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SUMMARY

Augustine H. H. Tan

The first major area of concern for host countries and foreign investors in ASEAN would naturally be the security-political outlook. Contrary to early prognostications at the time of the U.S. withdrawal from Vietnam, the super-power balance in the region has been largely unaltered.[1] Apart from Cambodia and Laos, no dominoes have fallen. The U.S. has reiterated her intention to be a major Asian Pacific power. Her military strategy in this part of the world has unquestionably changed. The latest manifestation of this is her announced withdrawal of troops from South Korea. The ASEAN countries appear quite resigned to the change though there is some anxiety about future U.S. actions lest the super-power balance is changed significantly.[2] On the positive side the Chinese-Soviet rivalry is probably helpful in preserving big power equilibrium in Southeast Asia. Hopefully too, Vietnam may be preoccupied with problems of food, employment and reconstruction.[3]

The ASEAN countries enjoy political stability. The changes of government in Thailand involve military personalities for the most part - the military and conservative character of the regimes has not been altered. The problems of insurgency in Thailand, Malaysia and the Philippines appear to be more manageable than was predicted. Successful cooperation between Thai and Malaysian security forces has given ground for further optimism. The ASEAN Heads of Government have correctly identified economic development as the antidote to internal subversion. Informal observers therefore expect continuing political stability in ASEAN for the next

decade.[4]

Economically, ASEAN is "considered one of the most promising areas in the developing world for foreign investment.[5]" Frank Zingaro has predicted real GNP growth of 7% per annum for ASEAN till 1980 and 6.5% from 1980-85.[6] The prediction is not overly optimistic as the region has a wealth of natural resources, a favourable climate for agriculture and a population of 250 million which can provide a sizeable market if per capita incomes are raised significantly.[7] More importantly, the countries of the region are committed to free enterprise.

Over the last two years, regionalism has gained significant momentum. Two ASEAN summits have been held. Finance, trade and other officials have held countless meetings. Agreement has been reached on five ASEAN industrial projects and a Preferential Trading Arrangement. Unfortunately, implementation has been tardy. Nevertheless, ASEAN is clearly a going concern. The regular consultations have helped to prevent potential conflict, for example, between Philippines and Malaysia over the ownership of Sabah. Such political and security by-products are immensely important in improving the climate for investment. Political instability and lack of security not only increase business risks but also shorten business horizons. The likelihood of continuing security and political stability in ASEAN will benefit the region by attracting the longer-term and technologically more sophisticated kinds of investment.

ASEAN's trade is primarily with the outside world, in particular, with the developed countries. Its sources of foreign investments are also the developed countries. For these reasons, we have to watch carefully economic trends in the advanced countries.

The economic slowdown in the industrial countries, together with serious unemployment and persistent inflation are matters of serious concern to ASEAN. So far, the economic recovery in the industrial countries has been mainly due to increases in consumption which have enabled greater utilization of existing productive capacity. What is significantly lacking is a healthy rate of new investments. Most economic observers explain this by pointing to two factors. One is the still considerable excess capacity of industrial plants all over the world. The other factor is uncertainty, brought about particularly by the energy crisis. The need for conservation of energy requires re-tooling and adaptation of plants and machine models. The need for producing alternatives to oil, such as coal, gas or nuclear fuels will require substantial capital investment, which will mean a diversion of investment money from productive channels.

Some economists have laid the blame for the current economic malaise on the double-digit inflation which began in 1972, and which was widespread, striking nearly all countries simultaneously. It is held by some that inflation eroded real purchasing power, lowering effective demand, thereby causing the recession of 1974-75. Similarly, the slowness in recovery in the industrial countries has been attributed to the adverse effects of inflation on consumption and investment.

One of the main causes of the virulent inflation is believed to be excessive government spending in industrial countries. This was prompted by concern with attaining full employment as well as by escalating demands for social services and welfare. The result was recurring budget deficits. Such deficits led to higher taxes on the one hand and the excessive issue of money on the other. High taxes unfortunately also robbed the enterprising of incentive for endeavour, hence penalising savings and investment.

