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63

ROLE OF REGIONAL COOPERATION: BUSINESS SECTOR DEVELOPMENT AND SOUTH-SOUTH INVESTMENT

ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

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Role of Regional Cooperation: Business Sector Development and South-South Investment

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PREFACE

This publication of the ESCAP Studies in Trade and Investment contains two papers that examine emerging issues in the field of business development among the developing Asia-Pacific countries and suggest some possibilities for regional cooperation in Asia and the Pacific. Those issues, the improvement of the business climate and the growth of the regional South-South investment, reflect an important part of the present interests of the Investment and Enterprise Development Section, Trade and Investment Division, ESCAP, and thus indicate the direction of its future work.

The first paper explores a role for regional (and subregional) cooperation in support of pro-business regulatory reform in Asia and the Pacific, and recommends some specific areas to explore further by the developing countries and donor agencies, where specific technical assistance must be provided to support such reform. The paper suggests to seek robust modalities of regional cooperation to support reform efforts across all or parts of Asia. Its conclusions present broad suggestions and hypotheses on likely fruitful areas for future regional cooperation initiatives, namely: 1) Intra-UN regional cooperation; 2) donor coordination; 3) regional forum and network; 4) training programme; 5) capacity building for national stakeholders; 6) support for sub-national agencies; and 7) regional diagnostic on the key regulatory constraints to trade and investment.

More and more developing countries in Asia are investing larger amounts of capital in other developing countries. The second paper provides an overview of the current trend of increasing South-South foreign direct investment (FDI) flows in Asia, specifically South, East and South-East Asia, as well as current policies and strategies related to inward and outward FDI. The paper also explores whether different impacts can be expected from South-South investment as compared to more traditional North-South FDI. Based on the findings, the paper presents some policy implications for developing countries aiming to better leverage FDI for sustainable development, and suggests a possible role of transnational corporations (TNCs) in this process. The paper concludes by examining contributions that regional cooperation could make to realize the benefits of FDI.

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CONTRIBUTORS

Nick J. Freeman is an independent economic development consultant. Prior to becoming an independent consultant, he was a Senior Fellow at the Institute of Southeast Asian Studies in Singapore, where he remains an Associate Senior Fellow. He was the first Viet Nam Analyst for Barings Securities in the mid-1990s, and then Head of Indochina Research at ING Barings, based in Bangkok. He holds an MA in South-East Asia from the School of Oriental and African Studies (SOAS) in London, and a Ph.D. in International Business from the University of Bradford. His current areas of expertise include private sector development and business liberalization in transitional economies, promoting FDI and portfolio investment inflows and SME finance.

Sung-Ah Lee is a former staff member of the Investment and Enterprise Development Section, Trade and Investment Division, ESCAP. Currently she is working as a project development and communication consultant at the German Agency for Technical Cooperation (GTZ) in pro-poor financial sector policy development. Prior to joining ESCAP, she was a marketing consultant at the International Trade Centre UNCTAD/WTO in Geneva and a marketing communications officer at LG Card Co. Ltd., a financial company in Seoul, Republic of Korea. She has worked in the fields of SME capacity-building, integrating SMEs from developing countries into global and regional value chains, South-South investment in the Asia-Pacific region and microfinance policy issues. She studied Consumer Science and Human Development at Ewha Women's University in Seoul, Republic of Korea and Media and Communications at the International University in Geneva, Switzerland.

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ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
APBF	Asia-Pacific Business Forum
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ATC	Agreement on Textiles and Clothing
BDS	Business development services
BEE	Business enabling environment
BIMP-EAGA	Brunei Darussalam, Indonesia, Malaysia, Philippines – East ASEAN Growth Area
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BIT	Bilateral investment treaty
BOT	Build, operate and transfer
BT	Build and transfer
BTO	Build, transfer and operate
CAREC	Central Asia Regional Economic Cooperation
CIEM	Central Institute of Economic Management of Viet Nam
CSR	Corporate social responsibility
DTT	Double taxation treaty
EDB	Economic Development Board of Singapore
EL	Enterprise Law
EPZ	Export processing zone
ESCAP	United Nations Economic and Social Commission for Asia and the Pacific
EU	European Union
FDI	Foreign direct investment
FEZ	Free economic zone
FIAS	Foreign Investment Advisory Service
FIE	Foreign-invested enterprise
FTA	Free trade agreement or free trade area

GDP	Gross domestic product
GMS	Greater Mekong Subregion
GMS-BF	GMS Business Forum
IFC	International Finance Corporation (part of World Bank Group)
IL	Investment Law
ILO	International Labour Organization
IPA	Investment promotion agency
IMF	International Monetary Fund
JETRO	Japan External Trade Organization
KOTRA	Korea Trade-Investment Promotion Agency
LDCs	Least developed countries
Matrade	Malaysia’s External Trade Development Corporation
M&A	Mergers and acquisitions
M&E	Monitoring and evaluation
MFA	Multi-Fibre Agreement
MFI	Multilateral financial institution
MPDF	Mekong Private Sector Development Facility (managed by IFC)
MNE	Multinational enterprise
NAFTA	North American Free Trade Agreement
NIE	Newly industrialized economy
ODA	Official development assistance
OECD	Organisation for Economic Cooperation and Development
OSCE	Organization for Security and Cooperation in Europe
PAR	Public administration reform
PECC	Pacific Economic Cooperation Council
PCI	Provincial Competitiveness Index (Viet Nam)
PSD	Private sector development
PRI	Principles for Responsible Investment
R&D	Research and development
RIA	Regulatory impact assessment

SAARC	South Asian Association for Regional Cooperation
SASEC	South Asia Subregional Economic Cooperation
SEZ	Special economic zone
SME	Small and medium sized enterprise
SOE	Sate owned enterprise
TA	Technical assistance
TNC	Transnational Corporation
TRIM	Trade-Related Investment Measure
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
UNDP	United Nations Development Programme
VAT	Value added tax
VNCI	Vietnam Competitiveness Initiative
WTO	World Trade Organization

I. REFORMING BUSINESS CLIMATES: WHAT ROLE FOR REGIONAL COOPERATION?

Nick J. Freeman

An overview of some of the lessons learned concerning the implementation of regulatory reform in support of improved business climates, and the potential for regional cooperation in this regard.

A. Introduction: current thinking on pro-business regulatory reform

1. The 'mainstreaming' of pro-business regulatory reform

It is widely accepted that a key element for any developing country pursuing the goal of economic development and poverty alleviation, is the need to develop the private sector, and the small and medium sized enterprise (SME) sector in particular. A range of factors and constraints may be cumulatively serving to inhibit the development of a more robust private sector, necessitating a carefully mixed cocktail of policies and interventions designed to support private sector development (PSD). These may specifically pertain to land, taxation, access to finance and other common business-related issues, where both regulatory and non-regulatory initiatives are required.

However, one over-arching – but not exclusive – determining factor for PSD and SME growth is the overall framework of basic regulations and legislation governing business and investment activities. If the general legal and regulatory framework is not conducive to businesses of various kinds, it goes without saying that it will be difficult to achieve a pro-business enabling environment. Further, studies show that an effective business environment does cause economic growth; "... an effective business environment is not just a characteristic of successful economies but also plays an important part in their success".[1] This is not to say that pro-business regulatory reform will, of itself, directly or automatically help in alleviating poverty in a country; but in generating economic growth, the poor should be one of the beneficiaries. A rising tide lifts all boats.

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[1] See World Bank, 'SMEs, Growth, and Poverty', p. 4. The report goes on to note that "cross-country comparisons do point to the potential benefits of policies that strengthen the business environment in ways that foster competition and facilitate commercial transactions for all firms, large and small. The results show that a measure of the business environment – an index incorporating information on entry and exit barriers, the protection of property rights and the efficiency of contract enforcement – is associated with the growth rate of GDP per capita".

Having recognized a clear correlation between business regulation and economic development (including that of poverty alleviation), most developing and transitional economies have embarked on pro-business regulatory reform programmes, of one kind or another, and with varying degrees of success.[2] And in so doing, policymakers in developing and transitional economies have cumulatively received considerable support and technical assistance from numerous members of the international donor community – both bilateral and multilateral agencies – as well as the private sector itself. Thus, the issue of improved business enabling environments (BEE) and pro-business regulatory reform has very much been 'mainstreamed' into the economic development agenda.

Nonetheless, differences of opinion persist, amongst policymakers and donor agencies alike, as to what is the optimal extent of business regulation reform, and the degree to which countries should seek to deregulate. For most economies in transition, regulatory reform typically entails a trend of deregulation (i.e., removing gratuitous regulations and simplifying overly prescriptive ones), but at which point should one stop? The views of the ILO and the World Bank, just for example, on what is the optimal depth and extent of business regulation are likely to differ in this regard.[3] However, there is a broad consensus that effort should be placed on introducing a better regulatory framework, however one wishes to define that, and in building the capacity to ensure that the framework is equitably and transparently implemented. Translating the letter and the spirit of business regulations into actions can often pose a greater challenge than the penning and passing of business laws and rules, notably in countries where state agencies and other institutions are less than fully robust.

2. The recent rise of guidelines and surveys pertaining to pro-business regulatory reform

This trend in pro-business regulatory reform has been reflected in recent years by the burgeoning number of business climate guidelines and surveys, seeking to provide guidance on, and plot progress (or the lack of it) in, developing conducive business enabling environments (BEEs), across virtually all countries and regions of the world. Examples include: i) The World Bank's 'Doing Business' annual survey; ii) the OECD's 'Guiding Principles for Regulatory Quality and Performance', and its 'Policy Framework for Investment'; iii) the OSCE's 'Best-Practice Guide for a Positive Business and Investment

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[2] To some extent, this has tended to be a twin-track process in many countries, focusing on: i) the development of local firms, and particularly SMEs on the one hand; and ii) on attracting FDI inflows, and particularly large-scale MNEs, on the other. This duality of approach is increasingly sub-optimal, as international business linkages and value chains become more established, and the distinctions between local and foreign businesses in a country becomes more blurred.

[3] Needless to say, opinions tend to vary across the international donor community on various sub-issues of pro-business regulatory reform. For example, on the desirability of investment incentives to encourage greater business activity in specific locations, and whether the economic costs of such initiatives outweigh the new investment it creates. Or on the use of credit guarantee systems to improve SMEs' access to finance, and both the costs entailed and the moral hazard risks that may arise.

Climate'; iv) the World Economic Forum's 'Global Competitiveness Index'; and v) the EBRD and World Bank's 'Business Environment and Enterprise Performance Survey', amongst others. Producing such documents has become something of a growth industry in itself. In the case of the 'Doing Business' global survey – spanning 175 economies in total – there have been a number of spin-off regional studies and profiles, including one on South Asia and one on East Asia and the Pacific, both published in 2006.[4]

With specific regard to business climate surveys and indices, we are now seeing similar exercises that profile and measure business climates across different locales within single countries, or within specific business sectors. One example within East Asia would be the Vietnam Provincial Competitiveness Index (PCI), developed by the Vietnam Competitiveness Initiative (VNCI).[5] This index seeks to compare standards of economic governance, and its impact on local business, across all 64 provinces and municipalities of Viet Nam. And a similar exercise has recently been undertaken across ten of the leading provinces in Cambodia. The 'Doing Business' survey has also conducted a few sub-national studies, in Mexico and Brazil.

Such surveys, rankings and indices have tended to attract fairly considerable attention in the domestic and international media, and thereby helped focus the minds of policymakers on the need to develop more conducive BEEs for the resident corporate sector.[6] (They can also assist policymakers in identifying where reform is most required, albeit only if they contain a diagnostic element.) And in this context, the first point of departure is typically the regulatory environment, over which policymakers should have a direct and fairly immediate ability to enact positive change. It should perhaps be added that, when seeking to pursue such regulatory reforms, policymakers from developing countries can typically harness and 'leverage' considerable donor expertise in this field, including from some fairly specialized agencies, including FIAS and UNCTAD.

But it should be kept in mind that pro-business regulatory reform is not the only approach by which the creation of a conducive BEE can, and should, be pursued. Even the best regulatory framework in the world will not bring about a vibrant corporate community if other key inputs are not also present, not all of which can be legislated for, or brought into being by the stroke of a regulatory pen. Other key inputs include: a range of financial services to help fund business development; the provision of business development services (BDS) to assist firms to grow; an adequate supply of land; a properly functioning

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[4] See: www.doingbusiness.org/Downloads/

[5] VNCI is a USAID-funded programme, implemented by DAI Inc. The Vietnam PCI has been jointly developed and conducted by the Asia Foundation and the Vietnam Chamber of Commerce & Industry. The basic PCI concept has subsequently been replicated in Cambodia (as the Provincial Business Environment Scorecard) and possibly Sri Lanka. See: www.vnci.org, and www.asiafoundation.org/pdf/CB_PBES_summary.pdf.

[6] As Michael Klein of the IFC puts it: "When some countries pull ahead, when they see incomes rise – that makes policymakers in other places wake up. ... The benchmarking of 'competitiveness' gets policymakers' juices flowing, often under pressure from the media ...". Foreword to Kikeri et. al. (2006).

corporate taxation system; a stable macro-economic and predictable socio-political environment; a relatively liberal (i.e., open) trading and investment regime; an acceptable standard of physical and social infrastructure, including human capital; and so on. For example, if one looks at the current SME development framework being pursued by Cambodia, reform of the legal and regulatory framework is just one of three main components; the others being access to finance, and SME support activities.[7]

3. Defining pro-business regulatory reform

Definitions of what constitutes pro-business regulatory reform can vary, although one can argue that it basically pertains to making positive changes to the legal and regulatory framework that govern the activities of businesses, so as to make the enabling environment for the resident business community more conducive. In the case of developing countries, such efforts to bring about a more conducive BEE often tend to focus, explicitly or implicitly, on one or both components of the corporate community: domestic SMEs and FIEs.

