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## Dynamics of legal and economic integration in ASEAN business competitiveness and international challenges

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**Asia-Pacific Research and Training Network on Trade**

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## **Dynamics of legal and economic integration in ASEAN business competitiveness and international challenges**

*by*

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## Executive Summary

After having provided with an overview of the patterns of ASEAN integration, this study analyses the competitiveness of the ASEAN region in three steps. The first is to establish the theoretical framework on competitiveness. This framework constitutes the basis of our research. In the second step, we assess the competitiveness of ASEAN economies according to the *Global Competitiveness Report* (GCR) indices. The third step is to consider the main challenges facing ASEAN economies by focusing inter alia on the role of inward and outward foreign direct investment (FDI).

We find that the economic globalization process has created a new environment within which emerging-market firms as well as the firms of the developed countries are under greater pressure than ever before to invest abroad. For the time being, most internationally involved ASEAN firms base their competitiveness more on the country-specific advantages than on their own firm-specific advantages.

ASEAN firms need to improve the sophistication of their operations and strategies. In this respect, government may play an important role by increasing the internal and external competition and by improving the context of firms' activity (e.g. corruption, intellectual property, etc.). Since institutions play an important role in increasing the competitiveness of firms and national economies, a deeper analysis of their role in the specific case of ASEAN countries would help to identify some of the specific drivers and brakes of the economic development process. Firms should be put under competitive pressure to encourage them to innovate. Clusters policy may also improve the effectiveness of the business environment. The analysis of the diamond component on the basis of the GCR indicators may help to identify the main weaknesses to be addressed as well as the main forces which should be operating in such a way as to develop for each ASEAN country as well as for the ASEAN group as a whole, unique value propositions.

The ability of ASEAN countries to continue to reform and enhance their business environment and to upgrade their national enterprises to a more sophisticated level will determine their future competitiveness. On the one hand, it seems that economic integration will remain the key to ASEAN competitiveness in the face of fiercer competition in the global market place. On the other hand, the trade and investment relations of the ASEAN countries with other countries, particularly with developed economies, will also foster their investment development path and prosperity.

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## 1. Introduction

The rapid growth of emerging market economies in Asia has been a notable feature of the global economy in recent years. This growth has been led most visibly by China and, increasingly, India, but several other Asian countries play an important and vibrant role as well. For the next few decades economic policy decisions in Asia, and in particular in the ASEAN community, will have profound effects on East Asia's economic integration and on the global economy. The ASEAN region has experienced remarkable economic dynamism and is actively engaged in an ambitious scheme of regional integration.

As ASEAN governments place greater emphasis on strengthening their domestic economies, the market is likely to continue to expand dynamically. There are the advantages of the tremendous growth opportunities, dynamism, and stability of a unified ASEAN bloc. ASEAN's agreement to create a unified market by 2015 is an extremely ambitious project, going well beyond anything it has attempted in the past. Indeed, the ASEAN Economic Community (AEC) promises to establish free flows of goods, services and FDI, as well as freer flows of skilled labour and cross-border capital. The goals are so ambitious that to be successful, this project to deepen regional integration will require a tremendous amount of political backing from both internal and external sources. Individually, ASEAN countries possess many strengths that have been crucial to their progress. Perhaps never in ASEAN's history has the alignment of political and economic aspirations been as strong as can be observed now. This alignment of interests allows ASEAN's members to pool their strengths in the pursuit of common goals.

After having provided with an overview of the patterns of ASEAN integration, this paper discusses the competitiveness of the ASEAN region in three steps. The first is to establish the theoretical framework on competitiveness. This framework constitutes the basis of our research. In the second step, we assess the competitiveness of ASEAN economies according to the *Global Competitiveness Report* (GCR) indices. The third step is to consider the main challenges facing ASEAN economies by focusing inter alia on the role of inward and outward foreign direct investment (FDI). One way to gauge the competitiveness of the ASEAN countries is to analyse their relative positioning towards FDI. According to Porter, Ketels and Delgado (2007), inbound and outbound FDI can serve as intermediate indicators of competitiveness. The view that a country's position towards FDI reflects its competitiveness is also shared in the investment development path (IDP). According to Dunning, Kim and Park (2008, p. 164), a country's trajectory along the investment development path 'reflects the changing competitive advantages of firms from particular countries vis-à-vis their foreign competitors, and the changing attractiveness of countries with respect to costs, markets, opportunities and natural or created resource endowments'.

## 2. Stakes and patterns of ASEAN integration

The regional integration process in which ASEAN is engaged is crucial for several reasons. First, if we look first at the Asian region broadly understood and in particular at its governance and its effects at the global level, the development of a strong community will help balance the economic power of China and India. Individually, ASEAN countries are, perhaps, too small to be important players in the economic and security game,<sup>1</sup> but as an integrated group of half a billion people they would be in the “major league”. The rise of ASEAN as an economic power (with similar advantages in production and scale to those of China and India) will help to bring greater symmetry and balance to managing the important transitional period in which we are now living. Second, the pivotal role of ASEAN in the region has to be underscored. ASEAN can be particularly effective, given its central role in regional organizations such as the Asia Pacific Economic Cooperation forum, ASEAN+3 (ASEAN plus China, Japan, and Republic of Korea), and the East Asian Summit (Bui, 2008). Finally, these developments also have an impact on politics. Integration will make the region safer by reducing development gaps and associated tensions within ASEAN, a stated priority on the integration agenda. To this extent, ASEAN economic integration will favour the strategic interests of the European Union and the United States of America (US). ASEAN countries are critical allies in the “war on terror” (Jones, 2006) and some have long-standing (albeit low-level) insurgencies. Assistance from the US in confronting these problems can be gained at both the local and regional levels. A strong AEC will also increase ASEAN’s potential leverage (and willingness to exercise that leverage) over Myanmar.

The 43rd ASEAN Ministerial Meeting (AMM) took place in Hanoi on 19 July 2010 along with 20 other related meetings to pave the way for the 17th ASEAN Summit organized in Viet Nam in October 2010.<sup>2</sup> This 17th ASEAN Regional Forum (ARF) will hold discussions on foreign policy and security issues. But since ASEAN has become an increasingly attractive destination for major global investors and the forthcoming ASEAN Summit will explore ways and means to improve even more the ASEAN attractively for FDI. Some concerns have arisen that the current crisis could weaken or slow down the regional integration process. However, in these uncertain times there is no doubt that ASEAN regional integration will continue and should even be strengthened and accelerated. Indeed, regional integration can cushion its members against the current global crisis and increase the resilience of the economies including through stronger intra-regional trade. Enhancing regional integration is the right response to the crisis. ASEAN regionalism is quite different from the conventional regionalism seen elsewhere. ASEAN integration schemes are not about integration among ASEAN members with the intention of forming a “closed or discriminatory trading bloc”, but rather a way for ASEAN countries to cooperate to increase their international competitiveness and integration with the world.

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<sup>1</sup> ASEAN was founded for two main reasons. Firstly, it was a means to promote peace and stability in the region. At that time, Southeast Asia was divided by ideological conflict and war. Coupled with territorial disputes and racial tensions between neighbours, there was a possibility that the differences could degenerate into a full-blown armed conflict, leading to a prolonged fragmentation of Southeast Asia. Secondly, it was founded to contain the spread of Communism to Southeast Asian countries. China at the time openly adopted a policy to export revolutions to Southeast Asia and had supported a number of local insurgency movements. See also Rodolfo Severino, “Association of South East Asian Nations,” Southeast Asia Background Series No. 10, Institute of Southeast Asian Studies, Singapore 2008, pp. 11–40.

