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Examination of the Singapore Shift in Japan’s Foreign Direct Investment in Services in ASEAN

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Abstract

Asia is fast becoming the largest recipient of Japan's foreign direct investment (FDI). Within the Asian region, the Association of Southeast Asian Nations (ASEAN) has been the major investment destination of Japan. In the manufacturing sectors, however, the investment flows from Japan to ASEAN—with Thailand being the largest recipient—has been declining. In contrast, Japan's FDI in the services sectors in ASEAN has been growing rapidly. The recent phenomenon of the Singapore Shift in Japan's FDI in the ASEAN services sectors proves interesting. The prominent strategy of Japanese companies is to establish a commercial presence in Singapore, which they expect to be the “hub” of Southeast Asia, thereby enabling them to supply services to the entire ASEAN region. The magnitude of the Singapore Shift varies for every services sub-sector. By comparing transport and logistics with finance and insurance industries, this paper considers the critical determinants of the Singapore Shift.

**JEL Classification:** F2, F13, F15
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1. INTRODUCTION

The 2004 World Investment Report of the United Nations Conference on Trade and Development (UNCTAD 2004) provides a comprehensive assessment of the "shift toward services" in foreign direct investment (FDI). So far, the trend seems to have been strengthening, rather than weakening. The services sector has evolved as a significant field in international trade as well as in international investment.

While there is a large body of economic analysis on the determinants of FDI in Asia, most analysis focuses either on the aggregate amount of FDI or on FDI in the manufacturing sector. It is surprising that FDI in services has not attracted increasing attention, given that the recorded growth is much higher in comparison with the manufacturing industry or primary industry. As has been pointed out by Banga (2005), traditional FDI theory based on manufacturing sectors ("FDI in goods") may be unable to capture the distinctive features of FDI in services.

The research focus of this paper is on FDI in services. It is particularly important to analyze FDI in services in a regional context. The distribution of services FDI among countries within a region should be analyzed in light of regional services and investment agreements. While it is argued that regional/bilateral investment agreements increase investment flows to the region from countries outside the region (Velde and Besemer 2005), a critical question remains unanswered: Which member country of a regional agreement attracts more FDI from outside? Services industries are usually highly regulated by government agencies and in particular investments in services sectors are usually strictly regulated, unlike the manufacturing sectors where the offering of investment incentives is common practice. Regulations on investment usually have negative impacts on FDI inflows in the services sectors (Kox and Nordas 2007). Thus, the recent proliferation of regional economic agreements to liberalize services trade and investment in the region is dramatically altering the environment in which international investments occur. It has become possible for companies outside the region to provide services across the region, if the region has a regional economic agreement covering services and investment and the companies have a commercial presence in at least one country in the region.

To examine the impact of regional agreements covering services and investments on the geographical distribution of services FDI, this paper analyzes Japan's services FDI in each of the Association of Southeast Asian Nations (ASEAN) countries. Such an empirical focus is crucial because Japan has been one of the largest investors in the world, and ASEAN has been the largest FDI destination of Japan. Moreover, given recent dramatic changes in regional governance of services and investments under various regional economic agreements in Asia, analyzing FDI within Asia can be an effective way to assess the impact of regional services and investment commitments on FDI in services. As we will see below, Japan's services FDI in ASEAN members is undergoing dynamic structural changes, which in itself is an interesting fact, deserving the attention of policymakers and scholars.

The next section briefly reviews the literature on geographical determinants of FDI and explains the methodology used in this paper for analyzing FDI in services. The third section provides an overview of Japan's services FDI in ASEAN. The trend in ASEAN's share of Japan's FDI, the share of services in Japan's FDI in ASEAN, and the shares of sectors in Japan's FDI will be analyzed. The fourth and fifth sections contain a detailed empirical analysis of Japan's FDI in ASEAN in the transport and logistics sector, followed by the

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1 It should be noted that services investment is usually covered by services trade agreements, while there are many bilateral investment treaties (BITs) covering services as well.

2 This happens when a regional agreement adopts the "substantial business operation" rule with regard to the rule of origin in the services sectors. Most ASEAN's agreements, including the ASEAN Framework Agreement on Services (AFAS) and the ASEAN-Japan EPA, adopt substantial business operation rules. For the details, see Fink and Nikomboriak (2007).
finance and insurance sector. In each section, the share among ASEAN members in Japan’s FDI is first reviewed and then the magnitude of the Singapore Shift in the sector is assessed. Japan’s investment policies at the company-level are also reviewed. An examination of the regulatory situation in each ASEAN member for each sector follows, taking into consideration the driving force behind the Singapore Shift. The sixth section gives an account of policy implications of the empirical findings in the preceding sections. The final section concludes, presents the main findings of the study, and suggests directions for future research.

2. LITERATURE REVIEW AND RESEARCH METHODOLOGY OF THE STUDY

2.1 Limits of Existing Literature on FDI Distribution

In analyzing services FDI in a regional context, we should pay close attention to the geographical distribution of FDI among neighboring countries, especially among member countries of a regional agreement. While some literature suggests that the formation of regional agreements increases FDI flows to a region, the question of which member country of a regional agreement receives more FDI from outside and whether the distributions are “zero-sum” have not been studied sufficiently. There are some studies that tackle the question of the geographical distribution of FDI, but their consideration of regional agreements is limited. Liu, Chow and Li (2007) argue that the People’s Republic of China (PRC) does not crowd out FDI from ASEAN countries on the grounds that ASEAN countries received above-average FDI from OECD countries while FDI in the PRC was below-average in relative terms against its economic fundamentals. Likewise, though the methodologies employed were different, Eichengreen and Tong (2007) analyzed if FDI in PRC deviated from FDI flows to other countries and concluded that FDI in the PRC and other Asian countries are actually complimentary because both are included in the same production networks. They admit, however, that FDI flows to the PRC replaced FDI flows to OECD countries to a degree. Meanwhile, Chantasaswat et al. (2004) find that the level of the PRC’s FDI is negatively related to ASEAN’s FDI share in total Asian FDI, though they confirmed that the correlation is positive if the levels of the PRC’s and ASEAN’s FDI are compared.

While those findings are interesting, this study sheds light on three main limitations. First, the empirical debate on the geographical distribution of FDI in Asia has focused predominantly on whether FDI in the PRC occurs at the expense of other Asian countries, whereas competition for FDI among ASEAN countries has attracted little attention. The reason for this, perhaps, is the premise that ASEAN economies are complementary because of linkages between their production networks and, therefore, FDI in one ASEAN country would automatically have a positive effect on its FDI in other ASEAN countries, especially in the case of manufacturing. However, it is also very plausible that ASEAN countries are actually competing for FDI to a certain degree, especially in services sectors.