This activity is typically not limited to simply introducing and revising new laws and regulations, or just as often, the removal of gratuitous laws and regulations. Equally important is effective enforcement (by state agencies) and compliance (by businesses) of such laws and regulations. Where state agencies are relatively weak or under-resourced, this issue of implementation can pose additional challenges in terms of capacity building, and may take longer to address than the relatively more speedy task of re-drafting and/or removing inadequate regulatory documents. Indeed, some aspects of pro-business regulatory reform are akin to – and can often overlap with – more general public administration reform (PAR) efforts, whereas other aspects may be more specific to particular business-related issues, such as access to finance.

In its 2006 'Doing Business' survey, the World Bank has identified ten components of the business environment, all of which relate to regulations – and their effective implementation – to a greater or lesser degree:[8]

i. Starting a business (including number of regulatory procedures)

ii. Dealing with licences (including number of regulatory procedures)

iii. Employing workers

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[7] In this specific case, reform of the legal and regulatory system comprises interventions focusing on: company registration; regulatory review and recourse mechanisms; commercial law; and smuggling. SME support activities comprise: BDS; access to markets; technology and human resource up-grading; and linkages. While the access to finance component comprises: leasing; simplified accounting for SMEs, credit information sharing; and collateral and land titling. See Sub-Committee on Small & Medium Enterprises (Cambodia), July 2005.

[8] See: www.doingbusiness.org. In reporting the results, each country is compared with the averages for its respective region (e.g., Asia and the Pacific) and the benchmark based on 22 high-income OECD economies.

iv. Registering property (including number of regulatory procedures)

v. Getting credit

vi. Protecting investors

vii. Paying taxes

viii. Trading across borders (including number of documents required)

ix. Enforcing contracts (including number of regulatory procedures)

x. Closing a business

These ten components probably reflect the key issues that pertain to the business environment, particularly when creating a system of measurement and comparison that can be applied to a diverse spectrum of countries across the globe, sometimes operating under very different legal and regulatory frameworks and systems. However, a more detailed (but probably not exhaustive) list might comprise all laws and regulations pertaining to the following business issues (table 1):

Table 1. Common components of the pro-business regulatory reform universe

Taxation	Foreign exchange and financial transfers
Employment	Competition and anti-monopoly laws
Trading (including external trade)	Intellectual property rights and protection
Investment and licensing	Industrial and other special zones
Incentives and promotion	Investment guarantees and protection
Property rights and protection	Civil codes and procedures
Contractual rights and responsibilities	Commercial and company laws
Legal entities for business and business associations	Labour and employment
Corporate governance and shareholders	Land and property
Secured transactions	Financial securities of various kinds
Bankruptcy and collateral	Banking, credit and finance regulations
Laws and regulations in support of a stable macro-economic environment conducive to business	Regulations to specifically promote SME and PSD development

When one considers that each country's laws and regulations on this range of topics may be supplemented by numerous sub-national regulations on some issues, one is struck at how large the issue of pro-business regulatory reform can potentially be. This has been cited as a reason why some countries struggle to embark on – and implement effectively – pro-business regulatory reforms, as the 'to do' list seems so daunting, relative to the government's internal capacities (and in some cases, its appetite and political will)

to achieve meaningful change. Where reforms entail the end of rent-seeking or other benefits for key stakeholders, the presence of sufficient political will is an important dynamic.

And even if there is the will to proceed to reform an array of regulatory issues pertaining to business, there is also the issue of sequencing interventions, so as not to inadvertently create unwelcome side-affects. In this regard, a good starting point is to conduct some form of diagnostic study that allows policymakers to identify priority areas on which to focus first, in a fairly systematic manner.[9] Another critical factor in sustainable pro-business regulatory reform is the need for a fairly strong sense of 'domestic ownership' of the reform process. There can be a tendency for developing countries to 'plug into' donor assistance in this field on a fairly ad hoc basis, without fully embracing the process, nor seeking to ensure that institutional capacity is developed to allow subsequent ownership. Hence the need to both harness and 'leverage' this assistance to optimal effect. It is at this stage that we can turn to the actual process of enacting pro-business regulatory reform.

B. Pro-business regulatory reform: the process

1. Formulating, initiating, implementing and sustaining reform

Pro-business regulatory reform is essentially an ongoing (never-ending?) process, and typically needs to be approached in these terms. Donor support projects may come and go, but regulatory reform is a hardy perennial, if somewhat cyclical at times.

Based on a series of country case studies, a recent World Bank report[10] suggests that the optimal approach to take in formulating and initiating pro-business reform (including regulatory reform), particularly when up against various challenges and constraints, is to:

i) use diagnostic tools and practices (e.g., in-depth analyses in specific industries or regulatory areas, benchmarking and business sector surveys) to identify priority business reform issues;

ii) seize windows of opportunity (e.g., a new commitment with an external body [such as World Trade Organization entry], the introduction of new information or a new analytical approach [such as Regulatory Impact Assessment], or a business sector crisis of some kind) to inject reform initiatives on to the wider business policy agenda;[11]

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[9] There is also an argument for commencing with some relatively easily-attained (but not inconsequential) goals, so as to gain some momentum, and have the kind of 'traction' that builds confidence for the potentially long reform process to follow.

[10] See Kikeri et. al. (2006).

[11] As Alf Persson has cautioned, however, such windows of opportunity can be "sometimes quite short and difficult to plan for, when advice and support has the potential to make an impact or difference; outside these occasions it is either too early or too late".

iii) bundle and sequence these reforms in a way that makes them more feasible (e.g., making them loan 'conditionalities' or milestones with an Multinational Financial Institution loan, or piloting reforms in specific locations or industries);[12] and

iv) use various methods to build up stakeholder support in favour of the reforms (e.g., supporting the development and capacity of business associations).[13]

Such an approach should help in getting pro-business regulatory reform momentum moving in the right direction. But sustaining that momentum, and implementing regulations where it matters (e.g., in the daily interface between companies and various state agencies that oversee corporate activity), also requires careful consideration and a strategic approach. Three key tools are:

i) providing capacity support (e.g., skills training or improved IT infrastructure) to state agencies, at both the national and sub-national level, to effectively implement regulatory reforms, and if need be, create incentives (e.g., performance targets) that better align their interests in doing so;

ii) supporting the creation of bodies that can effectively oversee the implementation of regulatory reforms, with a mandate and sufficient authority to tackle (or at least 'flag up') cases where slippage is apparent;

iii) building a series of monitoring and evaluation (M&E) procedures into pro-business regulatory reform support initiatives.[14]

It should also be borne in mind that business regulation is not solely an issue of (mandatory) enforcement by state agencies, but also one of (voluntary) compliance by members of the business community. Indeed, in developing or transitional countries where institutional capacities are not so strong, promoting compliance can be an effective way of translating regulatory reform from paper into practice. This can be achieved through advocacy and awareness raising initiatives, although one should be cognizant of the fact that for many SMEs in developing and transitional economies, the added costs (either real or perceived) of compliance may pose a burden that they cannot easily incur. In this context, the promotion of popular understanding of the rationale behind key laws and regulations, and why it is in the interests of businesses to embrace the revised regulatory framework, is also relevant. On regulatory issues pertaining to environmental protection and corporate governance, there is often a need to build up general public and business community support of such initiatives, and assist in providing the kind of capacity support necessary to allow for higher levels of compliance.

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[12] Donor TA and other inputs, in support of such reforms, likewise need to be "packaged in the right format to the right people at the right time, i.e., it must be directly useful and immediately usable for decision makers at the time when decisions or choices are made". Alf Persson.

[13] See Kikeri et. al., pp. 17-41.

[14] Also see Kikeri et. al., pp. 43-54.

2. Key challenges

One challenge often encountered in the pro-business regulatory reform process is that multiple state agencies play a role in the design and enactment of pro-business regulatory reform. It is likely to span the national ministries or agencies responsible for economic management, investment activity, justice and the legal system, finance, banking and so on. It is also likely to involve, at least at the implementation level, various sub-national state agencies of one kind or another. This can complicate matters where intra-agency communication and coordination is poor (which is often the case), as substantive reform efforts often require a champion to drive the process forward and ensure that momentum is sustained.

Another challenge is the unpredictable element of any regulatory reform process, rendering a conventional blueprint approach to reform support vulnerable to subsequent changes. Sticking to a long-term plan, even after some of the principal conditions on which the plan was first formulated have changed, is clearly sub-optimal. Instead, a more process-oriented approach is sometimes required, so as to have flexibility over time to respond to changing circumstances.[15] But it should be recognized that this approach can be more challenging to manage, and contains additional risks, notably in terms of remaining focused and achieving tangible goals (i.e., avoiding incremental drift away from the original outcomes). One of the principal challenges here, once again, is how to assist developing countries to create and maintain the kind of institutional depth and capacity that then allows them to effectively strategize, implement, monitor and evaluate more process-oriented approaches to pro-business reform.

Donor agencies involved in regulatory reform have recognized this issue and sought to respond in various ways. One response has been not to plan specific projects for their full life cycle, but rather to determine specific inputs/outputs (and the budget allocation to support them) on an annual basis, albeit within set guidelines and fixed outcomes desired of the Project. Of course, the risk here is that too much flexibility in approach will lead to an unfocused set of outputs and piecemeal initiatives, unless carefully guarded against. Another strategic response by donors has been to pool funding through multi-donor trust funds, from which money can be drawn down for specific needs at

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[15] This is how Alf Persson depicts the difference between a blueprint and process project. "A 'blueprint' project is the classic project, with fixed and easy to define goals, outcomes, outputs and activities. The project itself has a fairly large autonomy in relation to task definition, order, timing, priorities and budget allocation, and a periodic, steady pace of quarters, semester and years, when stock is taken and adjustments are made. A 'process' project is almost the opposite. The goals are soft and tricky to define in measurable terms; degree of achievement is relative and may furthermore depend on expectations and perspective; the agenda, schedule, priorities and pace are mostly outside the control of the project." A good example would be the acceleration in Viet Nam's business legislation reform agenda, as the country sought to advance its accession to the WTO. This was driven in part by the change from the MFA to the ATC agreement on garment exporters, which left Viet Nam's large garment manufacturing sector – as a non-member of WTO – at a distinct disadvantage. As a consequence, Viet Nam's policymakers had to rapidly make changes to a number of business laws, as part of its accession bid.

specific times. One underlying risk with this approach, however, is that it can become rather ad hoc and short term in nature, if it does not allow for a gradual building up of local capacities and ownership. Thus, some degree of balance has to be striven for, marrying the short-term flexibility of a process-oriented approach with the sustainability of a more long-term capacity-building approach.

Another challenge is any resistance to reform from, often powerful, vested interests and lobbies. Depending on the political framework, a number of approaches might be used to surmount such resistance, although the development of a powerful counter-lobby, in support of pro-business regulatory reform, can be beneficial. This might entail training, advocacy and/or capacity support, to assist relevant stakeholders (such as business associations and chambers of commerce, SME-oriented lobby groups of various kinds, consumer bodies, etc.) in developing an effective voice in support of reform efforts.

Even when regulatory reforms have been enacted, there is the challenge of sustainability, and more specifically, the risk that gains made will gradually be chipped away. For example, the discrete introduction of various kinds of licences or approvals, by ministries or local governments, can gradually undermine earlier reform efforts to remove gratuitous regulations. This common problem of ‘slippage’ often calls for the introduction of an effective monitoring and oversight body, with both the capacity and the authority to oversee and ‘lock in’ reforms over time.

3. Performance measures and accountability mechanisms

It is precisely because of these kinds of challenges that there is often a need for performance measures and accountability mechanisms, both for the pro-business reform process as a whole in a country or region, and for specific interventions. Best practice would strongly suggest that such monitoring and evaluation (M&E) measures, and accountability mechanisms, should be built into the approach, from the start, and not be belatedly introduced, sometimes as an after-thought. They also need to be sufficiently accurate that they can meaningfully measure progress, or a lack of it, yet without diverting too much (often limited) resources away from the pursuit of specific outcomes.

Furthermore, it also has to be recognized that finding a systematic and meaningful way of measuring what is – as noted above – a process can be difficult. With a static blueprint design, one can more readily set a series of milestones to be attained, and measure progress against such milestones. But with a process-oriented approach, the milestones can mutate, and so the determinants and measures of success typically evolve over time. Even where milestones are clear, meaningful measurement – of how inputs are employed on specific activities, which in turn generate outcomes that hopefully have some impact – can be quite difficult. For example, how does one measure capacity-building? Where multiple donor initiatives are involved in pro-business reform activity, how does one convincingly attribute a single donor input to a specific reform outcome? How does one convincingly attribute a specific regulatory reform – such as an improvement in the business registration process – to an increase in the number of new company incorporations, for

example, when other factors may also be contributing to this burgeoning in new firms?[16] Clearly, there tends to be quite a lot of 'white noise' surrounding pro-business reform activity in a developing or transitional economy, making the issue of M&E not always so simple.

Similar challenges are posed with regard to accountability mechanisms. Much depends on building institutional capacity and domestic 'ownership' of pro-business reform initiatives, so that an appropriate domestic stakeholder can take the helm, and has the resources to follow through with implementation. But this tends to be a long-term process, and needs to be sustained across a period that is typically much greater than the average donor project or reform initiative life cycle.