<sup>2</sup> ASEAN Viet Nam 2010 available from [http://asean2010.vn/asean\\_en/news](http://asean2010.vn/asean_en/news)

The so-called “ASEAN way” puts a premium on consensus and maintaining the sacrosanct principle of non-interference in the internal affairs of member states (Zhu G., 2007). Unlike Europe, Southeast Asia did not have a long history of bloody inter-state conflict and hence the confidence-building measures required to create a peaceful environment as a prerequisite for growth and development were of a different order (Zhu J., 2007). Furthermore during the Cold War, in the European case, the external hegemonic power, namely the US, encouraged regional integration whereas, in the Southeast Asian, case the US preferred a system of bilateral relations with individual countries and the incorporation of those countries within the much wider politics of the Asia-Pacific region. Opinion is divided on whether the ratification of the ASEAN Charter does indeed constitute a milestone in the history of the Association, coming as it did some forty years after its foundation, or whether it is a toothless document devoid of significance.<sup>5</sup> In Europe the approach has been to institutionalize regional integration first and to worry about a sense of European identity later – it being taken for granted that a mental Europe exists in the minds of Europeans. On the contrary, given that the very notion of Southeast Asia is of very recent origin (from the 1940s), the underlying concern in Southeast Asia has been terminology. The main concern therefore is with confidence building based on finding consensus on positions with which political elites feel comfortable. As a number of critics have indicated, this can mean accepting the lowest common denominator.

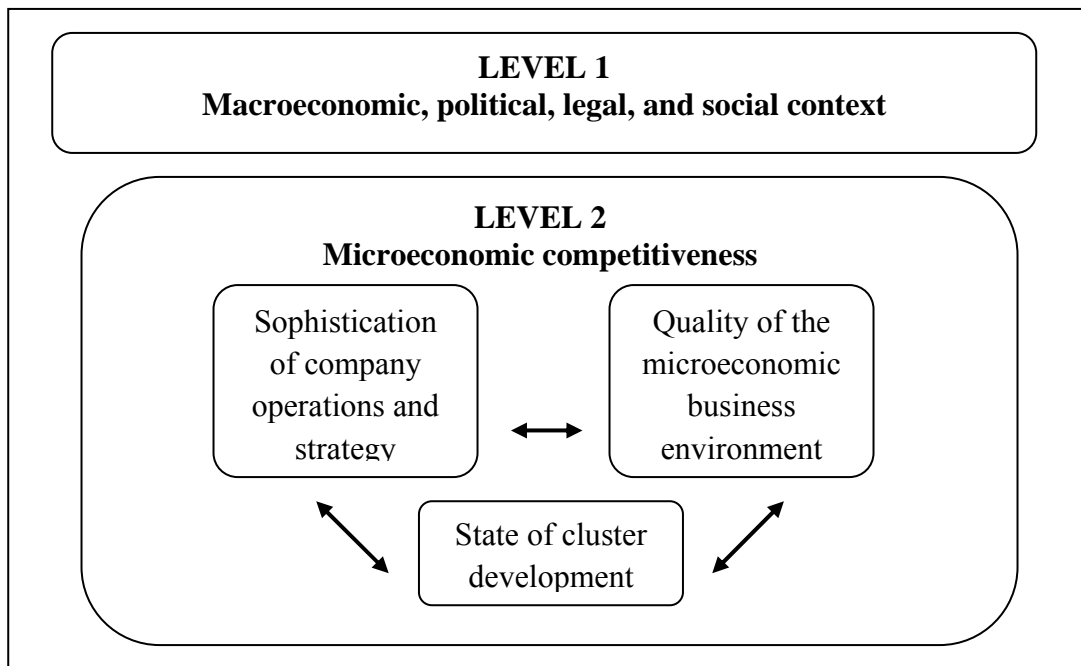
It is worth remembering that the ASEAN Charter speaks merely of ‘democratic development’ (not democracy per se) and the ‘spread of the market economy’ (not free enterprise or capitalism). In other words, the Charter is more about process than the setting of goals. Hence, while the goal is the creation of an ASEAN Community, the three pillars supporting this goal (the ASEAN Political-Security Community, the ASEAN Economic Community and the ASEAN Socio-Cultural Community) are in fact expressions of ongoing lightly structured processes. Of particular concern for many was Article 14 of the Charter, which envisages the creation of a High Level Panel to establish an ASEAN human rights body. Once again there was disappointment among Europeans at the vagueness of the proposal and the foreseeable lack of enforcement mechanisms.

Yet for some Southeast Asian participants, this incremental approach is the only possible way forward and the acceptance of such a body by the new, more authoritarian, ASEAN members is a positive step. In this regard, while ASEAN may have celebrated its 40th Anniversary recently, as a post Cold War Association covering all of Southeast Asia, it is just over a decade old. Will institutional creation engender its own momentum with significant spill-over effects (Chaise, 2006), as in Europe? It seems that any definitive assessment is premature, even if ASEAN has clearly entered a new stage in its development and could very soon fulfill its promises. The economic competitiveness is a key success factor to any regional integration and will hence remain very important for ASEAN in its quest for business competitiveness which we analyse in the following section.

### 3. Business competitiveness: the theoretical background

Competitiveness is a major preoccupation of both advanced and developing countries in an increasingly open and integrated world economy. However, despite its acknowledged importance, the concept of competitiveness is misunderstood (Ketels, 2006). The causes and effects of economic performance are confused. It is therefore important to explain the theoretical background of competitiveness and in doing so to identify the real roots of competitiveness of nations. Michael Porter offers a precise framework to analyse the roots of the competitiveness of ASEAN economies. The Global Competitiveness Index, published each year by the World Economic Forum, is based on this conceptual framework (World Economic Forum, 2010). We will scrutinize the competitiveness of the ASEAN economies on the basis of strong data which may be compared from one country to another. Economic prosperity is determined by the productivity of an economy (Lewis, 2005). The productivity is measured by the value of goods and services produced per unit of the nation's input (human, capital and natural resources). As indicated by Porter, "Productivity depends both on the value of a nation's products and services, measured by the prices they can command in open markets, and the efficiency with which they can be produced" (World Economic Forum, 2007, p. 52). Figure 1 illustrates the main determinants as well as the conceptual framework of competitiveness. It is important to distinguish the macroeconomic, political, legal and social context (level 1) from the microeconomic determinants of competitiveness (level 2).

*Figure 1: Determinants of competitiveness*



Source: Adapted from World Economic Forum 2007.<sup>3</sup>

A stable and sound context (level 1) improves the opportunity to create wealth, but does not create wealth on its own (World Economic Forum, 2007). Productivity depends on the microeconomic

<sup>3</sup> The WEF 2010 does not provide updated data.



component of an economy (level 2). According to Porter, “Wealth is actually created in an economy at the microeconomic level – in the ability of firms to create valuable goods and services using efficient methods. Only firms can create wealth, not government or other societal institutions” (World Economic Forum, 2007, p. 51).