Second, most studies deal with aggregated or manufacturing FDI, and conclude that FDI in ASEAN and the PRC are indeed complimentary (Chantasaswat et al. 2004; Liu, Chow and Li 2007). However, determinants of services FDI may be different from manufacturing FDI. One interesting finding by Eichengreen and Tong (2007) is that determinants of FDI are different between manufacturing and services. Using disaggregated data, they argue that the correlation between Japan’s FDI in the PRC and ASEAN is not high in the case of several services sectors. This implies that, in the case of some services sectors, the factors determining Japan’s FDI in PRC and in ASEAN are independent of each other. The nature of the geographical dispersion of services FDI could be different from that of FDI in the manufacturing sector.
Third, the important question as to which participating country in regional services investment agreements receives relatively large amounts of FDI from countries outside the region has not been analyzed adequately in the existing literature. Recent studies identify a positive relationship between investment agreements in the region and a region’s inward FDI from a country outside the region as well as a positive relationship between investment agreements and bilateral investment flows between members (Veide and Bezemer 2005 for the former, and Salacuse and Sullivan 2005 and Tobin and Rose-Ackerman 2002 for the latter). In analyzing FDI within Asia, one should bear in mind that the Asian region is replete with agreements covering investment issues. Services trade and investment have been and will be substantially liberalized within ASEAN in some sectors in the coming years. In addition, services trade and investment between Japan and individual ASEAN countries are also liberalized under their respective bilateral Economic Partnership Agreements (EPAs) with Japan, but to a different extent and at different speeds. This can lead to complications in making investment policy decisions based on geographical considerations of Japanese companies.

It is beneficial to briefly review industry-level studies on the determinants of FDI, though they are very limited. Most literature focuses on the determinants of FDI in the financial sectors. These studies suggest that market size and manufacturing FDI are important determinants of FDI in financial services (Yamori 1998; Moshirian 1997). Buch (1999) assesses the significance of the liberal regulatory regime governing FDI in financial sectors and finds the correlation to be positive. However, it should be noted that the regulatory regime is treated as a dummy variable (e.g., whether a country is a member of a regional agreement), without qualitative assessment of actual regulations and commitments.

There is only a limited amount of econometric literature on the determinants of FDI in services sectors other than financial services. Among such studies, Kolstad and Villanger (2008) find that market size and FDI in the manufacturing sectors are important variables in explaining transport FDI based on regression analysis. Meanwhile, based on the corporate-level analysis of a Norwegian maritime company, Kind and Strandenes (2002) conclude that Singapore’s aggressive policy to attract maritime services suppliers is one of the contributors to the large amount of transport FDI in the country.

2.2 Methodology

This paper analyzes the recent development of Japan’s outflows of FDI in the services sector at the sector-level from the angle of regional investment integration schemes. The paper specifically addresses the question of which countries in ASEAN receive Japan’s services FDI. The paper focuses on the Singapore Shift phenomenon recently observed among Japanese companies with services operation in Southeast Asia. In several services industries, Japanese companies concentrate their investments in Singapore among the ASEAN economies. This study examines the magnitude of the Singapore Shift in each services industry and why such shift occurs in a particular services industry, rather than in other services industries.

This study does not attempt to quantify the precise significance of each determinant of Japan’s FDI in ASEAN in each services sector by regression analysis. This would be very difficult because of the lack of time series services investment data at the disaggregated level and the difficulty of quantifying services regulations and commitments. Rather than conducting regression analysis based on an incomplete data set, this study employs eclectic methods, namely a combination of data analysis on available investment statistics, case studies on investment policies at the company-level, and qualitative assessment of services regulations and commitments under regional agreements.

First, to assess the situation of Japan’s services FDI in ASEAN, we will analyze not only investment data but also actual corporate behavior and consider if what can be observed at the data level is consistent with the investment policies at the company-level. Simply
analyzing investment data is insufficient to assess if the Singapore Shift occurred. Company-
level anecdotal examples in each industry are necessary to understand what exactly is
happening in Asia in terms of investment flows.

Second, the examination of possible factors to explain the Singapore Shift requires careful
qualitative analysis. Services FDI should be analyzed taking full account of the new
environment of regional integration in Asia. ASEAN has a regional investment agreement
and at the same time each ASEAN country (as an individual party) is engaged in an
investment agreement with Japan. But using simple governance indicators as a proxy
variable of investment environment or converting the regulatory status into binary variables
is not recommended. Detailed qualitative analysis of each country’s regulatory status and
services commitments in each services agreement at the sub-sector level is necessary.

In summary, this paper attempts to draw a sketch of the recent dynamic development of
Japan’s services FDI in ASEAN using available investment data and anecdotal company-
level examples, and to attribute those changes to the factors associated with regulatory
development under economic agreements in a qualitative manner.

3. OVERVIEW OF JAPAN’S FDI IN ASEAN

3.1 Investment Data

The critical problem that most research on services faces is the lack and/or inconsistency of time
series data. This paper mainly uses figures in the FDI section of the Balance of Payment (BOP)
Statistics of Japan. The Japanese finance ministry and central bank started to release BOP-
based FDI figures in early 2005, replacing the old Foreign Direct Investment Statistics (FDIS).

However, because of the difference of compilation methodologies between the two statistical
data sets, data before and after 2005 cannot simply be combined and then analyzed together for
the following reasons: First, BOP figures are more comprehensive and are based on financial
transactions, whereas FDIS is a compilation of figures reported by investors covering only
investments over 100 million yen. In the case of FDIS, investors are not obligated to report
transactions with a value of less than 100 million yen. As a result, the total amount using BOP-
based data is much larger than that of FDIS-based data. Second, the compilation of BOP
statistics is based on accounting rules. Therefore, outward investment (investment abroad) in the
BOP can be recorded as a negative figure. This happens when, for example, Japanese capital
assets in Thailand decline due to withdrawal of investment (disinvestment). By contrast, data in
FDIS is always positive, because this is the total of reported figures of implementation or
approval of new investment (withdrawal of investment in the past is not captured in the FDIS).
Finally, in the case of FDIS, fiscal year (FY) figures that cover the months of April to March of the
next year are normally used because Japanese companies usually produce and implement their
budgets on a fiscal year basis.