4. Donor support of the process

The means and modalities by which the donor community provides support to developing and transitional economies in the field of pro-business regulatory reform varies. Ideally, the modalities adopted will tend to depend on the needs and capacities of the particular country or locale (so as to be 'demand driven'), as well as the respective strengths and expertise of the individual donor agencies involved.

That said, a smorgasbord of potential modalities can be identified, and would commonly comprise some or all of the following:

i. Policy dialogue and advice, at various senior levels, on general issues directly or indirectly pertinent to pro-business regulatory reform;

ii. Policy advice on specific issues within the sphere of pro-business regulatory reform (e.g., competition and anti-monopoly policy, trade, taxation, etc.);

iii. Policy advice on PAR, and its impact on the implementation of pro-business regulatory reform (e.g., through institutional capacity building of various state agencies);

iv. Specific research studies (including diagnostics and RIAs) and workshops on issues relating to pro-business regulatory reform, intended to feed into, and better inform, various elements of the regulatory reform process;

v. Specific TA and funding support on specific issues within the sphere of pro-business regulatory reform, and/or PAR, including supporting capacity-building of relevant state agencies and institutions;

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[16] For example, a change in tax regulations may stimulate a rise in company numbers, as much as any liberalization in company registration, as previously informal businesses decide to formally incorporate in order to take advantage of new tax benefits. In Viet Nam, the introduction of the 1999 Enterprise Law, which radically simplified the company registration process, coincided with the introduction of VAT in the country. However, only formalized businesses could claim VAT, prompting a lot of informal businesses to register for the first time. Popular perception is that the Enterprise Law is exclusively responsible for the rapid increase in company registrations in Viet Nam, commencing January 2000, but might the introduction of VAT also have played a not insignificant role too?

vi. Specific TA and funding support for stakeholder dialogue on issues pertaining to pro-business regulatory reform (e.g., various fora, business associations, etc.), intended to build up local support, and thereby increase 'ownership' and compliance;

vii. The provision of various kinds of specialized training, study tours and advocacy projects in support of pro-business regulatory reform efforts, ranging from the drafting process through to implementation issues;

viii. Conditional, policy-based lending (budget support), disbursed in accordance with a mutually agreed roadmap of efforts – including pro-business regulatory reforms – aimed at creating a more conducive BEE, typically with TA attached to assist a country in meeting the set milestones.[17]

Such interventions are not mutually exclusive, and one often sees single or multiple donors adopting a multi-dimensional approach. Donor community coordination is clearly an important issue in this context, if redundancy and/or duplication of efforts are not to occur. There is also a need – but not always apparent – to have some degree of institutional memory within single donor agencies, and across relevant members of the donor community as a whole, on projects and initiatives pertaining to pro-business reform. Only by building on the knowledge and experience of past efforts (both good and bad) can one usefully and efficiently enact present – and formulate future – projects. That said, one needs to recognize that evolutionary change in donor policies and strategies towards this broad issue of pro-business reform poses a challenge. Nonetheless, the credibility of donor agencies to call for and promote capacity-building in developing countries is markedly undermined if they themselves have difficulty in maintaining attributes like institutional memory and robust internal institutional capabilities.

C. Pro-business regulatory reform: a case study

One Asian country that has made considerable progress in improving its regulatory framework governing business activity in recent years is Viet Nam.[18] The Enterprise Law of 1999 (which came into effect on 1st January 2000) is widely regarded as having been an epochal event in Viet Nam's economic reform and business liberalization process. Since then, the number of local company registrations has burgeoned considerably, assisted by a much less prohibitive set of regulatory demands placed on start-up ventures and operational companies.[19]

[17] Examples include: IMF, World Bank, ADB and Japan's Miyazawa Initiative. Bilateral donors sometimes collaborate in such loan programmes.

[18] Indeed, the 'Doing Business 2006: East Asia and the Pacific Region Profile' report (p. 37) charts Viet Nam as the country doing the most in East Asia and the Pacific terms of BEE reforms.

[19] See MPDF's *Beyond the Headline Numbers*.

The case study provided here is of UNDP Project VIE/01/025. Since late 2004, the Project has focused exclusively on providing support to the Vietnamese government in drafting, introducing and implementing a new Enterprise Law and Investment Law, as well as a handful of implementing decrees to support the enactment of these laws. Passed in late 2005, the two laws came into force in July 2006, and mark another important step in Viet Nam's bid to create a more conducive BEE through an improved regulatory framework for business.

1. VIE/01/025: Improving the regulatory environment for business

VIE/01/025 was a four and half years project, which commenced in April 2002 and drew to a close in December 2006. It initially had a budget of $2.5 millions USD (later increased to $3 millions USD), and was preceded by a four-year project (VIE/97/016) that supported the introduction of Viet Nam's 1999 Enterprise Law. The project was executed by the Central Institute of Economic Management (CIEM), under the Ministry of Planning and Investment. It was designed to address some of the important imperfections and constraints in the ongoing economic transition process that cumulatively serve to inhibit economic growth and reduce the impact of anti-poverty measures. The key premise underlying the project's logic was that a simple and transparent regulatory framework will facilitate business investment and economic growth, and provide greater opportunities for individuals and businesses with less access to decision makers. The original project document, developed in 2001, had six outcome targets, later reduced to five.[20]

However, in late 2004, the decision was made to re-orientate the project to focus exclusively on supporting the impending Enterprise Law (EL) and Investment Law (IL), which had recently been announced by the Government. As the project evaluation report notes, this was "in practice almost a new project" (i.e., from late 2004 onwards). In the context of Viet Nam's bid to accede to the WTO (achieved in late 2006), the passing of these laws became a relatively pressing matter, and – like much of the legislative agenda relating to business – they were fast-tracked for approval during 2005.[21]

The new IL and EL replaced earlier laws pertaining to investment and business activity, principally comprising: the first Enterprise Law, the Domestic Investment Promotion Law and the Foreign Investment Law. The over-arching aim of the two new laws is to provide a broadly uniform business and investment environment, for both domestic and foreign-owned firms alike, and thereby create, where possible, an equitable playing field for all members of the corporate community in Viet Nam: Private and state-owned, local

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[20] These were: improved capacity to address constraints through Business-Government Partnerships; more uniform and consistent policies and regulations concerning business entities; domestic business meetings – expand dialogue between business people and policymakers; strengthened capacity to effectively implement enterprise regulations – technical assistance; and identify and address institutional constraints on factor market development.

[21] Having originally been scheduled for National Assembly approval in May 2006, the two laws were submitted for discussion and approval at a single session of the full National Assembly, in November 2005.

and foreign. The EL and IL will probably serve as the main legal pillars of business legislation in Viet Nam, until at least 2010.

Both laws were passed by the National Assembly in November 2005, for enactment in July 2006, and the Project's attention then turned in 2006 to supporting drafting of the implementing decrees needed to give the two new laws a more tangible form, as well as a training and advocacy component. All but one of the implementing decrees were successfully introduced in mid-late 2006.[22]

The Project therefore concluded having largely met its revised objectives, as (re-) defined in late 2004. The independent evaluation study of the project stated that it had been "a success". Adding, "it is generally opined that the laws are better and were developed in a shorter time because of the project". While it is not appropriate here to detail all of the work conducted and supported by the project, some of the strategic outputs included:

i) Providing close, substantive support and technical assistance to the drafting teams of both the IL and EL;

ii) A number of empirical research studies, including one on 'Bringing the Enterprise Law to Rural Areas', which sought to identify and better understand the additional challenges of implementing such a business law outside of the main urban and economic hubs, where the profile of the corporate community tends to be very different. The study's findings fed into the drafting of both the EL and its implementing regulations;

iii) Working closely with the Prime Minister's Research Committee (PMRC), a regulatory impact assessment (RIA) of elements of the impending EL and IL, particularly with regard to business registration, was conducted. This was the first such RIA in Viet Nam, and therefore served as an educative pilot exercise in the methodological process entailed, as well as generating some interesting results that fed into the law drafting process;

iv) Promoting information-sharing and stakeholder dialogue on the likely impact of the new regulatory regime for business, as part of the legal drafting process;

v) Designing a comprehensive advocacy campaign for the IL and EL, so as to promote public awareness of the new laws, and thereby seek to increase regulatory compliance by the corporate community;

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[22] The implementing decrees being: the Decree on Transforming Foreign Investment Enterprises into Enterprises operating under the new Enterprise Law, the Decree on Transforming State-Owned Enterprises into Enterprises operating under the new Enterprise Law; the Decree on Business Registration; the Decree Guiding Implementation of the Investment Law; and the Decree on Overseas Investment by Vietnamese Companies. The draft Decree on Build-Operate-Transfer, Build and Transfer, and Build-Transfer-Operate had not been passed as of end-2006, following a decision by the Government to decentralize the method for issuing investment certificates, from the national to the local level, thereby necessitating a re-write.

vi) Working with other members of the donor community to coordinate related inputs and interventions, including hosting a series of government-donor fora to brief on developments and exchange views;

vii) Assisting in the organization of fora that allowed National Assembly members to discuss the submitted drafts of the IL and EL with the drafting teams, in the run-up to the National Assembly session at which the laws were formally debated and subsequently passed;

viii) Providing support to the drafting teams of the various implementing decrees under the EL and IL, including decrees on: Transforming FIEs into Enterprises operating under the new Enterprise Law; Transforming SOEs into Enterprises operating under the new Enterprise Law; Business Registration; a BOT, BT and BTO decree; a decree Guiding Implementation of the Investment Law; and a decree guiding Overseas Investment by Vietnamese Companies.

2. Transferability of lessons learned

A number of lessons can be learned from this project, as an example of how to support pro-business regulatory reform, with some potential for transferability.[23] The key factors behind the success of the project have been identified as including:

1. External factors:
   - Strong external pressure to produce results from international community, and from requirements of WTO accession, etc.
   - Strong commitment by Government at the highest level.
   - Widespread public interest in, and desire for, business reform.
   - Highly visible, tangible and easy to understand goals, with high symbolic value (business registrations, passage of key laws, etc.).
2. On the local counterpart's side:
   - Strong and genuine ownership, and commitment by its top leadership.
   - Committed, pro-active and competent managers in the local counterpart.
   - High degree of performance and result-orientation.
   - Willingness and capacity to accept, localize and make use of new ideas and inputs from outside the organization.

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[23] This section of the report is based in large part on the independent evaluation study report and a follow-on 'lessons learned' report, both penned by Alf Persson. The latter is detailed in the references section of this report.

3. On the donor's side:

   - Sustained commitment and personal engagement by resident representative, and strategic vision of what was most important in the project.
   - Steady focus on substance and results, high degree of pragmatism, and high inter-personal and management skills of the program officer.
   - Good understanding of, and sensitivity to, the particular conditions and requirements of process support, by the project officer as well as by the senior technical advisors.
   - Ability and willingness to imaginatively use contacts and networks to mobilize complementary support from other organizations and projects, sometimes on a pro bono basis.
   - Interaction between donor and local counterpart.
   - High degree of mutual trust and respect at all levels.
   - A clear understanding of respective roles, and a win-win attitude to resolving problems.
   - Openness and transparency in mutual interactions.

In terms of project management, the project was managed proactively and flexibly, with rapid decision-making, coupled with a strong focus on the priority goals. The management style was probably more informal than one normally encounters on donor assistance projects, in various respects. But "given the extremely compressed schedule for law drafting ... and the resulting rush and rapid evolution of the agenda, it is unlikely that any other approach could have succeeded in keeping the project support relevant and timely, and avoiding marginalisation (a real risk in donor support to fast-moving operational policy work)".[24]

The extent to which the lessons learned from this case study can be readily transferred and replicated is somewhat debatable. Some might argue that a number of fortuitous factors came together on this project, which would be difficult to plan for or replicate by design. Others, on the other hand, might argue that there are readily transferable lessons to be drawn. For example, that a project seeking to directly support regulatory (or policy) reform needs to be highly flexible in its approach, and not too 'locked into' a fixed schedule of output targets that become less pertinent over time, should external factors change. Rather, the project needs to be responsive to changing needs, and take advantage of windows of opportunity that arise, so as to have real impact, by responding to the (sometimes mutating) needs of the local counterpart.

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[24] See Persson, pp. 8-9.

D. Pro-business regulatory reform: regional cooperation experience

1. Factors driving regional cooperation in pro-business regulatory reform

The large majority of pro-business regulatory reform initiatives and interventions tend to be pursued in a country-specific manner, typically tailored to meet the specific needs of a particular country, or even a particular province or locale within an individual country. In most cases, some form of diagnostic or other research study will have identified specific areas where pro-business regulatory reform is most needed, from which one or more reform actions are then pursued. In this context, the notion of regional cooperation in the field of pro-business regulatory reform might, at first, seem rather incongruous. Given that different countries have different particular constraints (or at least, differing degrees of constraints) in the field of business regulation, and that differing approaches are needed to best address these constraints, tailored to meet specific local conditions, the notion of a more uniform, pan-regional approach could seem counter intuitive.[25]

The above notwithstanding, there is considerable potential for regional cooperation in the field of pro-business regulatory reform. Determining factors in this regard include (but are probably not limited to):

i. Notwithstanding numerous differences in individual country conditions, the principal kinds of regulatory constraints that inhibit business sector development are quite often broadly the same, even if the optimal approach in addressing such constraints may vary from country to country, depending on local conditions.[26] And the same kinds of dynamics are likely to drive pro-business regulatory reform, including crises of various kinds (often helpful in pushing larger 'reform leaps');

ii. Policy, legislative and regulatory frameworks and systems may also be quite similar in some countries within a region, and therefore the optimal approaches to address regulatory constraints can also be readily transferred, in some

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[25] A study in 2006 by the World Bank on reforming business climates asserts: "... reform is highly dynamic and idiosyncratic: there is and can be no standard process. Different investment climate reforms involve different mixes of technical, political and institutional issues and thus call for different approaches. The country context also matters, particularly the type of political system and the capacity to plan and carry out reform." (Kikeri et. al. 2006, p. 2.) The same study goes on to identify 10 "common lessons" that are often apparent in business climate reform.