The inflation wrought by excessive government spending and excessive money supply was exacerbated by rising trends in prices of energy, food and raw materials. Domestically, in many industrial countries, aggressive trade unions sought compensation for cost-of-living increases, regardless of productivity performance. This led to further price increases via the so-called wage-price spiral. Internationally, inflation was believed to be transmitted and magnified in a number of ways, via trade, changes in exchange rates, balance of payments, and capital flows.

Demographic factors have added to the unemployment problem in the industrial countries. The babies born during the post-war baby boom years are still reaching the job market in great numbers. At the same time, inflation has eroded family incomes to the point where more women are forced to work, thereby adding to the unemployment problem. Moreover, the changing age structure of the population, with fewer babies and children and greater numbers of aged persons, will force major shifts in patterns of production. The excess capacities in schools and colleges and in industries catering to babies and children on the one hand, and excess demand for nursing homes and homes for the aged illustrate the point. In the meantime, household formation by people of marriageable age has been affected by inflation.

Such explanations, however, cannot, in my view, account adequately for the persistent economic problems of the industrial countries today. A number of unanswered questions and contradictions emerge from the conventional analysis. For instance, why was there unparalleled economic expansion with little inflation from 1948 to 1965? If governments were irresponsible in their monetary and fiscal policies in recent years, why were they so virtuous or less irresponsible from 1948-1965? Why did the Bretton Woods system of fixed exchange rates work until 1971-73? If trade unions are irresponsible today why were they not so before, say 1965?

The real explanation is that economic expansion, at least until 1965, was smooth and rapid enough in the industrial countries. When there was sufficient economic growth, government treasuries were flush so that social and welfare programs could be financed without big deficits or increases in money supply. At the same time, with productivity increases, wages could rise without triggering the wage-price spiral. Internationally, balance of payments accounts could be reconciled without unduly threatening exchange rate parities because world trade and capital flows were sufficiently buoyant and liberal.

But what accounted for the smooth and rapid economic expansion? Two fundamental factors were at work. In the first place, in the aftermath of the Second World War, Europe and Japan were in need of reconstruction. The U.S. had the economic wherewithal, was generous with it and supplied the international economic leadership so badly needed. She made available capital and liquidity, directly via Marshall Aid, multinational corporations and via multilateral institutions, while her industries provided the hardware for European and Japanese reconstruction. In other words, there was economic complementarity between the U.S. on the one hand and Europe and Japan on the other. However, by 1958, this economic complementarity had lessened considerably, for not only had Europe and Japan recovered from the devastation of war, they had also developed the capacity to compete with American industry. The Treaty of Rome was a significant turning point. The dollar shortage was to develop into a dollar glut. At the same time, there was also a reduction of complementarity between the industrial countries and developing countries. This was due to the development of chemical synthetic raw materials and great increases in agricultural productivity in the industrial countries.[8]

The reduction of economic complementarity became more and more evident in the increasing economic stresses after 1958. In 1963, the U.S. imposed the Interest Equalization Tax, because of her concern over her deteriorating balance of payments. In August 1971, she ended the convertibility of the dollar into gold; devaluation of the dollar occurred in December of the same year. The second dollar devaluation followed in February 1973, and by March of that year, the Bretton Woods system of fixed exchange rates had broken down, perhaps irreparably. The oil embargo of 1973 and the subsequent quintupling of oil prices helped to push the world into its most serious recession since the thirties.

The other remarkable feature of the post-war period was the <u>widespread</u> nature of the economic expansion experienced by most nations in the world. What gave impetus to this expansion? It was the rapid progress of technological innovations in the industrial countries, particularly the U.S., that provided the engine of economic growth. Technological innovations had three important consequences. One was increases in productivity which resulted in higher standards of living. Another was in terms of qualitative improvements in products and methods of production. The third and most crucial consequence arose from those innovations which spawned spectacular new industries like television, jet travel and digital computers, none of which had existed as commercial enterprises in 1945. The creation of new industries based on technological innovations necessitated new investments, resulting in job creation and higher incomes. The more established industries too, benefited via input output linkages with the new industries. Internationally, the diffusion of new technological processes and products through the well-known activities of the multinational corporations gave impetus to economic expansion.