The analysis below basically relies on BOP-based FDI figures available after 2005. Since BOP-
based data are available for only a short period, the paper sometimes refers to the data before
“2004FY” (fiscal year 2004) using FDIS to examine the trend before 2004FY, without comparing
the level of BOP-figure and FDIS-based figures (since comparing share composition in BOP-
based statistics and FDIS-based statistics would be unwise). Data and figures using FDIS are
contained in the Appendix. Unless otherwise stated, we assume that the 2010 figure is double
that of the value reported for the first half of 2010, since data is available only for this part of the
year.3

3 For figures referring to the first half of 2010 here, the data values are not doubled.
3.2 Japan’s FDI in ASEAN, PRC, and India

Asia is the largest destination of Japan’s FDI (manufacturing and non-manufacturing), based on the average regional share of Japan’s total outward FDI in 2005–2009. Asia accounts for 26.2%, North America accounts for 26.0%, and Western Europe accounts for 23.2%.

Among Asian countries, ASEAN as a group and the PRC are the two major recipients of Japan’s FDI (see Table 1). ASEAN received 600–700 billion yen of Japanese FDI in total, which was as much as Japan’s FDI in the PRC. While Japan’s FDI in ASEAN has slightly declined in recent years, overall, it has maintained a high level. Despite the rapid rise of the Indian economy, Japan’s FDI in India remains smaller than its FDI in ASEAN and the PRC.

Looking at disaggregated sector-level figures, we can find interesting trends in Japan’s FDI in Asian countries. In the manufacturing sectors (food; textile; lumber and pulp; chemicals and pharmaceuticals; petroleum, rubber, and leather; glass and ceramics; iron, non-ferrous and metals; general machinery; electrical machinery; transport machinery; and precision machinery), the trend in Japan’s FDI in ASEAN has generally declined. This is in sharp contrast with Japan’s FDI in the PRC, which has remained roughly at the same level over the past five years. Because the differing trend in Japan’s FDI between PRC and ASEAN, Japan’s manufacturing FDI in the PRC has become larger than its FDI in ASEAN. Meanwhile, Japan’s FDI in India has recorded a growing trend, but the level itself is still much lower than FDI in ASEAN (a jump that can be observed in Japan’s FDI to India in 2008 is due solely to the increase in FDI in chemicals and pharmaceuticals investments).

The situation is totally different in the case of the services sector. Here, the seven sub-sectors related to services will be analyzed. The non-manufacturing sector in Japan’s BOP-based FDI statistics consist of ten sub-sectors, seven of which are services-related (construction; transport; communication; wholesale and retail; finance and insurance; real estate; and other services), while the other three are non-services (farming and forestry; fishery and marine products; and mining). Although the trend in Japan’s services FDI in ASEAN has been growing overall, it has been volatile. ASEAN receives a larger amount of FDI than the PRC in the services sector. However, it should be noted that Hong Kong, China has been a major recipient of Japan’s services FDI as well. Japan’s services FDI in India is increasing, but the level itself is still low (a jump that can be observed in Japan’s FDI in India in 2009 is due solely to the increase in FDI in the communications sector).

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4 In 2008, Japan’s FDI in India in the manufacturing sector was 512 billion yen, while FDI in chemicals and pharmaceuticals was 416 billion yen.

5 Since investment in the mining sector (e.g., oil and gas) is typically large and volatile, it is important to make a distinction between non-manufacturing and services.

6 In 2009, Japan’s FDI in India in the non-manufacturing sector was 271 billion yen, while FDI in communications was 257 billion yen.
Because Japan’s FDI in the manufacturing sector has been declining while Japan’s FDI in services has been increasing, the share of the services sector in Japan’s FDI in ASEAN has increased significantly in recent years (Table 1). The share of the services sector in Japan’s FDI in ASEAN was around 20% in 2005, but this declined in 2006. The share rose again to around 25% in 2007 and 2008 and reached a level slightly lower than 40% in 2009. While the data in 2010 covers only the first half of 2010, the increasing trend in the share of services seems to be continuing. The same can be said in terms of both FDI levels and shares for FDIS-based data prior to 2004FY, even though data are not comparable between the periods before and after 2005. The share of services in total FDI increased from around 25% in 2000FY to 35% in 2004FY (see Appendix, Figure A).

### 3.3 Japan’s FDI in individual ASEAN countries

A country-level analysis is necessary to understand the dynamics of Japan’s FDI in ASEAN. However, country shares vary significantly from sector to sector. In the manufacturing sector, Thailand is the major recipient of Japan’s FDI of the ASEAN countries (Figure 1). On average, Thailand’s share was roughly 40% of Japan’s total manufacturing FDI in 2005–2009, but it has been declining. Singapore, Malaysia, Indonesia, and the Philippines follow next. Recently, Viet Nam has also been becoming a major recipient of Japan’s manufacturing FDI. Thailand’s dominant share is consistent with the fact that Thailand is becoming the manufacturing center for operations of Japanese manufacturers, such as in the automobile industry. Nevertheless, Thailand’s share has been declining over the last few years, due in part to the country’s political instability. This decline in Japan’s FDI in Thailand is one of the major factors explaining the overall decline of Japan’s FDI in the manufacturing sector in ASEAN. Based on the analysis using FDIS (Appendix, Figure B), we can confirm that the share composition during 2000FY–2004FY is similar to that after 2005.

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7 A jump in Malaysia’s share in 2006 was due to investment in the electronic machinery industry only. In 2006, Japan’s FDI in Malaysia’s manufacturing sectors was 332 billion yen, while FDI in electric machinery was 279 billion yen.
Figure 1: Japan’s Manufacturing FDI in ASEAN by Country (BOP)

Source: Author's calculation based on Japan’s BOP statistics (various issues)

In the services sector, Singapore is the largest recipient of Japan’s FDI among ASEAN countries, with a growing overall trend despite its volatility (Figure 2). Singapore recorded negative figures in several services sub-sectors, with the wholesale and retail sector being the largest negative contributor in 2005 and 2006. However, its share in Japan’s services FDI in ASEAN climbed to 50% in 2007, dropped to 20% in 2008, and surged back to 70% in 2009. Singapore’s share in the first half of 2010 was roughly 50%. This increase in Japan's FDI in Singapore in recent years is the largest contributing factor explaining the overall increase in Japan’s services FDI in ASEAN. The shares of Thailand, Malaysia, the Philippines, and Viet Nam are roughly equal. Using FDIS 2000FY–2004FY data, the same trend can observed in Japan’s services FDI, except in 2003FY (Appendix, Figure C).