[26] For example, insufficient access to finance is a fairly generic problem faced by SMEs across the globe, in developing and developed countries alike. However, the specific kinds of regulatory constraints that are inhibiting the SME sector's access to finance tends to vary quite a lot between different countries and economies. And the ways by which these constraints are addressed will tend to vary from country to country, depending on the kind (and style) of business liberalization and economic development agenda being pursued.

cases. For example, there are some clear parallels between the Lao People's Democratic Republic and Viet Nam, and between China and Viet Nam, in terms of their regulatory frameworks for business, due in large part to their similar policies and political institutions, as well as their approaches to economic reform;

iii. For policymakers seeking to address regulatory constraints that are thwarting the development of a benign enabling environment for business, the actual experiences of their colleagues and peers in other countries can be particularly insightful. It can also help instill a greater sense of confidence that meaningful reforms can be attained, despite the presence of entrenched lobbies resistant to change. This kind of 'peer group' support and guidance can be particularly useful, although not often found at the more applied level;

iv. With regard to both members of the donor community that support pro-business reform, and the consultants (both firms and individuals) that provide inputs on specific pro-business reform projects, there is considerable retained knowledge that can be tapped by policymakers;[27]

v. As noted above, the burgeoning of various cross-country business climate surveys, rankings and indices has served to underline the importance of enacting the kind of conducive BEE that stimulates increased investment and business activity, which then translates into greater economic well-being. For policymakers (whether at the national or sub-national level) disappointed with their position in such surveys, it is intuitive to look more closely at other countries, typically from the same region and/or similar level of economic development, placed higher up the rankings, to see whether there are useful lessons to be learnt (and applied); and

vi. Recent years have seen more emphasis placed on donor coordination in general, including in the field of business liberalization and development. Although statements such as the 'Paris Declaration on Aid Effectiveness' do not specifically refer to regional cooperation as a vehicle for greater donor coordination, a convincing case can be made in this regard. Efforts to cooperate at the regional level on pro-business regulatory reform would certainly be of utility in increasing coordination and the more efficient use of resources.

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[27] One example from the donor community would be the Asian Development Bank (ADB). Its SME sector programme loan 'model' comprises a substantial technical assistance (TA) component that relates in large part to pro-business regulatory reform and capacity building. Some of the approaches used in the SME programme loan 'model' applied in Viet Nam have been modified for similar loans in neighbouring Cambodia and Lao People's Democratic Republic of constraints pertain. One example from the consulting field would be the work of Jacobs & Associates and their Regulatory Guillotine© approach to pro-business reform. Another would be EIM's MISTRAL® methodology for conducting regulatory compliance cost assessments.

All of the above could be viewed as issues pertaining to ‘knowledge management’. Where such knowledge management is not effectively harnessed, a considerable waste of resources can result, as each new pro-business regulatory reform initiative then entails some ‘reinventing of the wheel’, to a greater or lesser degree, even though this knowledge may be embedded in key institutions and individuals, albeit in a rather inert form.

In addition, it should be borne in mind that some smaller developing and transitional countries may wish to place greater emphasis on the region or subregion in which they are located, rather than their own individual economy. This is particularly true in FDI-oriented regulatory reform, where they may lack the scale of economy, market or labour force to attract foreign investment inflows in a purely solo capacity. This approach dovetails with trends in business, where production networks and value chains are increasingly spanning national borders, prompting companies to appraise regions and subregions as a whole, and not just specific countries, as if in isolation or mutually exclusive.

2. Regional and subregional cooperation in pro-business regulatory reform

Perhaps one of the more formalized (and successful) approaches to cross-country pro-business regulatory reform, on a subregional level, has been that of the Mekong Private Sector Development Facility (MPDF); an IFC-managed, multi-donor initiative, active in Cambodia, Lao People’s Democratic Republic and Viet Nam.[28] One of the main components of MPDF is its Business Enabling Environment (BEE) programme, working across all three countries, and which has focused on issues relating to pro-business regulatory reform. In this context, MPDF has been able to conduct some subregional cooperation in the field of pro-business regulatory reform. For example, when the Ministry of Commerce in Lao People’s Democratic Republic started to draft a new Enterprise Law, in 2005, MPDF provided some assistance by arranging for one of the principal drafter’s of Viet Nam’s Enterprise Law to comment on initial drafts of the impending law. (This support included an exchange of visits between Hanoi and Vientiane.)

Similarly, the Dhaka-based South Asia Enterprise Development Facility (SEDF) – also a multi-donor facility managed by the IFC – works in support of SME development on a subregional basis, across Bangladesh, Bhutan, Nepal and Northeast India. It too has a BEE programme and has done work in the field of policy and regulation, as well as investment climate assessments.[29]

Other regional activities by donors include the work of the ADB, notably in the form of the Greater Mekong Subregion (GMS) and the Central Asia Regional Economic Cooperation (CAREC), under its regional cooperation strategies and programmes. This includes its regional cooperation and integration (RCI) strategy, which has a trade and investment component. With specific regard to ESCAP’s work, it has also approached the issue of

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[28] See: www.mpdf.org

[29] See: www.sedf.org

pro-business regulatory reform, at both the regional and subregional level. On the subregional level, its support of the GMS Business Forum (GMS-BF) provides a platform for domestic private sector participation in GMS activities, including inputs on issues pertaining to the business enabling environment.[30] At the regional level, the Asia-Pacific Business Forum (APBF) is an annual event that seeks to promote "region-wide business networking, partnership building and dialogue among the business community, governments and civil society on how to create an enabling environment for sustainable business growth".[31]

The key is not only to derive economies of scale from cross-country (whether regional or subregional) initiatives in the field of pro-business regulatory reform (e.g., in training programmes), but to also create synergies of scale, by leveraging the benefits that stem from working with stakeholders from multiple countries (e.g., in exchanging experiences, both good and bad). And, as with any initiative, whether country-specific or cross-country, it needs to be demand-driven and pertinent. For a regional initiative, this need to be relevant to multiple countries, often with differing characteristics, poses an additional challenge, and might therefore suggest that a subregional or selective participant approach (e.g., working with just transitional economies in Asia, or LDCs) is more likely to gain traction.

Beyond the donor community universe, other Asian regional 'players' that have activities which relate, to a greater or lesser extent, to pro-business regulatory reform include ASEAN, PECC and its various forums (e.g., on trade and finance) and networks, APEC and the APEC Business Advisory Council (ABAC), and so on.

E. Regional cooperation in support of pro-business regulatory reform: conclusions and recommendations

As the previous section of this report seeks to explain, there is a role for regional (and subregional) cooperation in support of pro-business regulatory reform. To some extent at least, this is already occurring, formally and informally, intentionally or otherwise, in various forms and guises. Where this is conducted in a manner that brings about efficiencies and other tangible gains for policymakers and developing countries, it is clearly to be welcomed. But could more be done in this regard? The answer is almost certainly 'yes'. And might ESCAP be able to provide a value-added role in the field of regional cooperation in support of pro-business regulatory reform? Again, the answer would be 'yes', if sensibly and accurately defined, conceptualized, structured and implemented.

This final section of the report seeks to recommend some specific areas that ESCAP might wish to explore further, should it decide to play a greater role in the field of pro-business regulatory reform, from the perspective of regional cooperation. But it should

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[30] See: www.gmsbizforum.com

[31] See: www.unescap.org/apbf

be borne in mind that, if only to avoid duplication and redundancy of effort, care needs to be taken to ensure that any ESCAP led initiative in this field not only adds value, but also leverages ESCAP's own particular regional strengths. A number of other donor community agencies – such as UNCTAD within the UN umbrella, or FIAS within the World Bank Group – have considerable expertise and capacity in the general field of providing technical assistance to support pro-business regulatory reforms. And it is therefore important to ensure that a convincing case can be made in support of an ESCAP-led initiative within this particular field.[32]

In that context, the terms of this preliminary desk study do not allow for the identification of particularly detailed recommendations on the modality of regional cooperation to support pro-business regulatory reform efforts across all or parts of Asia. That would require a more in-depth feasibility study, including consultation with various pertinent stakeholders in the region, before a set of more specific and empirically robust recommendations could be put forward with confidence. However, this desk study seeks to conclude with some broad suggestions and hypotheses on likely fruitful areas for regional cooperation initiatives, which would hopefully serve as a useful starting point for a more thorough, follow-on feasibility study.

Where possible, these are tailored to be compatible with the existing portfolio of outputs provided by ESCAP, and where it is believed ESCAP has particular strengths to be leveraged, and where it can add most value. The ideas proffered here are not necessarily mutually exclusive, but could be dovetailed in such a way as to provide a suite of initiatives.

Within ESCAP, the Trade and Investment Division contains a number of components that are pertinent to the issue of pro-business regulatory reform; most notably the i) investment promotion and facilitation, and the ii) enterprise development components. A number of these activities have a regional or subregional element, such as in the field of trade facilitation, the GMS Business Forum, and so on.

1. Intra-UN regional cooperation in support of pro-business regulatory reform

Within the wider United Nations body, there are a number of individual agencies that conduct work related to pro-business regulatory reform. They principally comprise: UNCTAD, UNDP and UNIDO. In general, their respective efforts in this field tend to remain separate, although there has been some recent moves to collaborate on specific projects. In Viet Nam, for example, the 'One UN' initiative is being piloted, and has the potential to see UNDP's future efforts in various areas – including the field of pro-business

[32] Or alternatively consider working with UNCTAD or another agency on a regional initiative pertaining to cooperation in pro-business regulatory reform.

reform – better integrated with that of other UN agencies active in Viet Nam.[33] In Lao People's Democratic Republic, a project to promote PSD through strengthening business associations and the Lao chambers of commerce has already been formulated under a UNDP-UNIDO cooperation agreement on private sector development.[34]

From this author's experience on various pro-business regulatory reform projects, the inputs of UN-related agencies are often regarded by policymakers as being more neutral than some other members of the donor community, both bilateral and multilateral. As a consequence, the technical assistance and other inputs provided by UN agencies are often particularly welcomed by policymakers, notwithstanding the often modest budgetary and other constraints that such UN-funded projects have to contend with, relative to some of the more 'affluent' members of the donor community. As a consequence, this general perception tends to position ESCAP well to take on a regional role in promoting greater regional collaboration in the field of pro-business regulatory reform.

At the least, ESCAP is arguably well-positioned to serve, in the Asia-Pacific region, as a regional hub for various UN agencies' efforts in the field of pro-business reform, providing a vehicle for knowledge gained (generally through country-specific initiatives) to be collated, retained and disseminated to policymakers in the wider region. Such an intra-UN repository-like hub role in the Asian region would have the potential to leverage relevant inputs provided by UNCTAD, UNDP and UNIDO and ESCAP itself, often conducted in just a single country, on to a wider regional platform, from which other countries could then draw upon, where deemed useful.

2. Regional cooperation beyond the UN agencies

Beyond this, it might be possible for ESCAP to play a similar or expanded role in leveraging the pro-business regulatory reform initiatives of other, non-UN related, members of the donor community in the Asia-Pacific region. However, it is not clear, at this stage, to what extent other members of the donor community would wish to participate in such a scheme, or consider ESCAP to be the most appropriate body to serve in this role. One option might be for ESCAP to drive a process that leads to the development of some form of new regional vehicle (e.g., a small institute or Asian forum) designed to promote pan-regional cooperation in the field of pro-business regulatory reform, in conjunction with other interested parties, with a high degree of 'ownership' from participating countries. A possible model might be along similar lines to the OECD's Investment Committee, and its supporting directorate.

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[33] At the time of writing, it was anticipated that UNDP is to fund a new project, in 2007-2009, to support the work of a new government 'task force', mandated to oversee implementation of the new enterprise and investment laws. This follows on from projects VIE/97/016 and VIE/01/025, which have played an important role in support of the 1999 Enterprise Law and the 2005 revised Enterprise Law and new Investment Law. See Section C of this report.

[34] See: www.unido.org/data/Project/Project.cfm?c=41243

As noted above, pro-business regulatory reform has become ‘mainstreamed’ by many donor agencies as a key component of their activities in developing countries, including in Asia. And as a result, a substantial body of knowledge and experience on regulatory reform has been gradually built up. But there seems to be relatively little in the way of organized distribution and exchange of this information, across donor agencies or countries. Therefore there may be a useful role to be played in creating an Asian-wide platform that would allow stakeholders to access this body of knowledge, if properly collated and made available in the public domain. Such a repository of knowledge pertaining to pro-business regulatory reform could also serve as a platform on which to then build other initiatives, including some of those proposed below.

3. Regional forum and network

For example, leveraging ESCAP’s neutral image to establish a regional consultative forum (potentially comprising but not necessarily starting with all ESCAP member states), at which policymakers and regulatory practitioners from the region could discuss and exchange experiences on both policy and applied issues relating to pro-business regulatory reform. A working event at which national policymakers and practitioners would have an opportunity to discourse with their peers on ‘nuts and bolts’ issues relating to pro-business regulatory reform, on a regional platform not currently provided. Topics of discussion could range from ‘blue sky’ brain-storming on broad issues (such as corruption in implementing pro-business regulatory reform), through to the exchange of experiences on very applied issues and approaches (such as regulations specifically relating to bankruptcy, or incentives, or market entry and exit, etc.).