However, level 1 is a prerequisite to maintaining and upgrading a microeconomic context able to create wealth. This level constitutes an important challenge for most countries, but particularly for developing and emerging countries. As illustrated in figure 1, the microeconomic determinants of productivity rest on three interrelated areas: i) the sophistication of firms’ – domestic or foreign affiliates – operation and strategy; ii) the quality of the microeconomic business environment in which they operate; and iii) the state of development of clusters. According to Porter, the business environment depends on four main attributes of a nation, attributes that individually and as a system constitute the ‘diamond of national advantage’, or in other words, the playing field that each nation establishes and operates for its industries (Porter, 1998). These four attributes are:

- The factor conditions: the country’s position in factors of production, such as skilled labour or infrastructure, necessary to compete in a given industry;
- Firm strategy, structure and rivalry: the conditions governing how companies are created, organized, and managed, as well as the nature of domestic rivalry.
- Related and supporting industries: the presence or absence in the nation of suppliers’ industries and other related industries and institutions that are internationally competitive. These industries may be clustered.
- Demand conditions: the nature of domestic market demand for the industry’ products or services.

Multiple geographical levels of a national economy influence the quality of its business environment. In this respect, economic cooperation and coordination among neighbouring countries or countries located within a region is an important tool for improving the business environment, as well as for expanding trade and investment. Several alternative models based on the diamond have been developed over time (Rugman and D’Cruz, 1993; Rugman and Verbeke, 2003; Geisler Asmussen et al., 2008; Cho et al., 2008). Most of them, however, recognize the crucial role of the four facets developed by Michael Porter in determining the competitiveness of a given economy.

Of course, successful economic development is a process of several upgrading of the above mentioned components, in which an economy’s business environment evolves. This evolution as well as the determinants and the challenges differ according to the level of development of a given economy. Three main stages of development are considered (World Economic Forum, 2007): factor-driven economies, efficiency-driven economies (or in Porter’s definition: investment-driven economies) and innovation-driven economies.<sup>4</sup> Factor-driven economies compete on their factor endowments, primarily labour and natural resources. Firms compete primarily on the basis of price and supply of basic products and commodities, with their low productivity reflected in low wages. The main area of the diamond is the condition of factors. Investment-driven economies are

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<sup>4</sup> In the GCR, countries are allocated to stage of development on the basis of two criteria. The first criterion is the level of GDP per capita at market exchange rate. The second criterion is the extent to which countries are factor-driven economies according to the share of exports of primary goods in total exports (goods and services). It is assumed that economies that export more than 70 per cent of primary products are to a large extent factor driven.

characterized by more efficient production processes and better product quality. As stated by Porter, ‘heavy investment in efficient infrastructure, business friendly government administration, strong investment incentives, improving skills, and better access to investment capital allow major improvements in productivity’ (World Economic Forum, 2007). Technology comes through licensing, joint ventures, FDI and imitation. At this stage, nations assimilate foreign technology but also begin to develop the capacity to improve technology themselves.

Finally, as economies move into the innovation-driven stage, they are able to sustain higher wages and the associated standard of living only if their firms are able to compete with new and unique products. At this stage, firms must compete through innovation, producing new and different goods using the most sophisticated production processes. The dominant source of competitive advantage is the ability to produce innovative products and services at the global technological frontier using the most advanced methods. The national business environment is characterized by strengths in all parts of the diamond. Table 1 classifies ASEAN countries according to the main stages of development described above.

**Table 1:** ASEAN countries classified according to their stages of development

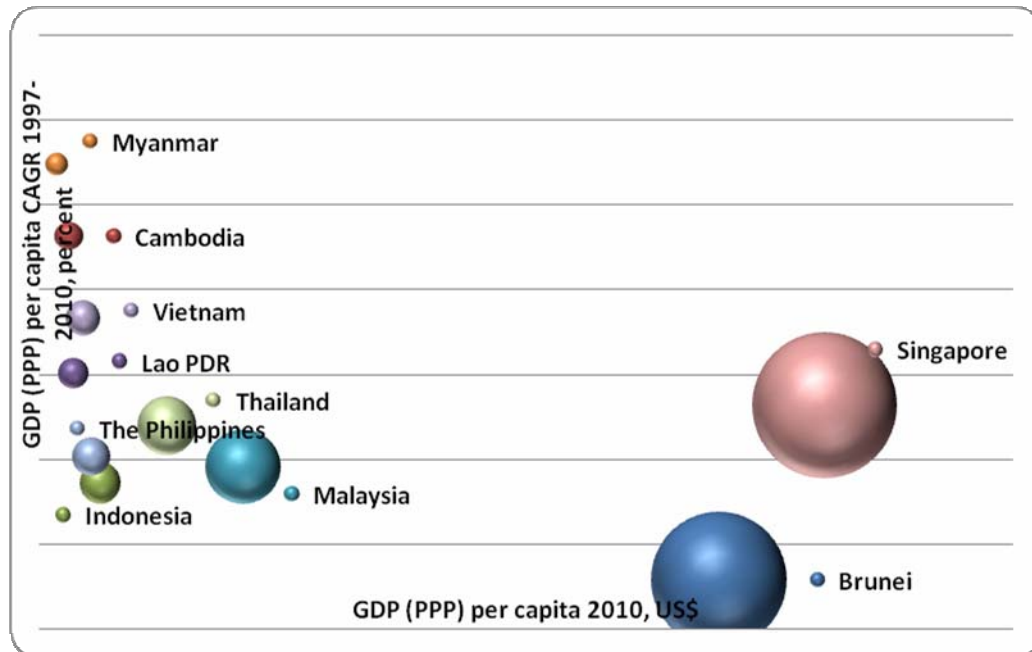
Factor-driven economies	Cambodia Indonesia Philippines Viet Nam Lao People’s Democratic Republic* Myanmar* Brunei Darussalam*
Efficiency-driven economies	Malaysia Thailand
Innovation-driven economies	Singapore

*Source:* Elaboration based on World Economic Forum 2010 (\*authors’ own classification).

#### 4. Economic performance of ASEAN countries and their determinants

The main indicator of economic performance is GDP per capita. Countries can be classified as low-, middle- and high-income based on this indicator. In its GCR report, the World Economic Forum used the cut-off point of US\$ 4,000 to distinguish low- from middle-income countries and US\$ 17,000 for separating middle- and high-income ones. In ASEAN, only Singapore and Brunei Darussalam are high-income countries, while Malaysia, Thailand and the Indonesia rank as middle-income, and the rest are considered low-income countries. With the single exception of Brunei Darussalam, whose high GDP per capita results from the country's revenue from oil, grouping the ASEAN countries based on GDP per capita yields similar results to those obtained when the stage of development is used as the criterion. ASEAN's low-income countries, namely the Philippines, Viet Nam, Cambodia, as well as Indonesia, are in the factor-driven stage of development, while Thailand and Malaysia fall under both the middle-income and investment-driven economies, and Singapore is the only one ASEAN country that has reached the innovation-driven stage. Figure 2 illustrates the GDP per capita (PPP) of ASEAN countries for 2010 as well as the compound annual growth rate (CAGR) of GDP per capita (PPP) for the period 1997–2010. In an international GDP per capita (PPP) comparison, Singapore and Brunei Darussalam rank third and fifth whereas the other ASEAN countries rank between the 57th (Malaysia) and the 160th places (Myanmar).