Figure 2: Japan’s Services FDI in ASEAN by Country (BOP)

Source: Author’s calculation based on Japan’s BOP statistics (various issues)

3.4 Major Services Industries in Japan’s FDI in ASEAN

While Singapore is the largest recipient of Japan's FDI in the services sector in ASEAN, the geographical distribution of FDI varies for each services sub-sector. Thus, we need to analyze the country composition of each sub-sector. Figure 3 shows the share of each services sub-sector in Japan's total services FDI in ASEAN. The shares are computed based on the average FDI outflows between 2005 and 2009. Finance and insurance takes nearly half of the total share, while the share of transport is one quarter. Communications has the third highest share, accounting for about 10% of Japan’s FDI in the services sector. The share of other services sub-sectors is marginal, even though the magnitude of increases in their levels is remarkable.
FDI in the finance and insurance, and transport sectors has increased significantly, although the rates of increase have been volatile. The average amount of Japan’s FDI in ASEAN in those sectors in 2005–2009 is as follows: (i) transport machinery—124 billion yen; (ii) electric machinery—117 billion yen; (iii) finance and insurance—85 billion yen; and (iv) transport services—43 billion yen. Therefore, finance and insurance, and transport are already as important as the transport machinery (such as automobiles) and electric machinery sectors in terms of the value of Japan’s FDI. In light of the above analysis, given the significance of the services sector, a picture of Japan's FDI in ASEAN that fails to take account of the services sector would be incomplete.

The next two sections will analyze two major sub-sectors in the services sector: transport, and finance and insurance. These sub-sectors are chosen because, first, they are the two most dominant sub-sectors in Japan’s FDI, and second, because the trends observed in those two services sectors are contrasting in terms of Japan's FDI distribution across ASEAN countries.

4. JAPAN’S FDI IN TRANSPORT

4.1 Japan’s FDI in ASEAN’s Transport Sector

Transport services under Japanese BOP classification includes railway services, road passenger transport services, road freight transport services, maritime transport services, air transport services, storage and warehouse services, and auxiliary transport services. Such coverage is roughly the same as transport services and logistics services under most services liberalization schemes and plans based on the W120 classification (Services Sectoral Classification List prepared by World Trade Organization (WTO) secretariat: MTN.GNS/W/120). Thus, it is important to analyze the transport sectors and the logistics sectors together.

As we have seen, transport is the second largest sector in Japan's FDI in ASEAN among the services sub-sectors, after the finance and insurance sub-sector. Japan's overall FDI in transport has been rising since 2005, but it increased more dramatically in 2009. Figure 4 shows that the value in 2009 (137 billion yen) is more than 70 times as high as in 2005 (1.9 billion yen).

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8 Note that W 120 does not have a sub-category of logistics services.
While Japan's transport FDI in Singapore recorded negative values (a decrease in Japan's assets in Singapore) in 2005, it recovered considerably in 2006, yielding a growing trend in FDI. Since 2006, Singapore's share has been dominant in Japan's FDI in ASEAN's transport sector. Singapore had a share of roughly 80% in 2006–2008, reaching more than 98% in 2009, and the concentration of investments in Singapore continues in the first half of 2010. Thailand is the second largest recipient of Japan's FDI in the transport sector, but its share is far behind that of Singapore. Moreover, the absolute amount of Japan's FDI in ASEAN countries other than Singapore in the transport sector has been declining in recent years. This means that there is already a notable Singapore Shift and the trend is becoming more prevalent in the transport sector.

4.2 Examples of Southeast Asian Operations of Japanese Logistics/Transport Companies

There have been many reported cases of Japanese companies following a Singapore Shift in terms of their investments in ASEAN. The typical case is the establishment of Regional Operating Headquarters (ROH) in Singapore to cover the entire ASEAN region. In cases like this, a commercial presence in Singapore enables these companies to provide logistics services, not only domestically in Singapore, but also in other ASEAN countries across borders. Below are illustrative examples of Japanese companies that largely operate their businesses in Asia via Singapore.

**Nippon Express Co., Ltd.** The ROH for Asia and Oceania of the largest Japanese total transportation company, Nippon Express, has been located in Hong Kong, China. However, in May 2010 the company announced its decision to reorganize its institutional structure with a view to establishing its ROH for Southeast Asia and Oceania in Singapore, as a response to the rapid increase in sales in Asia. The ROH in Hong Kong, China will cover the East Asia region (mainly PRC). According to the press release issued by Nippon Express, while its overseas sales increased by 139% over the past decade, sales in the Asian region surged by 276% over the same period. Nippon Express explains that business needs in the PRC and ASEAN are different, and focusing on Southeast Asia by means of the ROH is necessary. Since 2007, Nippon Express has also utilized Singapore as a logistics hub for transport between Japan and India.

**Yamato Transport Co., Ltd.** The second largest Japanese total transportation company, Yamato Transport, also recently decided to establish ROH for the ASEAN region in

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10 See: [http://www.nittsu.co.jp/press/2008/20080121_1.htm](http://www.nittsu.co.jp/press/2008/20080121_1.htm)
Singapore. The largest Japanese logistics company, Mitsubishi Logistics (Mitsubishi Soko), is also expanding its business in Asia by establishing a logistics base in Singapore. In December 2009, the Singaporean subsidiary of Mitsubishi Logistics (Mitsubishi Logistics Singapore Pte. Ltd.) merged with Singaporean logistic supplier Pioneer Express International. The press release of the former explains that the plan is to utilize Singapore as the center of its logistics network in Southeast Asia. Together with its Chinese subsidiary, Mitsubishi Logistics Singapore expects to expand the logistics business of the group of Mitsubishi Logistics in Asia.

4.3 Liberalization of Transport Sectors in ASEAN Countries

There are several reasons for the Singapore Shift in the transport sector. First, the transport and logistics market in ASEAN is rapidly integrating. In particular, logistics is a priority integration sector under the ASEAN Framework Agreement on Services (AFAS). In 2007, a formal agreement on the ASEAN Sectoral Integration Protocol for the Logistics Services Sector was concluded in Cebu, Philippines. The logistics liberalization scheme of ASEAN mainly covers the following sub-sectors: (a) Railway transport (central product classification [CPC]7112); (b) Road transport (CPC7123); (c) Maritime transport (CPC 7212, 7213); (d) Cargo handling (CPC 741); (e) Storage and warehousing (CPC 742); (f) Transport agency (CPC 743); (g) Postal and courier (CPC 7512); and (h) Packaging (CPC 876).