It might be argued that the Asia-Pacific Business Forum (APBF), supported by ESCAP, currently provides such a platform, albeit largely focused on a single, annual event. Such a forum could also serve as a basis for a regional network of business regulation-related policymakers and practitioners. Returning to the approach that pro-business regulatory reform – and pro-business/business climate reform in general – is a process, one can readily see how policymakers from one country could benefit from dialogue and support from their peers in other countries that are at different stages in that process. For example, the regulatory reforms undertaken by Viet Nam since 1999 in liberalizing the market entry procedures contain useful lessons for Cambodia, Lao People’s Democratic Republic and other Asian LDCs. On Viet Nam’s part, one of its next challenges is going to be regulatory reform that supports the development of larger domestic corporate entities, better able to compete in international markets, and here Hanoi may usefully learn lessons from the Asian NIEs.

A small secretariat could support this initiative, serving to identify specific themes and issues to ‘drive’ each forum event, from which more specific ‘spin off’ initiatives could be taken up, with support from either ESCAP or other members of the donor community, if so required. (The forum serving as a kind of diagnostic.) Such an initiative might not be optimal at the pan-Asian level, but more effective under smaller regional groupings, such as South-East Asia, South Asia, Central Asia, Pacific, etc. Or, even better, for the transitional/

post-communist economies of Asia, or the LDCs of Asia, where the regulatory constraints to a conducive BEE may be more akin and/or acute.

4. Training programme

Another option would be to establish and fund a regional training programme, focusing exclusively on the principles and skills of creating a more conducive BEE through regulatory reform, designed for policymakers and practitioners from around Asia. The course curriculum might span the range of skills necessary to conceptualise, design and implement pro-business regulatory reforms, and include training on applied skills, such as RIAs, as well as elements of capacity-building for institutions typically charged with implementing such reforms.

As well as the skills developed during such training, it could also serve as a vehicle for networking amongst policymakers and practitioners (also see above), so that past attendees are able to exchange ideas in their subsequent work. Such a regional approach would derive efficiency gains, relative to occasional and country-specific courses, both in terms of economies of scale and a regular running of the training programme. The approach would be very much practical and applied, as opposed to being academic or theoretical, and tailored to meet the needs of individuals directly or indirectly involved in the regulatory process for business in their home country. It should also probably have a fairly interactive approach, with attendees presenting and exchanging information from their own experience, so as to optimize the opportunity provided in bringing such individuals together. Materials used for the training could include (regionally-relevant) best practice manuals, tool kits and other documentation that could be subsequently used in home countries, and thereby serve as a supplementary source of reference for both attendees of the training programme and their colleagues.

That said, it would be important to ensure that such an initiative did not overlap or duplicate unduly the kind of work that FIAS and UNCTAD currently pursues.

5. Capacity building for national stakeholders

There is potential for greater capacity-building support, to be provided to stakeholders both directly and indirectly involved in the regulatory reform process, if not actually part of the regulatory drafting and implementation process. This is particularly true in some transitional economies. For example, the inputs provided by business associations, members of legislative bodies and sub-national governments, the judiciary, the media, relevant research bodies and think-tanks can be important in building up domestic appetite for, then conceiving and implementing, effective pro-business regulatory and legal reforms. There is the potential for regional initiatives to support such stakeholders, so that they can play a more effective role in driving and supporting the pro-business regulatory reform process. This might comprise a training programme, tailored to focus on the importance of such reforms, the roles they can usefully play in support of such reforms, and some training in the kinds of skills that will help them become more effective advocates for pro-business regulatory change.

6. Support for sub-national agencies and stakeholders

While much of the regulatory reform agenda takes place at the national level, the issue of implementation often falls on the shoulders of provincial or municipal state agencies, sometimes lacking the resources to perform this role effectively. Where this occurs, the pro-business reforms contained in new regulations (both in terms of content and spirit) can be markedly undermined by poor implementation at the sub-national level. Therefore there may be potential for a regional advocacy initiative, designed at raising awareness in sub-national agencies involved in implementing business regulations, on the importance of – and the economic benefits to be derived locally from – the pursuit of pro-business regulatory reform.

By exchanging experiences with their peers from other countries, through participation in a regional forum and/or network, this could serve to build capacity, 'ownership', and galvanize support at a level sometimes neglected in the pursuit of regulatory reform. It might also assist in encouraging sub-national agencies to be more pro-active in guiding national policymakers on the challenges of implementing regulatory reform at the local level. Alternatively, it could have a capacity-building component, although it is not fully apparent what that might usefully be, if pursued at the regional or subregional level. (This author is not aware of any other such initiative, bringing sub-national practitioners of business regulations together in a regional context. And in this regard in particular, it looks to be quite appealing.)

One variant might be to focus on sub-national agencies charged with implementing pro-business regulations located in more remote areas, where the challenges posed are more pronounced, and institutional capacities are probably weakest. Such as the northern region of Lao People's Democratic Republic, the northwestern provinces of Viet Nam, parts of Cambodia, and so on. Here one often finds that regulatory issues pertaining to business are less well implemented, and thereby serve to exacerbate the challenges that confront companies located in more remote locations.[35] There can also be some regulatory constraints that are quite specific to businesses in such locations, as opposed to more affluent and/or urbanized provinces and municipalities. And such locales are often not the counterparts or recipients of other donor initiatives in this field of business regulatory reform.

7. Regional issues pertaining to pro-business regulatory reform

Rather than seeking to pursue an initiative pertaining to all or most aspects of the pro-business regulatory reform agenda, at a regional (i.e., multi-country) level, it might perhaps be preferable to focus on just a small number of specific issues that come under the 'regulatory reform umbrella', but which contain a clear regional element. Such issues

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[35] Such as less robust institutional capacity within pertinent state agencies, poorer PAR, less skilled state agency officials, weaker ICT and other physical infrastructure, etc.

as external trade, or intra-regional investment activity, for example.[36] This might also dovetail with – and more readily build on – some of ESCAP's existing initiatives under the Trade and Investment Division's agenda, such as trade facilitation and investment promotion, or the Asia-Pacific Business Forum (APBF). However, it is not immediately apparent what could be usefully done that would provide added value, and be distinct from what is already being pursued by ESCAP and other agencies and bodies in this field (such as the work of ASEAN and APEC on regulatory issues pertaining to cross-border trade and investment, or various GMS-related initiatives).

One option might be to conduct some form of regional diagnostic on the key regulatory constraints to trade or investment in a few specific business sectors, where such research has not already been done, yet is merited, to serve as a platform for a regional initiative to address these constraints. A feasibility study (including a donor mapping exercise) would probably be necessary to identify whether there are some business sectors that might usefully benefit from such an initiative.

[36] As Kikeri et. al. (2006, p. 2) note, regulatory reforms specifically relating to external trade liberalization can often be a launch pad and driver of other pro-business reforms, as it can create a domestic dynamic in favour of other pro-business reforms, in areas such as land, finance, labour, etc.

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II. SOUTH-SOUTH INVESTMENT IN SOUTH, EAST AND SOUTH-EAST ASIA

Sung-Ah Lee

A. Introduction

More and more developing countries are investing larger amounts of capital in other developing countries, and developing countries in Asia are one of the most important sources of South-South foreign direct investment (FDI). Reflecting the trend that the bulk of South-South investment is intraregional, most of their investment is going to other developing countries in Asia. The expansion of South-South investment promises greater resources and opportunities for the least developed countries (LDCs), a more efficient allocation of capital by investors familiar with developing-country conditions, and easier transmission of technology and know-how to the host developing countries in addition to the general benefits of FDI.

Globalization is the main driver for such FDI flows as transnational corporations (TNCs) are responding to the opportunities and challenges of expanded markets and intensified competition at the regional and global levels. Governments are also responding as several countries in the Asia-Pacific region have developed policies for promoting outward FDI together with the policies attracting inward FDI. Moreover, a growing number of international investment agreements are being concluded between developing economies, while developing Asia already has the largest share of double taxation treaties between developing countries.

In the light of these recent developments, it is crucial for the developing countries to analyze the trends and characteristics of South-South investment and determine how they can maximize the benefits. This paper provides an overview of current trends in South-South FDI flows, as well as current policies and strategies related to inward and outward FDI, including the role and effects of investment promotion agencies. The paper also provides an overview of the impacts of FDI in developing countries and explores whether different impacts can be expected with the growth of South-South investment. Based on the findings, the paper presents some policy implications for countries wishing to better leverage FDI for sustainable development, and suggests a possible role of TNCs in this process. Since most South-South FDI is intraregional, the paper also looks into the contribution that regional cooperation could make to realize the benefits of FDI.

This paper is focused on South, East and South-East Asia, which share a number of commonalities. The Pacific and West Asia have very different conditions, which warrants a separate approach and analysis.

B. Overview and trends of FDI flows and policies in South, East and South-East Asia

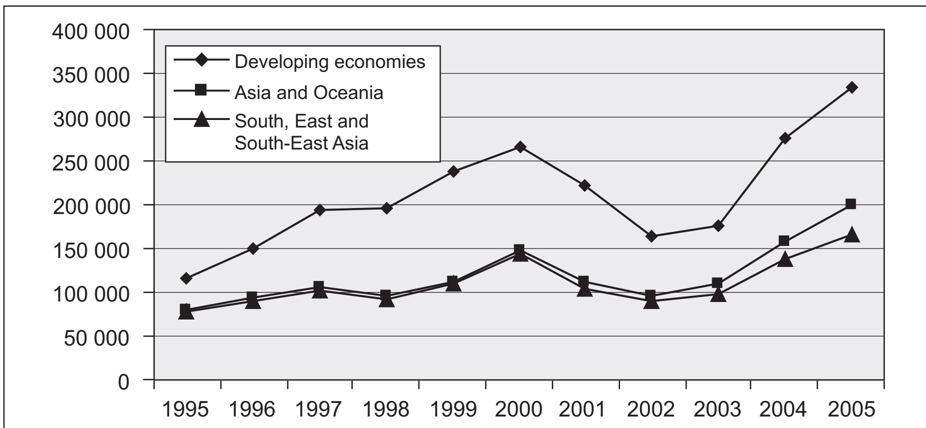
1. Geographical trends over time

Inflows and outflows of foreign direct investment in the region

Global flows of FDI, including those to developing countries, have grown considerably in the past two decades. In 2005, Asia and Oceania accounted for almost 60 per cent of FDI inflows into developing countries; of this, 83 per cent went to South, East and South-East Asia (figure 1). The rapid economic growth of South, East and South-East Asia has been the main contributor to the increase in FDI inflows.

Figure 1. Foreign direct investment inflows by host region

(Millions of United States dollars)



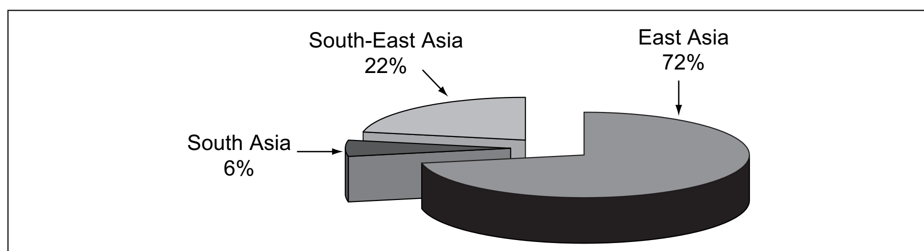
Source: United Nations Conference on Trade and Development, *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

Note: Japan is not included in South, East and South-East Asia.

At the subregional level, East Asia remained the most significant subregion for inward FDI (figure 2); China accounted for 61 per cent of these flows. In South Asia, India and Pakistan accounted for 90 per cent of the inward FDI into the subregion (India as 67 per cent, Pakistan as 23 per cent), while in South-East Asia, Singapore accounted for 54 per cent of the inflows. By country, China is the largest recipient of FDI inflows in the three subregions, followed by Hong Kong, China; Singapore; and Republic of Korea.

The number of countries receiving FDI inflows has grown during the past two decades. In 1970, there were 21 FDI recipients in Asia and Oceania, whereas in 2005 it had more than doubled to 48 countries (figure 3). In 1975, 12 countries in South, East and South-East Asia, including China, were not receiving any FDI inflows (or there was no data

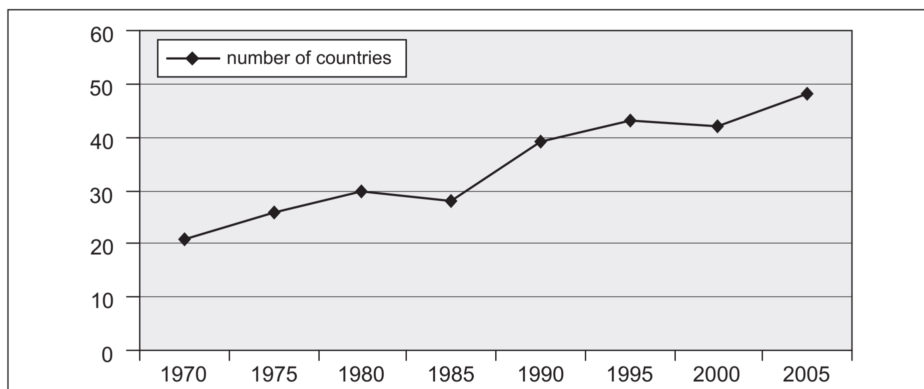
Figure 2. Percentage of foreign direct investment inflows in 2005 in South, East and South-East Asia



Source: United Nations Conference on Trade and Development, *World Investment Report 2006*: *FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

Note: Japan is not included in East Asia.

Figure 3. Number of host countries of inward foreign direct investment in Asia and Oceania



Source: United Nations Conference on Trade and Development, *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

available), whereas in 2005, all countries in these subregions were FDI recipients from at least one country (table 1).