**Figure 2: Gross domestic product (GDP) per capita (PPP, US\$) of ASEAN Countries 2010 and compound annual growth rate (CAGR) 1997–2010**



Notes: Size of bubbles representing GDP (PPP) per capita 2010; 2010 data is based on estimates by IMF staff.

Source: Elaboration based on International Monetary Fund (IMF) 2011.

As mentioned above, the macroeconomic, political, legal and social context is very important because it determines the opportunities to create wealth by influencing inter alia domestic and international investment, and the efficiency of business activities. Since this contribution focuses on the determinants of competitiveness, we will concentrate mainly on the microeconomic determinants of prosperity.

Regarding the main drivers of the competitiveness of ASEAN countries, let us focus on the major indicators developed by the Global Competitiveness Index (GCI). The GCI ranks 139 countries. The GCI covers seven ASEAN countries: Singapore, Malaysia, Indonesia, Thailand, the Philippines, Viet Nam and Cambodia.

According to Michael Porter's framework (see figure 1) two types of indicators may be extracted: namely, company operation and strategy indicators (COS) and national business environment indicators (NBE). These two microeconomic components of prosperity interact, the firms influencing the business environment and the business environment affecting the sophistication of firms' operations and strategies. The third component indicated in figure 1, the stage of cluster development, is in fact a major element of a business environment (Gugler and Brunner, 2007). Therefore, two main kinds of distinctive determinants have to be considered: i) the company, and ii) the business environment (including stage of cluster development). The three microeconomic indicators for ASEAN are presented in Table 2, whereas details of each indicator are shown in Tables 3 and 4.

**Table 2: The Global Company operation and strategy sub-indices 2010**

Country		Singapore	Malaysia	Indonesia	Thailand	Philippines	Viet Nam	Cambodia
GCI ranking	2010*	3	26	44	38	85	59	109
	2009**	3	24	54	36	87	75	110
	2008***	5	21	55	34	71	70	109
	2007****	7	21	54	28	71	68	110
	2006*****	8	19	54	28	75	64	105
COS ranking <sup>o</sup>	2007	14	20	23	36	46	79	106
	2006	14	22	32	33	44	76	100
	2005	14	26	42	34	40	76	n/a
NBE ranking <sup>o</sup>	2007	8	22	40	36	73	78	114
	2006	9	22	45	36	74	79	104
	2005	7	23	56	35	74	75	n/a
GDP per capita <sup>oo</sup>	2009	49763.958	13733.308	4155.451	8488.695	3515.941	2941.676	1993.068

Notes: \* out of 139 ranked countries; \*\* out of 133; \*\*\* out of 134; \*\*\*\* out of 131; \*\*\*\*\* out of 122; <sup>o</sup> out of 127; <sup>oo</sup> PPP, US\$; n/a, not available.

Source: Elaboration based on World Economic Forum 2007, 2008 and 2010, and on International Monetary Fund (IMF) 2011.

**Table 3: Company operation and strategy sub-indices 2010**

<b>COS SUBINDEXES*</b>	<b>SGP</b>	<b>MYS</b>	<b>IDN</b>	<b>THA</b>	<b>PHL</b>	<b>VNM</b>	<b>KHM</b>	<b>CHN</b>	<b>IND</b>
GCI ranking	3	26	44	38	85	59	109	27	51
Production process sophistication	14	30	52	60	86	69	118	55	43
Nature of competitive advantage	14	34	33	70	67	110	77	48	61
Capacity for innovation	17	25	30	56	80	32	101	21	33
Extent of staff training	4	13	36	62	46	58	92	57	59
Willingness to delegate authority	21	17	32	77	38	64	104	68	48
Extent of marketing	20	31	56	46	50	51	109	49	57
Degree of customer orientation	18	23	60	24	42	76	69	70	64
Company spending on R&D	8	16	26	48	85	33	82	22	37
Value chain breadth	10	20	26	37	59	76	103	41	42
Control of international distribution	58	17	33	41	45	72	124	42	64
Reliance on professional management	9	25	57	60	47	72	97	50	49
Prevalence of foreign ownership	2	56	54	60	104	114	91	103	81

Note: \* ranking out of 139 countries.

SGP: Singapore; MYS: Malaysia; IDN: Indonesia; THA: Thailand; PHL: Philippines; VNM: Viet Nam; KHM: Cambodia; CHN: China; IND: India.

Source: Elaboration based on World Economic Forum 2010.

**Table 4: National business environment sub-indices 2010**

<b>NBE SUBINDICES*</b>	<b>SGP</b>	<b>MYS</b>	<b>IDN</b>	<b>THA</b>	<b>PHL</b>	<b>VNM</b>	<b>KHM</b>	<b>CHN</b>	<b>IND</b>
<b>NBE FACTOR CONDITIONS SUBINDICES</b>									
GCI ranking	3	26	44	38	85	59	109	27	51
Reliability of police services	2	50	80	87	105	41	115	51	68
Quality of overall infrastructure	3	27	90	46	113	123	83	72	91
Quality of railroad infrastructure	6	20	56	57	97	59	99	27	23
Quality of port infrastructure	2	19	96	43	131	97	82	67	83
Quality of air transport infrastructure	2	29	69	28	112	88	83	79	71
Quality of electricity supply	9	40	97	42	101	98	112	52	110
Fixed telephone lines	28	80	82	93	106	35	135	57	110
Quality of primary education	3	30	55	73	99	78	111	35	98
Quality of maths and science education	1	31	46	57	112	51	111	33	38
Quality of management schools	6	35	55	58	61	107	118	63	23
Local availability of specialized research and training services	19	25	52	69	77	104	111	50	51
Cooperation in labour–employer relations	1	16	47	34	56	38	80	58	49
Financing through local equity market	5	11	13	28	56	35	123	52	10

Ease of access to loans	4	10	14	31	55	71	92	51	39
Venture capital availability	3	8	9	44	75	57	76	27	31
Mobile telephone subscribers	17	47	98	32	88	58	122	111	118
Internet users	16	39	107	86	112	83	137	77	118
Quality of scientific research institutions	11	32	44	59	108	63	106	39	30
University–industry research collaboration	6	22	38	42	85	62	115	25	58
Availability of scientists and engineers	10	33	31	40	96	66	121	35	15
Utility patents per million population	11	29	89	65	71	87	90	51	59
<b>NBE RIVALRY SUBINDICES</b>									
Property rights	3	41	84	89	99	81	110	38	61
Intellectual property protection	3	33	58	84	103	109	9	49	66
Judicial independence	21	52	67	54	111	64	108	62	41
Favouritism in decisions of government officials	3	38	28	76	131	61	58	37	72
Efficiency of legal framework in settling disputes	1	30	60	46	122	61	72	44	47
Efficiency of legal framework in challenging regulations	6	30	55	48	116	58	61	51	37
Efficacy of corporate boards	5	17	54	78	56	74	95	85	76
Business costs of terrorism	102	103	101	120	126	109	107	79	127
Business costs of crime and violence	17	93	75	82	104	88	95	47	67
Intensity of local competition	28	38	54	37	65	75	106	19	30
Extent of market dominance	14	30	42	69	109	48	80	23	26
Effectiveness of anti-monopoly policy	9	32	35	56	92	58	79	50	29
Prevalence of trade barriers	5	88	58	70	89	112	77	69	96
<b>NBE RELATED INDUSTRIES SUBINDICES</b>									
Local supplier quantity	63	29	43	26	68	61	129	19	7
Local supplier quality	39	37	61	43	70	91	121	54	60
<b>NBE DEMAND SUBINDICES</b>									
Buyer sophistication	10	24	35	46	60	45	53	7	43
Government procurement of advanced technology products	2	8	30	59	129	18	65	12	76

Note: \* ranking out of 139 countries.