Under the agreement, ASEAN members committed to completing the liberalization of those sectors in a timely manner. Mode 1 (cross-border supply of services) and Mode 2 (consumption abroad) should be fully liberalized by 2013. For Mode 3 (services trade through a commercial presence), the plan is to increase the foreign equity cap to 49% by 2008, to 51% by 2010, and to 70% by 2013. In 2015, 100% commercial presence of foreign-owned logistics entities will be allowed. This means that logistics-related investment should be completely free of restrictions by 2015 within ASEAN, enabling entities to provide logistics services to ASEAN countries by establishing a commercial presence in any one ASEAN country. This scheme of integrating logistics services in ASEAN explains why the region is fast becoming an attractive market for Japanese companies and why Japan’s FDI in ASEAN in transport has increased overall. However, this does not fully explain why Japanese companies choose Singapore as their investment destination, which suggests the Singapore Shift phenomenon is part of the explanation.

Second, Singapore has reformed its regulatory framework in the logistics sector and has conducted a thorough liberalization of the sector. Since then Singapore has been attempting to attract international logistics suppliers to achieve its goal of being ASEAN’s regional transport and logistics hub and the country has allowed full foreign ownership in the primary logistics sub-sectors (freight transport agency services, and storage and warehouse services). Among ASEAN countries, apart from Singapore, only Lao PDR and Cambodia allow full foreign ownership in the primary logistics sectors. In contrast, the level of openness in the logistics sector of Thailand, for example, is not comparable with Singapore, despite the Thai government’s claim that Thailand is ASEAN’s logistics hub. Under the Foreign Business Act enforced in 2000, the Thai government restricts business operations of

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13 For a detailed analysis of Singapore’s maritime industry, see Kind and Strandenes (2002).
majority foreign-owned companies, which is applicable to most transport and logistics services. Moreover, Thailand’s plan to open up its logistics sectors to other ASEAN members is to just follow the liberalization schedule under the AFAS logistics framework. Majority foreign ownership will only be allowed in 2010. The foreign equity cap is due to be increased to 70% in 2013, and full foreign ownership will be permitted in 2015. In the case of the Philippines, the government maintains strict foreign equity cap regulations on public utilities/services including various transport services, which is stated in the republic’s constitutional provisions. Foreign equity participation in public utilities in the Philippines should be no higher than 40%.

Third, Singapore has committed to maintain its liberal regulatory regime by making commitments under the Economic Partnership Agreement (EPA) with Japan to a considerable degree compared with Thailand or the Philippines. While Singapore's transport/logistics commitment at the WTO/General Agreement on Trade in Services (GATS) negotiations has been relatively weak, its commitments under the Japan-Singapore Economic Partnership Agreement (JSEPA), signed in 2002, are very substantial. Whereas Singapore's GATS commitments in transport services are limited to three sub-sectors, its commitments under JSEPA cover almost all sub-sectors with the notable exception of air passenger transport. In contrast, Thailand's transport services commitments under the Japan-Thailand Economic Partnership Agreement (JTEPA) signed in 2007 are not at all comprehensive. Its coverage is far more limited than Singapore’s commitments under JSEPA. Thailand excludes critical sub-sectors for the logistics industry, such as freight transport agency services (CPC748). Thailand’s schedule in critical logistics and transport sectors usually maintains the 49% foreign equity cap restriction (e.g., maritime freight transport [CPC 7212]) in line with its Foreign Business Act, and also includes several restrictions in Mode 3 (the form of commercial presence, nationality requirement, etc.). The only selling point of the JTEPA is that the Thai government allows foreign majority ownership in logistics consulting services (part of CPC 86509), but the liberalization of this sub-sector alone does not address actual commercial needs. The coverage of the Philippines’ commitment under the Japan-Philippines Economic Partnership Agreement (JPEPA), on the other hand, is as broad as Singapore’s, except regarding commitments in internal waterways transport, even though scheduling for the Philippines’ transport sub-sectors are “standstill” commitments. However, the Philippines does have a 40% foreign equity cap restriction in many of its Mode 3 commitments.

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14 Thailand is chosen because the country has a strong desire to establish itself as the logistics hub of ASEAN. Theoretically speaking, the Philippines has a geographical advantage in that it serves as Japan’s gateway to ASEAN because of its east-end location in the ASEAN region (for example, Fedex uses Manila as a regional hub, though its operations in the Philippines have been shrinking).

15 Singapore’s current GATS commitments in transport include CPC7212 and CPC745 only.

16 One of the few successes is that majority ownership via Japanese capital is allowed in the logistics sector, but the equity ceiling is pegged at 51%.
### Table 2: Transport Commitments of Singapore, Thailand, and the Philippines in EPAs

<table>
<thead>
<tr>
<th>Sectors or sub-sectors</th>
<th>JSEPA</th>
<th>JTEPA</th>
<th>JPEPA</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Maritime Transport Services</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Passenger transport (7211)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>b. Freight transport (7212)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>c. Rental of vessels with crew (7213)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>d. Maintenance and repair of vessels (8868**)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>e. Pushing and towing services (7214)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>f. Supporting services for maritime transport (745**)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>B. Internal Waterways Transport</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Passenger transport (7221)</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Freight transport (7222)</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>c. Rental of vessels with crew (7223)</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>d. Maintenance and repair of vessels (8868**)</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>e. Pushing and towing services (7224)</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>f. Supporting services for internal waterway transport (745**)</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>C. Air Transport Services</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Passenger transport (731)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Freight transport (732)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. Rental of aircraft with crew (734)</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>d. Maintenance and repair of aircraft (8868**)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>e. Supporting services for air transport (746)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>D. Space Transport (733)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Passenger transport (7111)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>b. Freight transport (7112)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>c. Pushing and towing services (7113)</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>d. Maintenance and repair of rail transport equipment (8868**)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>e. Supporting services for rail transport services (743)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>F. Road Transport Services</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Passenger transport (7121+7122)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Freight transport (7123)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. Rental of commercial vehicles with operator (7124)</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>d. Maintenance and repair of road transport equipment (6112+8867)</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>e. Supporting services for road transport services (744)</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>G. Pipeline Transport</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Transport of fuels (7131)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Transport of other goods (7139)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>H. Services auxiliary to all modes of Transport</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Cargo-handling services (741)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Storage and warehouse services (742)</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>c. Freight transport agency services (748)</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>d. Other (749)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** ** indicates that the service specified constitutes only a part of the total range of activities covered by the CPC concordance.

**Source:** Author’s compilation

In summary, given the high degree of a Singapore Shift in the transport sector, despite the fact that other ASEAN countries also pursue attracting FDI in their respective transport sectors to a certain degree, it can be inferred that bilateral investment liberalization is critical in explaining services FDI in Singapore. It is likely that inflows of transport FDI to Singapore will partly crowd out FDI in other ASEAN members. Japanese companies will typically choose a relatively liberalized economy as an investment destination to supply services all over ASEAN.