Examining sectoral data, the primary, manufacturing and services sector all received higher FDI flows in 2005. In particular, inflows to the services sector such as finance, telecommunications and real estate increased significantly. This was partly driven by large deals in financial services and telecommunications in China, following liberalizing reforms. Foreign banks and financial institutions invested about $12 billions in China's banking industry in 2005, compared with $3 billions in 2004. Also, the services sector remains the main target of cross-border mergers and acquisitions (M&As) in developing Asia.

Table 1. Foreign direct investment inflows to South, East and South-East Asia, 1975 and 2005

(Millions of United States dollars)

Countries	1975	2005
South, East and South-East Asia	2 672	165 093
East Asia	417	118 192
China	..	72 406
Hong Kong, China	377	35 897
Korea, Democratic People's Republic of	..	113
Korea, Republic of	6	7 198
Macao, China	..	770
Mongolia	..	182
Taiwan Province of China	34	1 625
South Asia	112	9 765
Afghanistan	..	1
Bangladesh	..	692
Bhutan	..	1
India	85	6 598
Maldives	2	14
Nepal	..	5
Pakistan	25	2 183
Sri Lanka	..	272
South-East Asia	2 143	37 136
Brunei Darussalam	1	275
Cambodia	0	381
Indonesia	1 292	5 260
Lao People's Democratic Republic	0	28
Malaysia	350	3 967
Myanmar	3	300
Philippines	114	1 132
Singapore	292	20 083
Thailand	86	3 687
Timor-Leste	..	3
Viet Nam	4	2 020

Source: United Nations Conference on Trade and Development, *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

In South-East Asia, on average 30 per cent of FDI inflows went to the manufacturing sector between 1999 and 2003 (table 2). The electronics sector was one of the most important industries. The services sector, including financial services and trade/commerce, also accounted for a large share of FDI into South-East Asia, reflecting the same trend

Table 2. Share of foreign direct investment inflows into ASEAN countries by economic sector, 1999-2003
(Per cent)

Economic sector	1999	2000	2001	2002	2003	1999-2003
Agriculture, fishery and forestry	-0.1	0.6	0.0	3.6	0.9	0.8
Mining and quarrying	7.7	5.0	10.9	13.1	21.1	10.9
Manufacturing	24.1	33.4	33.8	40.3	23.9	30.1
Construction	-0.3	-0.7	7.8	-6.8	0.6	0.5
Trade/commerce	15.9	8.6	7.1	17.6	11.6	12.0
Financial services	24.0	27.8	-43.1	49.6	27.9	16.3
Real estate	2.3	3.0	7.0	2.4	3.6	3.6
Services	7.8	6.0	1.7	10.8	-1.4	4.9
Other (not classified)	18.6	16.3	74.7	-30.7	11.8	20.9
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Association of Southeast Asian Nations (ASEAN) Secretariat, ASEAN foreign direct investment database, 2004.

with the whole region. The large share of FDI inflows into the financial services sector is to a great extent the result of liberalization of the sector following the Asian financial crisis. As a consequence, multinational banks increased their ownership of bank assets. In Thailand for example, foreign banks accounted for five per cent of total bank assets in 1990, and 18 per cent by 2002. Sectoral distribution of FDI inflows, however, differed by investing country. For example, two-thirds of Japanese FDI in South-East Asian countries went to manufacturing.

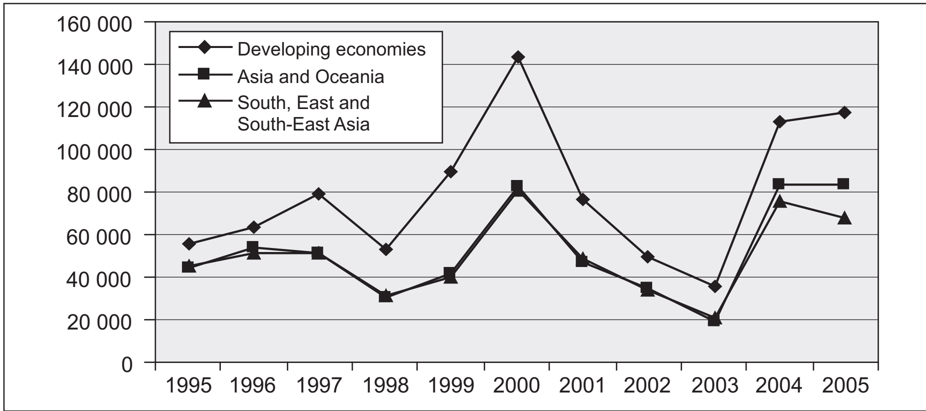
A 2003 survey of top management from some of the world's largest TNCs reveals that services such as information technology support functions, back office administration, research and development, call centres, treasury operations and distribution and logistics will increasingly be moved to developing countries (AT Kearny 2003). The Philippines stands to receive FDI in call centres, while Malaysia and Singapore could receive more investment in logistics and distribution. Such inclinations suggest that service sector FDI could become increasingly more important in the region.

Outbound foreign direct investment from developing countries

South, East and South-East Asia are not only growing as a recipient of inward FDI but also as a source of the outward FDI. The available data suggest that FDI from developing economies has grown rapidly over the last decade and will continue to grow despite a decrease in 2000-2003. FDI from developing economies accounted for about 16 per cent of the world outward FDI in 2005 of which about 71 per cent came from Asia and Oceania. South, East and South-East Asia accounted for about 81 per cent of the outflows from Asia and Oceania (figure 4). By countries, Hong Kong, China accounted for 48 per cent of the total outflow from South, East and South-East Asia followed by China

Figure 4. Foreign direct investment outflows by home region

(Millions of United States dollars)

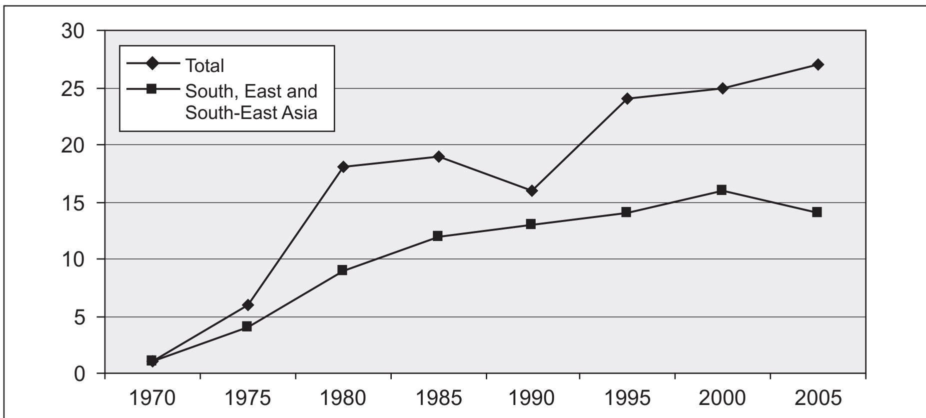


Source: United Nations Conference on Trade and Development, *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

(17 per cent), Taiwan Province of China (nine per cent), Singapore (eight per cent), Republic of Korea (six per cent), Indonesia (five per cent) and Malaysia (four per cent).

The number of home countries for outward FDI has also increased (figure 5). However, FDI from developing economies is relatively concentrated as the top five countries accounted for 66 per cent, and the top 10 countries for 83 per cent of the total outward FDI

Figure 5. Number of foreign direct investment home countries in Asia and Oceania, 1970-2005



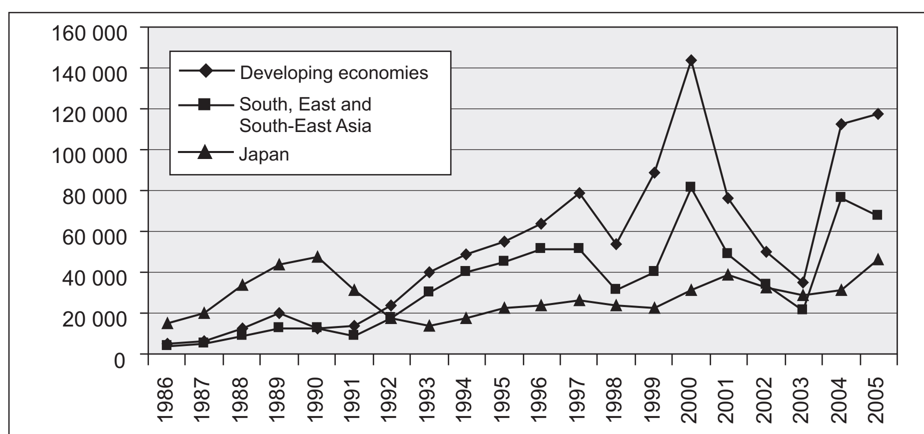
Source: United Nations Conference on Trade and Development, *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

stock from these economies in 2005. Among the top 10 countries, six originate from South, East and South-East Asia (Hong Kong, China; Singapore; Taiwan Province of China; China; Malaysia; and Republic of Korea). Asia is growing significantly as a source of FDI and most of this FDI has gone to other Asian countries.

Japan has not been included in the above analysis focusing on the developing countries of Asia. When Japan is included as a part of South, East and South-East Asia, Japanese outward FDI in 2005 accounted for 70 per cent of all outward FDI from South, East and South-East Asia, of which many countries in the region were recipients (see figure 6).

Figure 6. Foreign direct investment outflows by home region and Japan

(Millions of United States dollars)



Source: United Nations Conference on Trade and Development, *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

Intraregional flows of foreign direct investment

The lack of data on the origin and destination of FDI in some of the home and the host countries in the region makes it a bit difficult to capture the precise picture of intraregional FDI flows. However, using the existing data, UNCTAD estimates suggest that intraregional FDI accounted for almost half of the total flows to Asia in 2002-2004. These flows have grown over the years encouraged by regional and subregional integration efforts, the expansion of production networks and the relocation of production to lower cost areas within the region.

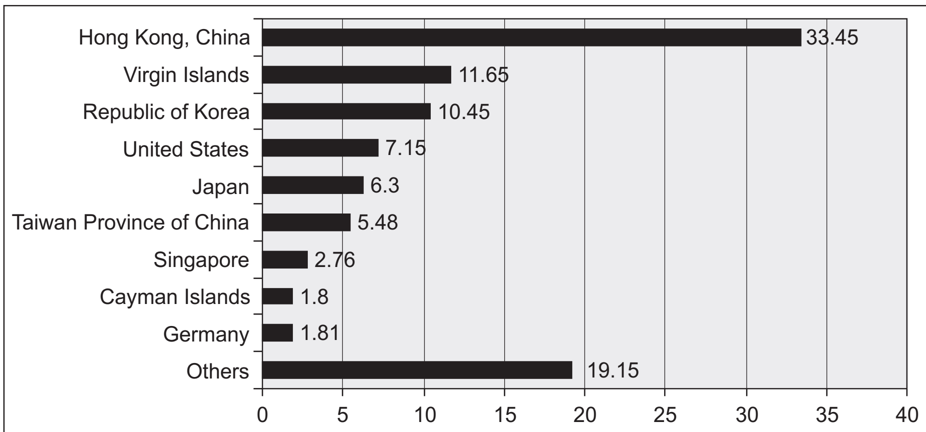
Intraregional flows were particularly significant between and within East Asia and South-East Asia. The largest intraregional flows have been within East Asia, originating largely from Hong Kong, China; Taiwan Province of China; and Republic of Korea and targeting China. There were also significant flows from Hong Kong, China to Malaysia and

Singapore, and from Taiwan Province of China and Republic of Korea to the Philippines and Viet Nam (UNCTAD 2005b).

Since 1979, when China launched economic reforms and allowed foreign capital participation in its economy, it has become the second largest FDI recipient in the world after the United States of America, and the largest host country among developing nations. For 20 years (1979-1999), actual FDI inflows into China amounted to $306 billions, which is equivalent to 10 per cent of direct investment worldwide and about 30 per cent of developing country FDI inflows. Intraregional FDI inflows are significant in China, with inflows from Hong Kong, China; Republic of Korea; Japan; Taiwan Province of China; and Singapore accounting for almost 60 per cent of all inflows into China in 2005 (figure 7). However, it is important to keep in mind that some of the inflows from Hong Kong, China are the results of round-tripping. Chinese firms try to benefit from the special treatment given to foreign investors by sending funds to Hong Kong, China and then back into China (UNCTAD 2006c). This round-tripped FDI inflows account for 25 per cent (UNCTAD 2003) to about 50 per cent (Xiao 2004) of total FDI flows into China.

Figure 7. Top 10 sources of China's inward foreign direct investment in 2005

(Per cent)

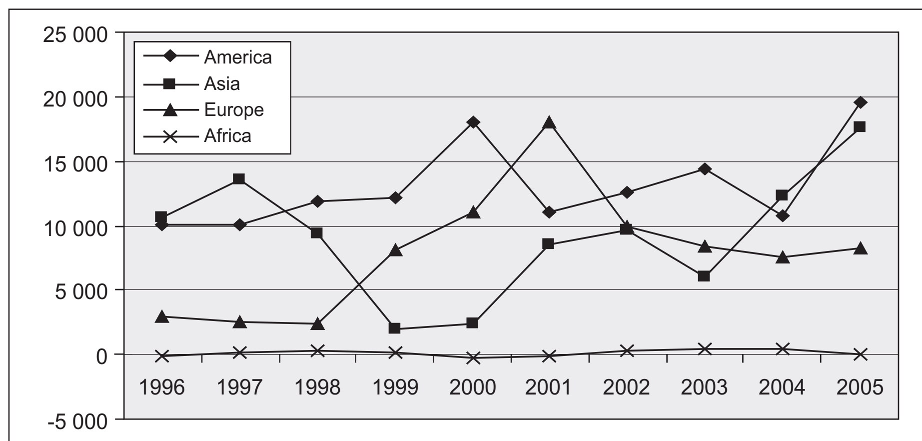


Source: Ministry of Commerce of China, *Invest in China website*, investment statistics <http://www.fdi.gov.cn/pub/FDI_EN/Statistics/>.