SGP: Singapore; MYS: Malaysia; IDN: Indonesia; THA: Thailand; PHL: Philippines; VNM: Viet Nam; KHM: Cambodia; CHN: China; IND: India.

Source: Elaboration based on World Economic Forum 2010.

Successful economic development depends on a process of upgrading, in which the national business environment supports and encourages sophisticated and competitive practices of firms located there (Porter, 2008). Nations at different levels of economic development are therefore facing different challenges. Factor-driven economies, which are often low-income countries, are challenged by the need to integrate foreign technology through inward direct investment in order to upgrade their status to the next level. Indicators that are significant at this stage include: competitive advantages that are beyond cheap inputs, production process sophistication, value chain breadth and reliance on professional management. Firms of the investment-driven and middle-income economies are challenged by the need to increase their efficiency at producing more advanced products and services. Crucial indicators at this stage include: extent of regional sales, control of international distribution, extent of branding, company spending on research and development (R&D), prevalence of foreign technology licensing and extent of staff training. Once countries reach the innovation-driven stage, their firms are confronted by the need to sustain and upgrade their competitiveness through factors such as the capacity for innovation, the breadth of international market coverage, and the willingness to delegate autonomy (World Economic Forum, 2010).

A closer look at the COS sub-indices for the ASEAN factor-driven economies reveals that Indonesia performs better than the Philippines, Viet Nam and Cambodia in all the four COS indicators that are crucial for their stage. The higher COS scores of Indonesia can be interpreted as this country having a better opportunity to upgrade to the efficiency-driven stage than the Philippines, Cambodia and Viet Nam. The main weaknesses that the latter three countries need to address are the sophistication of their firms' production processes and nature of competitive advantage, and the need to integrate more professional management. Of the two investment-driven economies of ASEAN, Malaysia outperforms Thailand in all categories. Thailand's most apparent weakness lies in the areas that are most crucial for a further upgrading, such as company spending on R&D, the extent of staff training and the prevalence of foreign ownership. The strongest performer in ASEAN is Singapore, whose strength is based on the prevalence of foreign ownership, the extent of staff training, the reliance on professional management and the company spending on R&D.

Regarding the national business environment features, we may rely on the components of the diamond to analyse the forces and weaknesses of ASEAN countries. Let us observe the performances according to the main important factor condition components. Under factor condition, we do not rely solely on inherited factors such as labour, natural resources, capital and infrastructure, but also include factors that involve sustained and important investment and are specialized. These are created factors. As noted by Porter, 'nations succeed in industries where they are particularly good at factor creation' (Porter, 1998).

We observe that Singapore (ranked 3<sup>rd</sup>), followed by Malaysia (27<sup>th</sup>) and Thailand (46<sup>th</sup>) benefit from a high quality of overall infrastructure. Regarding the quality of primary education, only Singapore (ranked 3<sup>rd</sup>) and Malaysia (30<sup>th</sup>) benefit from real forces. The same observation is made of the quality of management school. Thailand remains ahead of Singapore, Indonesia and Malaysia in the field of local availability of specialized research and training services as well as financing through local equity market. Factor conditions are quite weak in Cambodia, the Philippines and Viet Nam, which are factor-driven economies. A lack of sophisticated and created assets undermines their economic performances.

One of the most important determinants of national competitiveness in an industry is the context in which firms are created, organized, and managed, as well as the nature of rivalry. As indicated by Porter, 'the pattern of rivalry at home also has a profound role to play in the process of innovation

and the ultimate prospects for international success' (Porter, 1990). Important competitive advantages of Singapore rely on this facet of the diamond, since international competition is quite strong. On one side, property rights and intellectual property protection are well enforced and on the other side, the prevalence of trade barriers is quite low. However, there is room for strengthening domestic competition. Most of the other ASEAN countries are quite protected from international competition and the intensity of domestic competition is rather weak. Domestic firms lack the powerful stimulus required to create and sustain strong competitive advantages. Many studies have shown that the lack of competition negatively affects firms' productivity and innovation management (OECD, 2006; OECD, 2005).

The third broad determinant of national competitiveness in a specific industry is the presence within the nation of supplier industries or related industries that are internationally competitive (Porter, 1990). As observed by Porter, competitive advantage in some supplier industries confers potential advantages on a nation's firms in many other industries, because they produce inputs that are widely used and important to innovation and to internationalization (Porter, 1990). In this field, Singapore is facing major weaknesses in particular as far as quantity and quality of local suppliers are concerned.

The fourth component of the diamond is the demand conditions. As stated by Porter, nations gain competitive advantage in industries where the home demand gives their companies a clearer or earlier picture of emerging buyer needs, and where demanding buyers pressure companies to innovate faster and achieve more sophisticated competitive advantages than their foreign rivals' (Porter, 1998). The ASEAN countries register a lower score than the NBE score for most sub-indicators, reflecting the demand condition. This is not surprising since demand conditions become stronger drivers of competitive advantage once the country has already achieved a high level of development. Of course, other factors such as historical legacy and government policies affect the factors of the four components of the diamond. As far as government policies are concerned, their effectiveness is directly reflected in the strengths or the weaknesses of most of the diamond's components (e.g. availability and quality of infrastructure, effectiveness of competition policy, and effectiveness of education). A deep analysis of government policies as well as of the historical legacy of each country would go beyond the scope of this chapter. However, these features play an important role in the dynamics of the 'diamond' and of the firms located within a specific economy. The example of Singapore is eye-catching. Since achieving independence in 1965, Singapore has reached one of the highest rates of growth in the world. Limited in size and natural endowments, Singapore historically derived its competitive advantage from its natural port and strategic location at point of convergence of important shipping lines. The classic port-based *entrepôt* economy was closely related to the development of shipping, communications, banking, and insurance services and facilities. On this basis, Singapore was guided towards a Unique Value Proposition by the nation's first prime minister after independence, Lee Kuan Yew. The government viewed the port as its lifeline. Singapore promoted the development and expansion of the former British Navy refuelling facilities by multinational oil companies interested in developing oil deposits in Indonesia, and soon became the largest petroleum refining centre in Asia. The British naval dockyards were converted into a ship-repair centre and Singapore's importance as a port increased. Infrastructure, a hardworking labour force, and a pro-business government shaped Singapore's competitive position on the world markets. Contrasting with its relatively unstable neighbours, Singapore became a main attraction for FDI and a protagonist for regional economic development.