In light of the above, Singapore’s regulation of the transport and logistics industry is relatively liberal (Mode 3) compared with other ASEAN countries and is bound by high levels of commitments under JSEPA. Thailand’s regulation is slightly more liberal than that of the Philippines, but its commitment under JTEPA is relatively weak, leaving a large policy space for the Thai authorities to maneuver in. The quality of the Philippines’ binding commitments under JPEPA is relatively higher in the sense that no policy space is afforded between commitments and actual regulations (standstill commitments). Nevertheless, these services sectors are highly-regulated by the government as stipulated in the constitution of the Philippines, which is also reflected under JPEPA commitments in the transport sector.
Meanwhile, the logistics sector will only be fully liberalized within ASEAN under the AFAS Logistics Scheme, including all modes of services supply, by 2015. As a result of this, many Japanese companies choose Singapore as a services investment destination in its role as a regional hub.

5. FINANCE AND INSURANCE

5.1 Japan’s Finance and Insurance Sector FDI in ASEAN

Figure 5 shows Japan’s FDI in finance and insurance in ASEAN countries. While it is volatile, the level is high. As we have seen, Japan’s FDI in the finance and insurance sector is becoming as large as its FDI in transport machinery and electric machinery. What should be noted here is that there is no dominant recipient of Japan’s FDI in terms of share as far as the finance and insurance sector is concerned. The largest recipient has frequently changed over time—Thailand in 2005; Singapore in 2006, 2007, and 2009; and Viet Nam in 2008. Singapore’s share is slightly higher than that of other countries based on the average share in 2005–2009, but we cannot say that Singapore has the majority share, unlike in the case of the transport sector. Indonesia’s financial sector is also a constant recipient of large amounts of FDI from Japan, although it has not been the leading recipient in any single year. In 2005–2009, on average, Singapore and Indonesia belonged to the first group. Malaysia, Thailand, and Viet Nam were in the second group, although the difference between the two groups is not very substantial. The Philippines’ share is very small compared with that of the others.

Figure 5: Japan’s Finance and Insurance FDI in ASEAN by Country

Source: Author’s calculation based on Japan’s BOP statistics (various issues)

5.2 Examples of Southeast Asian Operations of Japanese Financial Institutions

This section gives an account of three illustrative examples of Japanese companies that have substantial overseas business expansion strategies in banking, insurance, and securities in Asia. Because Japan’s domestic market is shrinking, Japanese financial institutions need to increase profits from their operations in other parts of Asia. Such a strategy is particularly important for the second or third largest financial institutions in the Japanese market in terms of their share of the domestic market.

Bank of Tokyo-Mitsubishi UFJ, Ltd. Japan’s largest commercial bank, Tokyo-Mitsubishi UFJ Bank, has strengthened its business operations in Asia. In October 2006, the bank invested in the CIMB Group, the second largest financial services provider in Malaysia.
While Tokyo-Mitsubishi UFJ’s share holding was limited to 1.1% at that time, it soon increased to 4.5% in February 2007. Meanwhile, in November 2006, Tokyo-Mitsubishi UFJ Bank, together with ACOM (Tokyo-Mitsubishi UFJ Bank’s subsidiary specialized in consumer finance), announced its plan to merge with Indonesia’s Bank Nusantara Parahyangan Tbk (Bank PNB) in order to enter the loan business as well as the consumer finance business in Indonesia. Tokyo-Mitsubishi UFJ held 20% of the total share of Bank PNB, while ACOM held 55.4%.

**Mitsui Sumitomo Insurance Co., Ltd.** The second largest Japanese accident insurance company, Mitsui Sumitomo Insurance, has been actively engaged in its overseas operations in Asia, in particular. Because the leading accident insurance company in Japan—Tokyo Maritime Insurance—dominates the domestic market in Japan with a strong profit base, Mitsui Sumitomo Insurance needs to expand its overseas businesses to be able to compete with Tokyo Maritime. In fact, the company’s overseas premium income recorded a sharp increase in recent years (Table 3), with one third of the increase (2001FY–2007FY) in the company’s total premium income being earned in Asia. The company’s overseas business plan is to target half of its sales in Asia, 30% in Europe, and 20% in the US.

<table>
<thead>
<tr>
<th>Table 3: Mitsui Sumitomo’s Premium Income in Asia-Pacific</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Amount</strong></td>
</tr>
<tr>
<td><strong>2001FY</strong></td>
</tr>
<tr>
<td>Taipei, China</td>
</tr>
<tr>
<td>Malaysia</td>
</tr>
<tr>
<td>Singapore</td>
</tr>
<tr>
<td>Thailand</td>
</tr>
<tr>
<td>Hong Kong, China</td>
</tr>
<tr>
<td>India</td>
</tr>
<tr>
<td>Indonesia</td>
</tr>
<tr>
<td>Philippines</td>
</tr>
<tr>
<td>PRC</td>
</tr>
<tr>
<td>Australia</td>
</tr>
<tr>
<td>Viet Nam</td>
</tr>
<tr>
<td>Republic of Korea</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Source: Toyo Keizai

Based on the company’s policy to establish subsidiaries in all ASEAN countries where foreign general insurers are permitted to get a license, Mitsui Sumitomo purchased 25% of shares in Asia Insurance (Cambodia) Limited in 2004. This was Mitsui Sumitomo’s eighth local subsidiary in Asia. In August 2008, Mitsui Sumitomo established its first fully-owned local subsidiary in Viet Nam, the first 100% Japanese-owned accident insurance company approved by the Vietnamese government. In April 2009, Mitsui Sumitomo Insurance also established a subsidiary in Lao PDR, the first Japanese insurance subsidiary in the country. Mitsui Sumitomo holds 51% of the shares while the Lao Finance Ministry owns 49%. This was achieved soon after the Lao PDR government liberalized the establishment of insurance subsidiaries in 2007. Mitsui Sumitomo Insurance’s business expansion in more developed ASEAN countries is also significant. For example, in June 2010, MSIG Insurance (Malaysia) merged with Malaysia’s Hong Leong Assurance Bernard, becoming the second largest

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20 Available at: [http://www.toyokeizai.net/business/strategy/detail/AC/094ae7dfbde1d1d22b5cd1d8c4c88c/](http://www.toyokeizai.net/business/strategy/detail/AC/094ae7dfbde1d1d22b5cd1d8c4c88c/)

21 Since 1997, the company has been operating an insurance business in Viet Nam through the United Insurance Company of Viet Nam, a joint company with Bao Ming.
player in the market. Mitsui Sumitomo will hold 70% of the shares of the newly-transformed MSIG Insurance (Malaysia), while Hong Leong will hold 30%.