The depth of the 1974-75 recession, the persistence of inflation, the serious unemployment pervasive in virtually every industrial country and the sluggishness of new investment in those countries can be explained by the same factors that accounted for the inflation-free economic expansion of the fifties and much of the sixties. In the first place international economic relationships, particularly between the industrial countries, have altered from complementarity to competition. More crucially, if there is a slackening of technological innovations, productivity, profitability and investment would be adversely affected. Furthermore, government pump-priming efforts to create employment in such a context would have little success and would only trigger more inflation.

Instability in foreign exchange markets and increasing protectionism in the industrial countries are the outcomes of the deep-seated economic difficulties described earlier. Consequently, investment flows are likely to be impeded. David Heenan's observations[9] point to the same conclusion. In his view, U.S. business since the past two years has become less expansionist worldwide and has become more inward-looking, for three reasons:

- there is the growing attractiveness of home markets;

- there is greater scrutiny by U.S. Government regulatory agencies of U.S. investments abroad; and

- there is the impending expenditure of billions of dollars on rationalizing and stabilizing the U.S. energy situation.

To these important observations may be added Thanat Khoman's comment [10]: "we have to recognize that investments are going to places (U.S., Europe) where there is greater security, greater incentives, greater technical know-how of the people and labour."

ASEAN countries should therefore re-evaluate their investment criteria. Those countries which have too restrictive foreign investment criteria, expecially in regard to local participation in management and capital, and types of investment may find themselves with little to choose from.

The prime motivation of business is profits, not charity or welfare.[11] Without profits, capital equipment cannot be replaced and if losses occur, subsidies from government may be necessary to prevent the enterprise from shutting down. Investors face three types of risks: political, technical and commercial. Investing abroad is usually riskier than at home. Expected rates of return are consequently higher. As Herbert C. Cornuelle put in, "firms already face enough risks without having to include uncertainty over host country policies among their worries."[12] Potential investors naturally look carefully at the track record of the host country.[13]

Once established, the plants of foreign investors, whether oil wells, oil refineries or manufacturing equipment, become potential "hostages". The temptation is great to squeeze more of the economic rent from such established enterprises. In some cases, particularly in the extractive and natural resource-type industries, developing countries may feel that contracts negotiated in the past are exploitative, perhaps because of corruption or ignorance. More favourable contracts are then forced on the investors. This has happened in the case of petroleum and minerals. Whatever the justification for such re-negotiations, the sanctity of contracts is being violated. Potential foreign investors must then add such risks to their calculations. Hence, if ASEAN countries wish to improve our climate for investment, we would do well to honour our past commitments. How we treat established foreign investors will certainly affect the willingness of potential ones to come in.

We certainly need more positive attitudes towards foreign investment. Governments in ASEAN need to have such commitment, not only at the high echelons of government, but also at the operational levels of bureaucracy. David Lyman [14] rightly pointed out that many foreign investors who were enthusiastic after meeting Presidents, Prime Ministers or Ministers of Finance, become disillusioned at the implementation stage. It is the lack of capacity to follow through, as Mohamed Nor bin Abdullah[15] pointed out, that is at the root of the problem.

Corruption raises costs of implementation and production and also injects uncertainty: the price of a license may vary with every change of official. Then red tape can cause serious delays. It should be appreciated at official levels that time means money in business. Countries like South Korea and Singapore have long realized this. Dong Ha Cho referred to the establishment of a one-stop agency in South Korea, the job of which is to facilitate implementation for foreign investors. Singapore has the Economic Development Board, which serves the same purpose. The Board's main function is to promote new foreign investments. Once the foreign investor has agreed to set up his operations in Singapore, the Board helps to secure factory space and clear immigration formalities. The Board also operates financial assistance and industrial training schemes. The Capital Assistance Scheme can provide loans or capital up to 50 percent of the equity required. The Board's Industrial Training Schemes provide assistance for both overseas and local training of skilled labor.

The prime concern of ASEAN countries should be the creation of new jobs. If there is insufficient domestic investment for the purpose, the gap must be filled by foreign investment. It is a sad commentary on the insensitivity of policy makers when unemployment is serious and they worry about laying down difficult