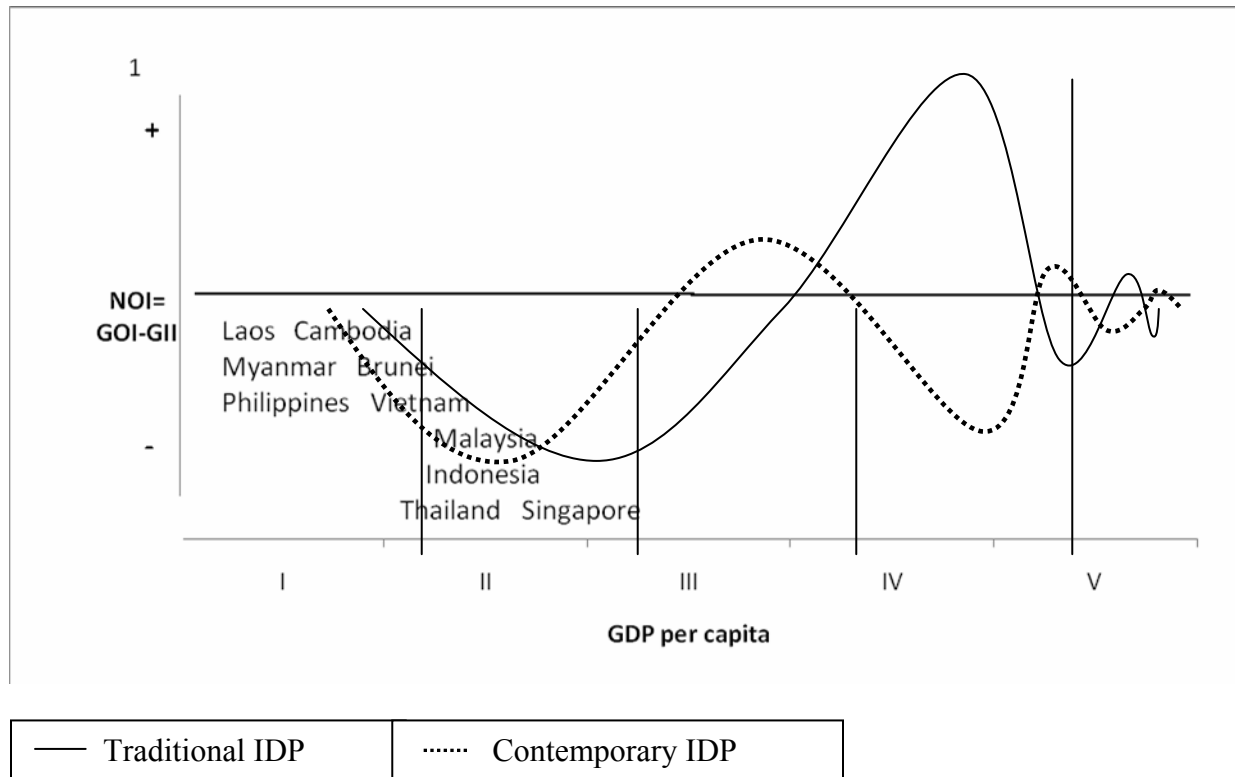


## **5. Challenges for ASEAN competitiveness in the international arena**

As observed above, the competitiveness features of the ASEAN economies are at different stages and levels. A different indicator for national competitiveness is a country's international investment positioning (Dunning and Gugler, 2008). One theory that links a country's involvement in inward and outward FDI is the investment development path (IDP). According to the IDP theory, a country's inward and outward investment position is systematically linked to its level and structure of economic development as well as to the degree of competitive advantages of its firms (see Dunning, 1981; Dunning and Narula, 1996, 2004; Dunning et al., 1997). Countries will engage in outward FDI only when they have reached a certain level of economic development, at which time domestic firms have accumulated sufficient competitive advantages (Dunning, 1998; Dunning and Lundan, 2008). The IDP suggests that as countries move through the different stages of economic development, each of which reflects the countries' propensity to move from being net recipients to become net sources of FDI, their firms display different levels of competitiveness.

In the first stage when countries have few location-specific factors and domestic firms have not yet accumulated enough ownership advantages to engage in overseas activities, there is likely to be little inward and outward FDI. In the second stage, inward FDI starts to rise as location-specific factors develop, but outward FDI remains minimal owing to the continuing development of local firms. During this stage, the country continues to be a net recipient of FDI. As indigenous firms accumulate their ownership advantages in stage 3, they begin to expand abroad, leading to an increase of outward FDI. Stage 4 is reached when a country's outward FDI stock exceeds or equals that of inward FDI, reflecting the competitiveness level of domestic firms in the global economy. Finally at stage 5, the country's net investment position tends to fluctuate around zero—a sign of a similar significance level of inward and outward FDI. Dunning and Narula (2004) placed the least developed countries, or those they call the 'falling behind' economies, in stages 1 and 2; the more advanced developing countries, the 'catching up' ones, were placed in advanced stage 2 and stage 3; and developed economies in stages 4 and 5. This view implies that as the competitiveness of Southeast Asian countries improves, we should see more of their outward investment (figure 3). We now explore outward FDI from ASEAN in greater detail.

**Figure 3: The Investment Development Path (IDP)**



Source: Elaboration based on UNCTAD 2008 and Dunning et al. 1996.

Two types of indicators that can be used to assess the role of ASEAN countries in their FDI activities are the percentage of inward/outward FDI stock<sup>5</sup> to GDP and the inward/outward performance index. While the former can indicate the significance of inward/outward FDI to the country's economy, the latter is an indicator of a home country's inward/outward FDI relative to its size in the world economy. It is calculated as the ratio of a country's share in global inflows/outflows to its share in global GDP (UNCTAD, 2006) (Table 5).

<sup>5</sup> The FDI statistics collected by UNCTAD's *World Investment Report* are based on national official data, complemented by those obtained from other international organizations (e.g. IMF) or regional organizations (e.g. ASEAN Secretariat) and UNCTAD's own estimates (UNCTAD 2008, p. 250). For those economies for which stock data are not available, estimates can be made by adding up FDI flows over a period of time. As the ASEAN Secretariat does not collect FDI stock data, this paper uses the UNCTAD estimate method by adding up FDI flows over the period for which statistics are available.