**Daiwa Securities Group Inc.** The second largest securities group in Japan, Daiwa Securities, also decided to strengthen its commercial bases in Asia. In November 2009, Daiwa announced to increase capital resources allocated to its local subsidiaries in Asia, from 90 billion yen to 190 billion yen. While some functions and operations originally assigned in Tokyo will be moved to its subsidiary in Hong Kong, China, the company also plans to establish new local subsidiaries in Malaysia and Indonesia, where Daiwa is yet to establish a commercial presence. Daiwa’s goal is to achieve a five-fold increase in sales in Asia within 2 years.

**5.3 Liberalization of the Finance and Insurance Sector in ASEAN Countries**

Given the importance of financial services for economic development, ASEAN members acknowledge the significance of liberalizing the financial services sectors under the AFAS. The AFAS package concluded in 1998 included a select number of financial sub-sectors, but coverage was not substantial. In 2002, finance ministers agreed to start negotiations exclusively on financial services (the second financial package), followed by the third financial package concluded in 2004, and finally the fourth financial package concluded in 2008.22 However, the resulting level of openness of financial services within ASEAN remains insignificant.

The ASEAN Economic Community Blueprint adopted in 2007 still does not contain concrete steps for liberalization in the financial services sector. The blueprint states that “liberalization measures of the financial services sector should allow members to ensure orderly financial sector development and maintenance of financial and socioeconomic stability”, emphasizing the importance of national policy objectives. It is clear that actions to be taken in completing the economic community blueprint imply that liberalization of the financial services sector under the AFAS is not aimed at creating a common market. ASEAN’s commitments in financial services in the blueprint can be summarized as follows:

- Progressively liberalize restrictions in sub-sectors or modes as identified by each member country by 2015;
- Progressively liberalize restrictions in the remaining sub-sectors or modes, which are not identified under “pre-agreed flexibilities” by 2020.

Other individual ASEAN members still maintain restrictive regulatory frameworks in the field of financial services while Singapore, Indonesia, and Malaysia have relatively liberalized financial services sectors. This means that the problem is not limited to the quality of commitments, but includes the reform of current restrictive regulations within these countries as well. For example, in Singapore the government formally lifted a foreign equity cap in the banking sector.23 The insurance sector in Singapore is also open to full foreign ownership. In Indonesia, 99% foreign ownership is permitted in the banking sector, while the foreign equity cap is pegged at 80% in the case of insurance. Malaysia boldly instituted reform in financial regulation in 2009. The foreign equity cap was increased from 49% to 70% for domestic Islamic banks, investment banks, and insurance companies. Meanwhile, in Thailand, restrictions on the foreign equity cap and foreign board member shares remained at 25% for financial institutions (both banking and insurance) until 2008 when the government increased the foreign equity cap to 49% in August 2008. However, increasing foreign ownership from anywhere between 25% and 49% will still require prior approval from the central bank of Thailand. In the Philippines, the Act Liberalizing the Entry and Scope of Operations of

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22 For an analysis of ASEAN’s services liberalization scheme, see Hamanaka (2009).
23 However, it publicly announced that it will not allow foreigners to take over the three local financial institutions.
Foreign Banks in the Philippines restricts foreign equity participation to 60% in banking sectors as long as foreign banks meet qualification requirements\(^\text{24}\), while participation is limited to 40% otherwise. Full foreign ownership is allowed in the insurance sector in the Philippines (see Table 4).

**Table 4: Foreign Equity Cap in Financial Sectors in ASEAN Countries**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Singapore</th>
<th>Indonesia</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>100%</td>
<td>99%</td>
<td>49%&gt;70%</td>
<td>60%/40%</td>
<td>25&gt;49%</td>
</tr>
<tr>
<td>Insurance</td>
<td>100%</td>
<td>80%</td>
<td>49%&gt;70%</td>
<td>100%</td>
<td>25&gt;49%</td>
</tr>
</tbody>
</table>

ASEAN countries do not have ambitious commitments in financial services under their EPAs with Japan, except for Singapore. Under the JTEPA signed in 2007, Thailand’s schedule included a foreign equity cap of 25% in Mode 3 in both banking and insurance. The Philippines’ commitments in financial services under JPEPA is limited to the banking sector and does not include commitments in the insurance sector beyond the GATS, despite actual regulation allowing full foreign ownership.\(^\text{25}\) Meanwhile, Singapore’s commitments under JSEPA do not impose any restrictions ("none" commitment) in the insurance sector and Singapore does not have a foreign equity cap in the banking sector (see Table 5).

**Table 5: Commitments on Foreign Equity Cap under EPAs with Japan**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Singapore</th>
<th>Indonesia</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>None</td>
<td>49%</td>
<td>30%</td>
<td>60%</td>
<td>25%</td>
</tr>
<tr>
<td>Insurance</td>
<td>None</td>
<td>49%</td>
<td>30%</td>
<td>51%</td>
<td>25%</td>
</tr>
</tbody>
</table>

In summary, it is safe to assume that the financial services sector will not be fully liberalized even among ASEAN members in the near future. Many ASEAN countries maintain a restrictive regulatory environment, unlike in the case of transport and logistics. Therefore, a Japanese financial institution needs to obtain licenses from the respective government of the ASEAN country in which it wishes to start a business. For the financial services sector, using a commercial presence in one ASEAN country as a strategy to supply services all over ASEAN is not a viable option. As a result, there is no Singapore Shift in the case of financial services.

The actual level of deregulation appears to be more important as a determining factor for the bilateral investment than the level of commitments. For example, Japan’s FDI in the financial services sector in the Philippines is negligible although the Philippines’ commitments are more comprehensive than the commitments of most other ASEAN countries, except for Singapore. The problem is that the Philippines’ actual regulatory environment is more restrictive than that of other ASEAN countries. The fact that Thailand receives Japanese FDI in the financial services sector to a certain degree even though its level of deregulation and its commitments are insignificant implies that other factors such as market size and manufacturing FDI are also important.

### 6. POLICY IMPLICATIONS OF THE SINGAPORE SHIFT

Sector-level comparative analyses of Japan’s FDI in ASEAN reveal that Japan’s outward FDI is concentrated in the most FDI-friendly country in ASEAN, namely Singapore, which enables Japan to provide services throughout the ASEAN region in some services sub-sectors. Some Japanese companies also use Singapore as a regional hub so that services can be provided all over the ASEAN region by establishing a commercial presence in

\(^{24}\) Qualifications include wide ownership, public listing in the country of origin and global/national rankings. See information available at the USTR website.