As mentioned earlier, Japan is a big source of FDI in the region, particularly in China and in ASEAN countries. As shown in figure 8, FDI to Asia decreased steeply during and immediately following the Asian financial crises in 1997-1999, during which time flows to North America and particularly Europe increased. Since 2000 however, FDI intraregional outflows began to increase again. In 2005, North America was the largest recipient of Japanese FDI, although Asia was not far behind.

Figure 8. Japan's outward foreign direct investment by region (Balance of payments basis, net and flow)

(Millions of United States dollars)



Source: Japan External Trade Organization (JETRO), *Japanese trade and investment statistics: Japan's outward and inward foreign direct investment* <http://www.jetro.go.jp/en/stats/statistics/>.

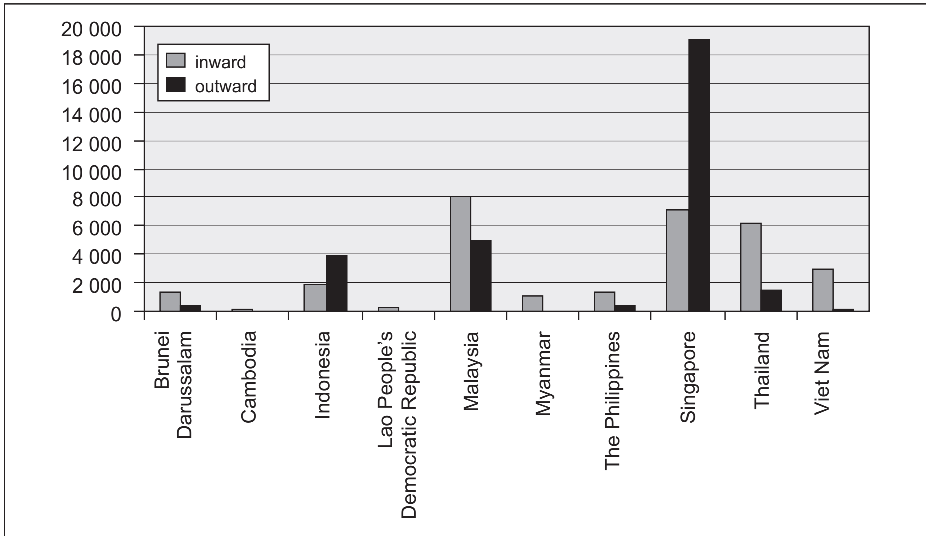
In ASEAN countries, intra-ASEAN investment accounted for one fifth of total FDI stock in this subregion, with most of the outward FDI stock accounted for by Singapore (63 per cent) followed by Malaysia (16 per cent), Indonesia (13 per cent) and Thailand (five per cent) (figure 9). The biggest recipient of intra-ASEAN FDI is Malaysia (26 per cent), Singapore (24 per cent) followed by Thailand (20 per cent), Viet Nam (10 per cent) and Indonesia (six per cent). Intra-ASEAN FDI flows decreased dramatically during 1998-2000 as a result of the Asian financial crisis but has since then increased modestly (figure 10).

FDI trends in LDCs in the region

FDI inflows into the group of 50 least developed countries (LDCs) increased rapidly during the last ten years, rising to $11 billions in 2003. Among those 50 countries, 15 countries are from Asia and Oceania, nine of which are from South, East and South-East Asia. Most of the increased flows into LDCs in the past decade have been in Africa, while growth has been rather slow in Asia (figure 11).

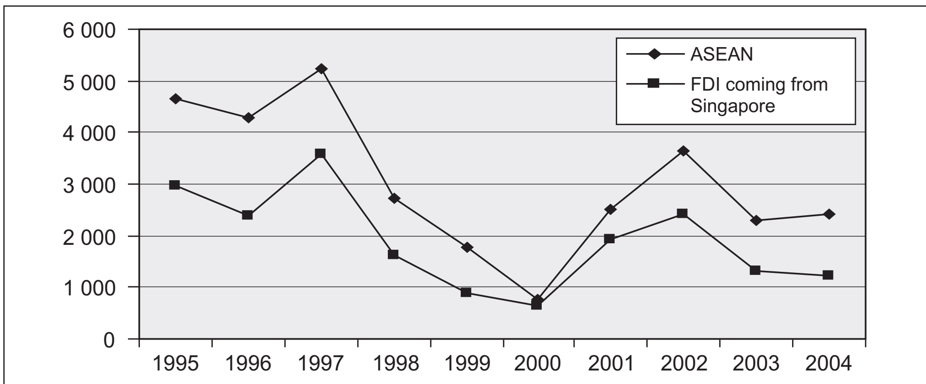
While FDI may be relatively small in many LDCs, it may have a higher share of GDP and gross fixed capital formation than more developed countries. According to UNCTAD's Inward FDI performance index where it calculates the ratio of a country's share in global FDI inflows to its share in global GDP, countries such as Angola (18), Congo (17), Ethiopia (39), Sudan (16), Tanzania (44), Tajikistan (29) and Zambia (46) rank higher than China (55). Also the share of FDI inflows as a percentage of gross fixed capital formation

Figure 9. Intra-ASEAN foreign direct investment stocks by country, 1995-2004
(Millions of United States dollars)



Source: Association of Southeast Asian Nations (ASEAN) Secretariat, ASEAN foreign direct investment database, 2004.

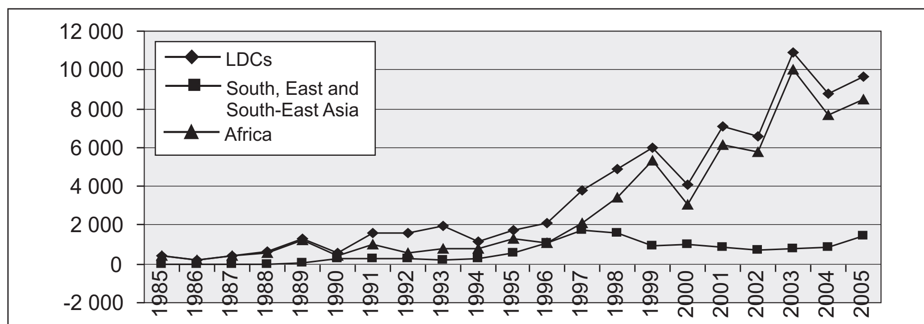
Figure 10. Intra-ASEAN foreign direct investment flows, 1995-2004
(Millions of United States dollars)



Source: Association of Southeast Asian Nations (ASEAN) Secretariat, ASEAN foreign direct investment database, 2004.

Figure 11. Foreign direct investment inflows in least developed countries by region, 1985-2005

(Millions of United States dollars)



Source: United Nations Conference on Trade and Development, *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

in 2005 was about 20 per cent in Africa as a whole, whereas it was only around eight per cent in developed countries as a whole in the same period (UNCTAD 2006c).

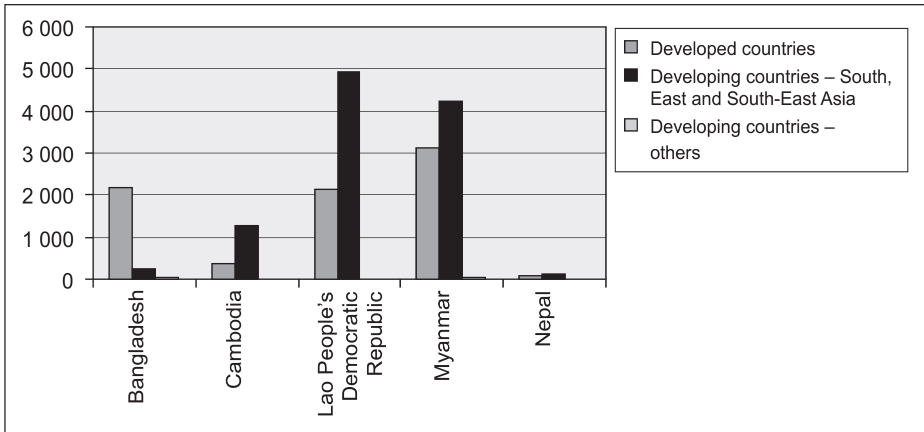
In Africa, all except the three oil-producing countries (Angola, Equatorial Guinea and Sudan) received less than $1 billion in 2004; 21 economies received less than $100 millions. A similar situation exists in Asia and Oceania, where 12 of the 15 LDCs received no more than $100 millions in 2004. In African LDCs, the bulk of FDI was natural resource-related. In the case of Asian LDCs, which have fewer natural resources than Africa, cross-boarder M&A took place in a more diversified group of industries, including services such as electricity and telecommunications in Bangladesh and the Lao People's Democratic Republic.

A large share of FDI to LDCs comes from developed countries, in particular France, the United Kingdom and the United States of America. However, during the past decade, developing countries became important sources of FDI for LDCs. According to UNCTAD's data on greenfield projects in LDCs reported during 2002-2004, 40 per cent came from developing countries including China, India, Malaysia and South Africa.

In the case of Asian LDCs developing countries as a group were a larger source of FDI than developed countries in 2001 (figure 12). It is also significant that most of the FDI coming from developing countries originated from South, East and South-East Asia, which shows a strong trend of intraregional investment. For example, India is the largest investor in Nepal. In Myanmar, the largest investor is Singapore, followed by the United Kingdom and Thailand. In Cambodia, the largest investors are Malaysia, Singapore and Taiwan Province of China, while in the Lao People's Democratic Republic, the largest investors are Thailand, Republic of Korea and Malaysia. In Bangladesh, on the other hand, the largest investors are the United Kingdom and the United States of America.

Figure 12. Foreign direct investment inward stocks in the host country by source region, 2001

(Millions of United States dollars)



Source: United Nations Conference on Trade and Development, *FDI in Least Developed Countries at a Glance: 2005/2006* (New York and Geneva, 2006).

Note: The data are collected from investment promotion agencies in each country and are on approval basis.

2. Increasing number of investment arrangements in the region

Bilateral investment treaties and double taxation treaties

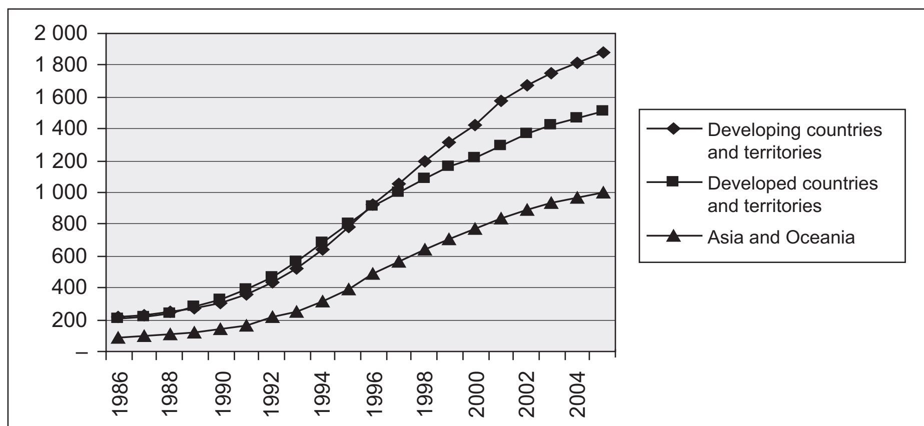
During the past decade, the number of investment arrangements signed by developing countries increased substantially; about one fourth of such agreements are among developing countries. Bilateral investment treaties (BITs), double taxation treaties (DTTs) and various types of preferential trade agreements with investment components established this trend (see figures 13 and 14).

The number of bilateral investment treaties between developing countries leaped from 47 in 1990 to 603 by the end of 2004, involving 107 developing countries. Double taxation treaties between developing countries also rose, from 96 in 1990 to 345 in 2004, involving 90 developing countries (UNCTAD 2005). The number of South-South BITs and DTTs increased during the same period that South-South FDI flows increased; however, there is no clear cause and effect relationship between these investment arrangements and FDI flows.

Economic integration agreements dealing with investments

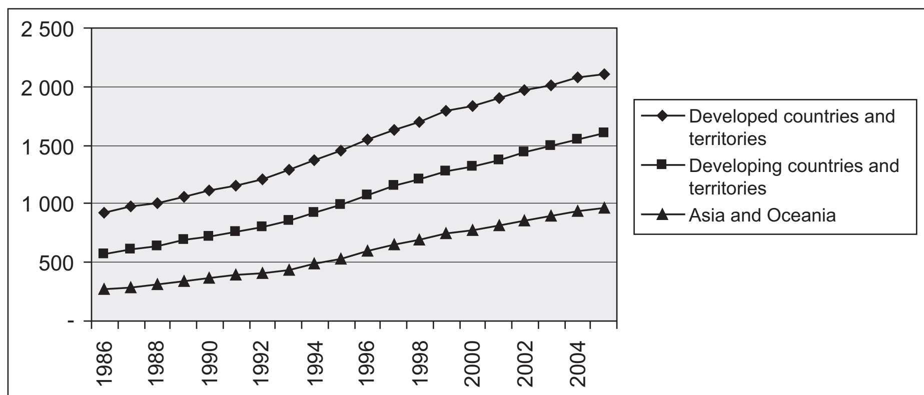
In mid 2005, Asia ranked third in terms of the number of intraregional economic integration agreements dealing with investment, with 27 treaties. Countries in the Americas had signed 49 treaties, and European countries had 33 agreements.