*Table 5: ASEAN as FDI home and host economies*

Country	Inward FDI stocks as a percentage of GDP			Outward FDI stocks as a percentage of GDP			Outward FDI stocks (US\$ millions)			Inward FDI performance index			Outward FDI performance index		
	1990	2000	2009	1990	2000	2009	1990	2000	2009	2005	2006	2009	2005	2006	2007
<b>Southeast Asia</b>															
Brunei Darussalam	1	64.5	100.2	–	7.4	6.9	–	447	732	2	64	58	47	60	74
Cambodia	2.2	43.1	48.2	–	5.3	2.9	–	193	307	–	–	–	–	–	–
Indonesia	6.9	15.2	13.5	0.1	4.2	5.6	86	6,940	30,183	106	103	119	43	43	52
Lao People's Democratic Republic	1.4	32.1	27.7	–	1.2	0.4	–	21	20	–	–	–	–	–	–
Malaysia	23.4	56.2	39	1.7	16.9	39.5	753	15,878	75,618	68	67	123	31	25	22
Myanmar	5.4	53.1	18.5	–	–	–	–	–	–	82	101	107	–	–	–
Philippines	10.2	24.2	14.5	0.9	2.7	3.8	406	2,044	6,095	109	99	110	59	67	49
Singapore	82.6	121.5	200.7	21.2	61.2	124.5	7808	56,766	213,110	4	6	18	12	8	10
Thailand	9.7	24.4	36.2	0.5	1.8	5.9	418	2,203	16,303	49	54	70	67	65	66
Viet Nam	25.5	66.1	57.1	–	–	–	–	–	–	55	62	41	90	86	84
<b>East Asia</b>															
China	5.1	16.2	10.1	1.1	2.3	4.9	4455	27,768	229,600	64	75	76	62	58	59
Hong Kong, China	262.3	269.3	432	15.5	6	395	1192	388,38							
Taiwan Province of China	5.9	6.1	13.1	18.4	20.7	49.2	6	66,655	181,008	132	122	122	28	31	34
Republic of Korea	2	7.4	13.3	0.9	5.2	13.9	2301	26,833	115,620	115	126	124	50	51	48
<b>South Asia</b>															
India	0.5	3.7	13.3	n.a	0.4	6.3	124	1,859	77,207	119	110	63	63	50	50
<b>Averages</b>															
<b>World</b>	<b>9.1</b>	<b>18.1</b>	<b>30.5</b>	<b>8.5</b>	<b>19.4</b>	<b>32.8</b>									
<b>Developing economies</b>	<b>13.6</b>	<b>25.2</b>	<b>27.8</b>	<b>4</b>	<b>12.9</b>	<b>14.6</b>									
<b>Asia</b>	<b>15.9</b>	<b>25.5</b>	<b>25.8</b>	<b>3.2</b>	<b>14.8</b>	<b>17.4</b>									

Source: UNCTAD (2010).

Table 5 confirms that ASEAN members remain largely recipients of FDI as opposed to being source countries. It is clear that inward FDI contributed overwhelmingly more to the ASEAN economies than outward FDI. The contribution of inward FDI to the overall economy of all ASEAN countries, except Indonesia, Myanmar and the Philippines, was also higher than the average of other developing economies, indicating the significance of inward FDI to their economy. One implication is that most of the ASEAN countries compete against each other for inward FDI from other countries. Their success differs, however. Table 6 shows that while Brunei Darussalam, Malaysia, Singapore and Thailand were included in the frontrunner group that attracts inward FDI, Indonesia, Myanmar and the Philippines were considered under-performers (UNCTAD, 2010).

**Table 6: Matrix of ASEAN's inward FDI performance and potential, 2008**

	High FDI performance	Low FDI performance
High FDI potential	<b>Front runners</b> Brunei Darussalam, Malaysia, Singapore, Thailand, Hong Kong, China	<b>Below potential</b> China, Taiwan Province of China, Japan, Republic of Korea
Low FDI potential	<b>Above potential</b> Viet Nam	<b>Under-performers</b> India, Indonesia, Myanmar, Philippines

Source: UNCTAD (2010).

When outward FDI stock is considered, only Singapore and Malaysia recorded a higher percentage of outward FDI stock per GDP (124.5% and 39.5%) than the developing countries' average (14.6%). Likewise, when the outward FDI performance index (for 2007) is compared, only these two countries were ranked in the top 25 of the overall 141 countries, whereas the Philippines, Indonesia and Thailand followed rather far behind. Applying the IDP model to these patterns, we can conclude that the ASEAN economies remain competitive in attracting inward FDI thanks to their location-specific advantages. By contrast, the competitiveness of the local firms in these economies, with the exception of Singapore and Malaysia, remains rather weak, leading to the relatively low level of outward FDI when compared to other emerging economies. Singapore and Malaysia's relatively prominent role as ASEAN's outward investors was clearly reflected by the absolute amount of their outward FDI stock. Although Southeast Asia ranked as the third most important source of FDI from developing economies following East Asia and South and Central America, the majority of outward FDI from this region originates from these two countries. In 2009, the outward FDI stock of Singapore and Malaysia accounted for about 85% of Southeast Asia's total outward FDI stock.

From the above analysis, we can conclude that despite Southeast Asia's increasing significance as an outward investor, this role is still limited when compared with the region's traditional role as FDI recipient. In addition, it is clear from the above table that ASEAN countries performed rather differently when it came to outward investment (Globerman and Shapiro, 2008; Pananond, 2008). While Singapore and Malaysia led the pack with their continued strong performance during 2005–2010, the Philippines showed a strong improvement, while Indonesia's performance dropped and Thailand showed no significant change during the same period (see Table 5). It should be noted that ASEAN countries are competing with other developing economies in their outward investment. Two other outstanding performers are China and India, both of which have improved their outward FDI performance over the same period. ASEAN's relatively weak performance on outward FDI implies that ASEAN firms are not doing too well when faced with strong challenges in the international arena. The weak competitiveness of ASEAN firms is reflected in their limited presence in the international markets. Very few ASEAN firms are currently among the world's major players. According to Fortune Global 500 (2010), of the world's largest corporations, only four firms—two from Singapore, one each from Thailand and Malaysia—originate from ASEAN. In the 2010 *World Investment Report*, 15 firms from ASEAN made it to the list of the top 100 multinationals from developing countries, while China alone accounted for thirteen. Table 7 shows details of these 15 multinationals from ASEAN.

**Table 7: ASEAN multinationals in the world's top 100 non-financial multinationals from developing and transition economies, ranked by foreign assets, 2008**

Country	Rank No.	Name of company	Industry
Singapore	13	Singtel Ltd.	Telecommunications
	26	Capitaland Limited	Real estate
	33	Wilmar International Limited	Food & beverages
	52	Flextronics International Ltd.	Electrical& electronic equipment
	61	Fraser & Neave Limited	Food & beverages
	71	Keppel Corporation Limited	Diversified
	86	Neptune Orient Lines Ltd.	Transport and storage
Malaysia	5	Petronas-Petroliam Nasional Bhd	Petroleum expl./ref./distr.
	31	Axiata Group Bhd	Telecommunications
	38	YTL Corp.Berhad	Utilities
	56	Genting Berhad	Hotels
	66	Sime Darby Berhad	Diversified
Philippines	91	Tanjong Public Limited Company	Pharmaceuticals
	85	San Miguel Corporation	Food & beverages
Thailand	89	PTT Public Company Limited	Petroleum expl./ref./distr.

Source: UNCTAD (2010).

Table 7 also reveals another significant characteristic of leading multinationals from Southeast Asia—that many of these firms are actually owned by the state. Partial state ownership in private firms is mostly evident among the Singaporean firms. Of Singapore’s top seven multinationals, six were partly owned by the Singaporean government through its main holding company Temasek (see also Goldstein and Pananond, 2008). Government-linked-companies (GLCs)<sup>6</sup> are the most active overseas investors for Singapore and Malaysia. Although for Malaysia, private non-GLCs have become increasingly active in expanding overseas, the role of GLCs in Singapore’s regional and global investment continues to be dominant. If one disregards these large GLCs, the presence of ASEAN multinationals is even more limited, further underlining the necessity for ASEAN firms to improve their business competitiveness.