\(^{25}\) The Philippines’ GATS schedule in the insurance sector (51% foreign equity participation) is reflected in JPEPA.
Singapore. Such inclination toward the Singapore Shift is strong in transport services, but not evident in the case of financial services.

One important policy implication of the Singapore Shift is that countries need to minimize restrictions on services FDI from outside the region, if services trade is liberalized within a region under an FTA or EPA. This is because otherwise outside investors would simply choose another country in the region to supply services to that country. When FTA or EPA members decide to liberalize trade and investment in a particular services sector where the Singapore Shift may occur, it is important to liberalize the sectors for outsiders as well.

Furthermore, competition to provide a favorable investment environment among regional economies is not limited to minimizing restrictions on FDI, but also includes granting investment incentives. If one member country of a regional agreement provides investment incentives to the companies and business entities outside the region, other member countries may also need to offer similar incentives to companies outside the region to avoid crowding-out effects. Because services trade is liberalized within a region, it is natural for companies outside the region to choose the most FDI-friendly country in the region as its investment destination to supply services across the region. What should be noted is that simply providing incentives to attract FDI without liberalizing the investment regime or minimizing the restrictions on FDI is not an effective investment policy. Countries should provide investment incentives in addition to liberalizing FDI and ensure that commitments to ensure a liberal investment regime are made under regional economic agreements or GATS.

In addition to transport services, services such as communications (courier and value-added telecommunication) and distribution (wholesale, in particular) can be provided across the ASEAN region by establishing a commercial presence in just one ASEAN country. The actual extent of this kind of shift occurring in those services sub-sectors will need careful examination. Figure 6 presents the amount and share received by each ASEAN country of Japan’s FDI in the distribution sector. While there are no disaggregated figures for wholesale and retail, Singapore’s share in Japan’s distribution services FDI in ASEAN appears to be on an upward trend.

**Figure 6: Japan’s Distribution Services FDI in ASEAN by Country**

![Figure 6: Japan’s Distribution Services FDI in ASEAN by Country](source)

7. CONCLUSION AND FUTURE RESEARCH AGENDAS

The recent proliferation of services agreements has drastically changed the restrictions and conditions on Japan’s FDI in ASEAN. On the one hand, services trade and investment have been liberalized within the ASEAN region, and will eventually be completely liberalized within

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26 See footnote 2.
the ASEAN region in the coming years for some sub-sectors. On the other hand, services trade and investment between Japan and individual ASEAN countries have also been liberalized under their respective bilateral EPAs, but to differing degrees.

In the case of transport, liberalization of trade and investment within ASEAN has already reached a considerable level, and will be fully liberalized in the near future. Many Japanese companies choose Singapore as an FDI destination because the country continues to have the most liberal regulatory environment in the transport sector, and has committed to maintaining such an environment under its EPA with Japan. The strategy of Japanese companies is to supply transport services throughout ASEAN through a commercial presence in Singapore. As a result, a considerable degree of Singapore Shift can be observed in this industry.

By contrast, in the case of financial services there is no clear evidence of a Singapore Shift. This is mainly because financial services have not and will not be fully liberalized even among ASEAN members in the near future. To supply financial services, Japanese financial institutions need to obtain licenses and establish a commercial presence in each ASEAN country. Singapore and Indonesia were each able to attract a large amount of Japan’s FDI in the financial services sector, but their shares are not very dominant. The relatively large amount of financial FDI flows to Singapore and Indonesia can be explained by the fact that these two countries maintain relatively liberal regulatory regimes, particularly in terms of the foreign equity cap on financial institutions. While Thailand maintains a high level of restriction on FDI in financial services, and its commitment in the financial services sector under JTEPA is insignificant, the country still attracts a certain amount of financial services FDI from Japan, perhaps because of its large accumulation of manufacturing FDI from Japan. However, Japan’s financial services FDI in the Philippines is negligible, even though the Philippines’ regulatory environment and commitments are more favorable than those of Thailand.

The main focus of this paper has been the analysis of Japan’s FDI in ASEAN with a special reference to Singapore. The question worth considering at this stage is whether the phenomenon of the Singapore Shift can be generalized. One way to test this is to analyze Japan’s FDI in a region other than ASEAN that has a regional economic agreement covering services and investment within the region as well as bilateral agreements between each country in that region and Japan, and to examine if a shift of FDI to one country occurs, as in the case of the Singapore Shift in ASEAN. However, in reality there is no region other than ASEAN that would be suitable for testing this hypothesis. Another way to critically test if the argument can be generalized—which appears more interesting and effective—is to analyze other countries’ services FDI in ASEAN. Korea for example would be a good candidate for analytical study given that it is an investment exporter and has economic agreements covering services and investment with each individual ASEAN country. If a similar phenomenon can be observed in Korea’s FDI in ASEAN, a thorough examination of the determinant factors of such a shift can be studied more fruitfully. If this phenomenon is unique to Japan, we should find factors peculiar to Japan that lead to the Singapore Shift in Japan’s FDI.

Another important follow-up research question is related to methodology. It is quite difficult to conduct regression analyses to assess the precise impact of each factor on bilateral services FDI flows at the sector-level, due mainly to gaps in investment data and the difficulty of including the level of investment restriction (in the context of bilateral agreements) in the explanatory variables. In-depth company-level case studies based on corporate executive interviews seem to be an effective alternative method to assess the decisive factors of services investment decisions, and to identify concrete business models applied in their Southeast Asian operations. In particular, the manner in which Japanese and other countries’ companies utilize their Singapore base to provide services to other ASEAN countries and whether Singapore, acting as a regional hub, actually crowds out operations in other Southeast Asian countries, should be examined at the individual company-level.
REFERENCES


APPENDIX

Figure A: Japan’s FDI in ASEAN by Sectors until 2004FY (FDIS)

![Figure A: Japan’s FDI in ASEAN by Sectors until 2004FY (FDIS)](image)

Source: Author’s calculation based on Japan’s FDIS statistics (various issues)

Figure B: Japan’s Manufacturing FDI in ASEAN by Country, 2000-2004FY (FDIS)

![Figure B: Japan’s Manufacturing FDI in ASEAN by Country, 2000-2004FY (FDIS)](image)

Source: Author’s calculation based on Japan’s FDIS statistics (various issues)

Figure C: Japan’s Services FDI in ASEAN by Country, 2000-2004FY (FDIS)

![Figure C: Japan’s Services FDI in ASEAN by Country, 2000-2004FY (FDIS)](image)

Source: Author’s calculation based on Japan’s FDIS statistics (various issues)