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<sup>6</sup> For Singapore, GLCs are those in which Temasek Holdings or other statutory boards hold more than 20 per cent of the voting shares. For Malaysia, GLCs are defined as non-financial public enterprises in which the government has an equity of more than 50 per cent and with sales turnover of at least RM 100 million (see Bank Negara Malaysia, 2006).

## **6. Development of ASEAN free trade agreements**

The present round of talks on multilateral economic integration has reached a deadlock because issues of negotiation have been extended to non-tariff matters and are beyond the scope of pure trade (“trade and... issues” and Singapore issues). Developed and developing countries have been unable to reach an agreement on such matters as agricultural subsidies, labour standards and the environment. Developed countries found themselves in disagreement over the Doha Development Agenda (DDA), especially on Singapore issues: transparency in government procurement, trade facilitation, investment and competition policies. In fact, the General Agreement on Tariffs and Trade/World Trade Organisation (GATT/WTO) framework is incapable of dealing with new issues of international relations such as trade in services, e-commerce, government procurement, and movement of labour. Such new issues are now dealt with in regional trade agreements (RTAs) contributing to the attractiveness of regional deals in which ASEAN is now very much involved (Lester and Mercurio, 2009).

Analysts of trends in Asian regionalism have emphasized the risk of irrelevance, pointing in particular to APEC (Ravenhill 2001) and more recently to ASEAN (Aggarwal and Chow 2008, Ravenhill 2008). One source of concern comes from the fact that at the same time that members of Asian regional organizations elaborate new and ambitious plans, they continue to strike individual agreements either among themselves or with outside actors. Particularly intriguing and largely unexplored in Asian regionalism is the mismatch between ambitious action plans and very weak implementation machineries.

The bilateral relationships between India and China, India and Japan, and India and South Korea are growing, and this trend is likely to continue. ASEAN is an important institution and has significant geo-strategic value, making it an entity with which all the major powers could interact. This has given ASEAN an important position of influence, particularly in Asia. Currently, ASEAN holds separate annual summit meetings with China, Japan and Korea (ASEAN +3); and with India (ASEAN +1). As cooperation deepens, ASEAN is also actively broadening linkages with global partners. The APEC forum sees ASEAN cooperating with the US and others on both sides of the Pacific on economic issues. Supplementing its activities at the multilateral level, ASEAN has also exploited bilateral FTAs. There is no FTA between ASEAN and the US. However, effective FTAs with ASEAN seem to have become a US priority. Indeed, China, Japan, South Korea and India have negotiated such arrangements with ASEAN, and the European Union also hopes to reach a similar agreement. From the US perspective it seems, however, that at the moment, Southeast Asian policies are too varied for a serious US–ASEAN FTA to be feasible.

Nevertheless, several countries are ready for effective agreements, and once the ASEAN Economic Community has been in place for a few years, a modern, comprehensive arrangement will be feasible. The US would therefore be well advised to adopt a two-step approach:

- (1) begin negotiations with all remaining ASEAN countries by the end of 2010; and
- (2) plan for the creation of an ASEAN–US Economic Space by 2020.

FTA negotiations are, however, progressing with many countries. To date, individual ASEAN countries have initiated or completed more than 20 FTAs with major trade partners around the globe. It seems that an ASEAN model of an FTA is emerging. Most ASEAN FTAs focus essentially on trade in goods, with very shallow sector-specific liberalization commitments. Few ASEAN FTAs have yet reached the implementation stage, making it impossible at present to assess their economic effects. As in the case of WTO negotiations, agricultural liberalization is a sensitive issue in many middle- and low-income members of ASEAN, and many FTAs appear to be placing too much emphasis on the reduction of tariffs on agricultural products, which are also often a stumbling block to further negotiations on important areas, such as trade facilitation and investment liberalization. In any case main trade partners of ASEAN should consider the gap of developments among ASEAN countries and expect cautious negotiations. These efforts help to drive ASEAN's growth and ensure that the region's economic integration will realize its full potential.



## 7. Concluding Remarks

As East Asian countries begin to work more closely together, their economies will naturally become more integrated. As Asia's economies have grown larger and more complex, they have also become more integrated through trade, direct investments, financial flows, and other forms of economic and social exchange. ASEAN is fully part of this phenomenon with one specific characteristic which is its own institutional integration. During the past four decades, Southeast Asia has been transformed from a region of strife and poverty to one of progress and democracy. Much still remains to be done, and many promises have yet to be fulfilled, but ASEAN's "coming of age" is nevertheless a historic milestone.

Competitiveness is a major preoccupation of both advanced and developing countries in an increasingly open and integrated world economy. We considered it important to analyse ASEAN's competitiveness on two levels. The first level concerns the industrial competitiveness of ASEAN and the role of MNEs. Regional integration will work only if it is possible to deepen intra-ASEAN cooperation. Regional integration itself will only be a success if a second condition is met: namely, to broaden ASEAN's linkages with global partners what ASEAN will have to do by securing new deals with economies such as the US and the European Union. The competitiveness of ASEAN firms remains however limited and despite Southeast Asia's increasing significance as an outward investor, this role is still limited when compared with the region's traditional role as an FDI recipient. More precisely ASEAN economies' competitiveness features are at different stages and levels. Singapore is quite apart as an innovation driven economy. Singapore as well as other Asian countries that are not members of ASEAN seems to play the role of leading geese fostering the development of the other ASEAN countries.

The economic globalization process has created a new environment within which emerging-market firms as well as the firms of the developed countries are under greater pressure than ever before to invest abroad. As noted by Sauvart, international competitiveness of firms can also be reached creating a portfolio of locational assets, such as regional or global network of foreign affiliates (Sauvart, 2008, p. 7). Firms need ownership-specific advantages to be competitive in international markets and to be able to invest abroad (Ketels, 2008; Cantwell & Barnard, 2008, p. 80). As indicated by Sauvart, the survival in foreign markets as well as the prosperity in competition with domestic rivals become possible thanks to the combined effect of location of host countries, internalization within their own corporate networks and ownership-specific advantages (Sauvart, 2008, pp. 8-9). For the time being, most internationally involved ASEAN firms base their competitiveness more on the country-specific advantages than on their own firm-specific advantages (Rugman and Doh, 2008; Rugman, 2008; Gugler and Chaisse, 2009).

ASEAN firms need to improve the sophistication of their operations and strategies. In this respect, government may play an important role by increasing the internal and external competition and by improving the context of firms' activity (e.g. corruption, intellectual property, etc.). Since institutions play an important role in increasing the competitiveness of firms and national economies, a deeper analysis of their role in the specific case of ASEAN

countries would help to identify some of the specific drivers and brakes of the economic development process (Dunning et al., 2008). Firms should be put under competitive pressure to encourage them to innovate. Clusters policy may also improve the effectiveness of the business environment. The analysis of the diamond component on the basis of the BCI indicators may help to identify the main weaknesses to be addressed as well as the main forces which should be operating in such a way as to develop for each ASEAN country as well as for the ASEAN group as a whole, unique value propositions.

The ability of ASEAN countries to continue to reform and enhance their business environment and to upgrade their national enterprises to a more sophisticated level will determine their future competitiveness. On the one hand, it seems that economic integration will remain the key to ASEAN competitiveness in the face of fiercer competition in the global market place. On the other hand, the trade and investment relations of the ASEAN countries with other countries, particularly with developed economies, will also foster their investment development path and prosperity.

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