Figure 13. Accumulation of bilateral investment treaties signed by region



Source: United Nations Conference on Trade and Development, *World Investment Report 2006*: *FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

Figure 14. Accumulation of double taxation treaties signed by region



Source: United Nations Conference on Trade and Development, *World Investment Report 2006*: *FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

The expansion of these economic integration agreements dealing with investments among Asian countries is a recent phenomenon. These agreements, to a large extent, are similar to North-South or North-North agreements. However there are certain elements specific to South-South investment agreements:

(1) Agreements solely among developing countries are less likely to include specific liberalization commitments; rather they tend to emphasize promotional measures for the facilitation of investment flows. A number of new agreements

among developing countries in Asia contain the promise of future liberalization, but it is still too early to know how negotiations will turn out (UNCTAD 2006);

(2) Agreements among developing countries tend to have less extensive provisions on the protection of intellectual property rights. Although intellectual property would be protected against host country action in the same way as other forms of investment, these agreements generally do not provide special protection of intellectual property against private infringement; and

(3) Many South-South investment agreements include specific features to strengthen their development dimension. For example, they are more likely to have provisions for special and differential treatment based on the level of development of the parties involved. Many of these agreements also include the provision of technical assistance and capacity building (UNCTAD 2005).

It is interesting to see that developing countries in Asia are actively signing international investment agreements among themselves to attract and facilitate investment flows coming from the region, and at the same time seeing these agreements as one tool among others to achieve development goals. It is also interesting to see that there is no agreement between two major Asian groups: East Asia and South Asia. The possibility and benefit of such agreements could be further analyzed.

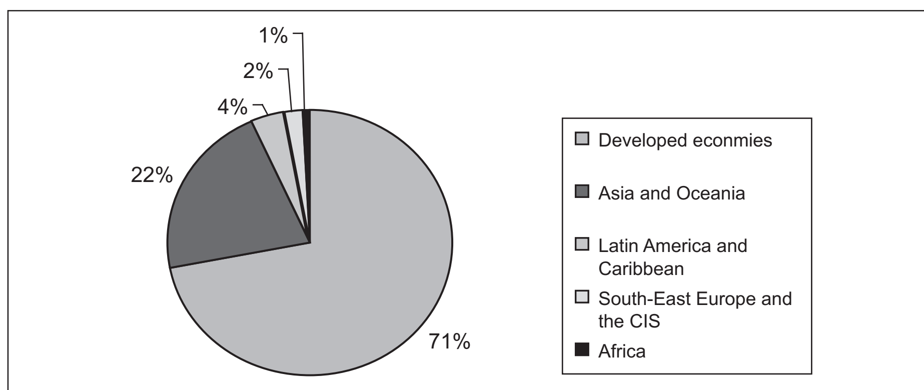
3. Increasing number of Asian transnational corporations

Developing countries now account for about one fourth of the total number of transnational corporations (TNCs) in the world (figure 15). Asia and Oceania account for almost 77 per cent of the total number of TNCs from developing countries. South, East and South-East Asia account for 88 per cent of the TNCs from Asia and Oceania. Government statistics indicate that the number of TNCs from South, East and South-East Asia has grown at a fast pace. For example, the number of parent companies in India, China, Republic of Korea and Hong Kong, China increased by 440 per cent over the past decade from 2,115 to 11,422. The number of TNCs increased by 809 per cent in India, by 805 per cent in China, by 611 per cent in the Republic of Korea and by 90 per cent in Hong Kong, China. This is a substantial increase compared to developed countries, which saw a growth of 47 per cent during the same period.

Most of these parent companies are relatively small TNCs, although the number of large TNCs in developing countries is also increasing. According to the Fortune 500, there were only 19 TNCs from developing countries in 1990, whereas in 2005 there were 47. As mentioned earlier, South, East and South-East Asia is home to most of the top TNCs from the developing countries. According to UNCTAD data, among the top 100 non-financial TNCs from developing countries, 77 were from this region. Hong Kong, China has the biggest number of these top 100 TNCs, followed by Taiwan Province of China and Singapore (figure 16). From other developing region, TNCs are mainly from Brazil, Mexico and South Africa. In terms of industrial distribution, they are operating in a wide spectrum of manufacturing and services, such as automotives, electronics, chemicals, petroleum refining

Figure 15. Number of parent corporations by region

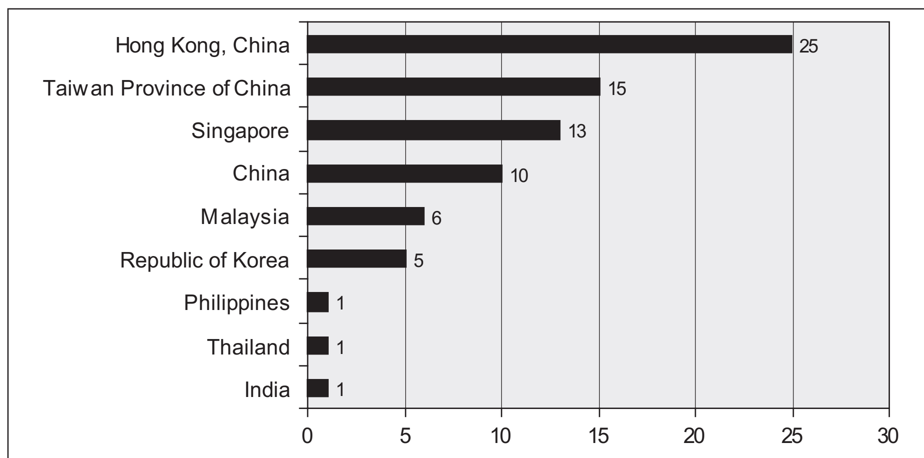
(Per cent)



Source: United Nations Conference on Trade and Development, *World Investment Report 2006*: *FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

Note: Data were collected from the latest available year from each country and therefore the years may not be consistent from each country.

Figure 16. Number of top 100 TNCs from developing countries in South, East and South-East Asia by country, 2004



Source: United Nations Conference on Trade and Development, *World Investment Report 2006*: *FDI from Developing and Transition Economies: Implications for Development* (United Nations publication, Sales No. E.06.II.D.11) statistical annex.

and steel, banking, shipping, information technology services and construction. There are more state-owned or government-linked enterprises in developing countries compared to developed countries, although most of the top Asian TNCs are privately-owned enterprises.

The reason for the increased outward expansion of developing country TNCs is not much different from that of developed country TNCs. One of the most important motives for FDI by developing country firms is market-seeking. Rising cost of production in the home economy is another factor, particularly for TNCs in East and South-East Asia. This factor has driven TNCs to invest in other developing countries with lower production costs. Growing global competition and the search for competitiveness as well active outward-oriented and open policies of the home and the host countries have also contributed to the increased expansion of TNCs.

As mentioned above, there is a significant regional aspect to most developing country TNC activities. This is because developing country TNCs have a greater familiarity with regional markets due to geographical proximity or ethnic and cultural ties. TNCs from developing countries also seem less worried about challenging business conditions and political instability in their region. The implications of these trends for host countries will be discussed in Sections C and D. Despite the regional focus, there are indications that TNCs from developing countries are increasingly moving beyond their immediate region. Many Asian TNCs are on their way into Africa, Latin America, North America and EU countries (Battat, Joseph and Dilek Aykut 2005).

4. The role and effect of investment promotion agencies

Most countries have an investment promotion agency (IPA) as part of its strategy to attract FDI. Some of the most active IPAs are from this region, such as KOTRA (Korea Trade-Investment Promotion Agency), JETRO (Japan External Trade Organization), Matrade (Malaysia's External Trade Development Corporation), Thailand's Board of Investment, the Economic Development Board of Singapore (EDB) and Australia's Invest Australia.

A typical IPA in a developing country is relatively young, created less than 10-15 years ago as part of a ministry or as an autonomous agency. Frequently, its mandate also includes promoting domestic investment and exports. In some countries, the promotion of investment in some key sectors (mining, agriculture, tourism and special economic zones or export processing zones) is under the responsibility of relevant ministries, not the IPA.

Wells and Wint (2001) group the main functions of an IPA into four categories, namely image building, investment generation, investor services and policy advocacy.

- *Image building:* Nation branding and promotion by advertising in general media, participating in investment exhibitions, conducting investment missions and information seminars in investment opportunities;
- *Investment generation:* Identifying and targeting specific sectors and companies for specific projects;

- *Investor services:* A range of services to assist and facilitate investors in analyzing investment decisions, establishment of a business and ongoing operations; and
- *Policy advocacy:* The initiatives to improve the investment climate such as participating in policy task forces, drafting recommendations for policy decisions, conducting surveys of the private sector, etc.

A survey undertaken by FIAS revealed that, on average, the largest amount of IPA financial outlays go to investment generation (33 per cent), followed by investor service (32 per cent), image building (27 per cent) and policy advocacy (seven per cent). Given the "effectiveness" findings below, this "traditional" allocation should be reviewed.

An enabling business environment is a key success factor for IPA effectiveness. A number of studies indicate that the work of an IPA does make a difference and is positively associated with increased FDI flows in the country. A study undertaken by FIAS (2004) revealed some key findings related to the effectiveness of IPAs:

(1) Greater promotion can positively complement attractive market size and investment climate. Given that the main motivations of FDI are efficiency- and market-seeking, the investment climate plays a critical role. TNCs go for the most competitive location with a good enabling climate. Empirical analysis confirms that the better the investment climate, the greater the IPA effectiveness. This raises important implications for the IPA's function of policy advocacy, which will be discussed later in this section and also in Section D;

(2) IPA budgets need to be sufficient to exert an impact;

(3) Countries with poor investment climates or low level of development get better results from improving the business conditions than from spending on investment promotion;

(4) Policy advocacy is a vital function since it directly and indirectly contributes to improving the investment climate; and

(5) The effectiveness of IPAs is enhanced when they have strong visibility, report to the highest political level, and have a high degree of private sector involvement.

As policy advocacy appears to have the strongest association with FDI inflows due to its direct links to improving the overall investment climate, a practical implication for developing countries would be to focus on improving such climate. The improvement of the investment climate will not only attract greater FDI inflows but will also enhance the effectiveness of other IPA activities including expensive promotions. Moreover, improvements in the investment climate have far-reaching consequences as they encourage both domestic and foreign investment.

One function of IPAs, which has increased recently, and is not covered in the four categories mentioned above, involves facilitating and promoting outward FDI. Most IPAs that have this function have a separate department or overseas country offices.

In general, countries should reach a certain level of development and entrepreneurial capacity before undertaking outward FDI promotion. According to UNCTAD's World Investment Report 2006, the IPAs of several developing countries, mostly in Asia, are actively undertaking such activities as more countries are now viewing outward FDI as a vehicle to enhance the competitiveness of their firms and industries. However, premature market entries can result in costly failures, both financially and psychologically (UNCTAD 2006c).

Malaysia, Republic of Korea, Singapore and Thailand provide match-making services. For example, the Thai Board of Investment set up country desks in China, Japan, United States of America, Europe and South-East Asia to help Thai investors find partners in these countries. KOTRA has country desks focusing on supporting Korean investment in Cambodia, China, Myanmar, Kazakhstan, Viet Nam and Brazil as well as their 102 overseas offices. Other instruments to promote outward FDI include workshops and training for outward investors, country-specific information, legal assistance and counseling and investment insurance.

C. The impacts of FDI

1. Positive and negative effects in general on developing countries

The growth of investment promotion and international investment agreements, as highlighted in the earlier section, reflects the positive perception held by policymakers towards FDI. In particular, FDI is often associated with higher economic growth and development, technology and knowledge spillovers, increased domestic investment, competitive business environments and increased exports, employment and foreign exchange. Nevertheless, a number of countries, including LDCs, harbour a strong suspicion of antipathy toward foreign involvement in their economies.

FDI and economic growth

Studies that have found a positive relationship between growth and FDI inflows have qualified the relationship on certain host country characteristics. Borensztein and others (1998) find that FDI contributes to growth only when there is a sufficient level of absorptive capacity in the host economy, while Balasubramanyam and others (1996) associate FDI with growth only in export promoting countries. Alfaro and others (2004) find that FDI benefits when host countries have sufficiently developed financial markets. Zhang (2001) finds a positive effect of FDI on growth in Indonesia and Singapore, while economic growth may have led to increased FDI in Malaysia and Thailand.

It may be concluded that there is a positive link between FDI and economic growth, provided that the host country meets certain characteristics such as an enabling environment, stability and skills. The relationship between FDI and economic growth could be further explored through other impacts of FDI illustrated in this section

FDI and technology and knowledge spillovers

A recognized advantage of FDI is that technology and managerial skills foreign investors bring can add value and induce local firms to become more efficient and increase human capital formation. However, it is important to target firms that will play a positive role.

In a review of experiences of five Asian countries (China, India, Republic of Korea, Thailand and Viet Nam), the Asian Development Bank (ADB) (2004) concluded that spillovers had been positive generally and for specific industries. ADB cautioned however, that there were “questions about the (i) magnitude of the impacts, (ii) speed of technology transfer, and (iii) government development of an enabling framework.” In general, there is strong evidence to suggest that countries benefiting from these spillovers are those whose domestic firms had reached a level of capacity high enough to bridge the technology gap and absorb the know-how. For LDCs in Asia, the above evidence suggests that spillovers' impact would be minimal unless absorptive capacity was improved.

FDI and domestic investment

FDI may help to raise domestic investment. Bosworth and Collins (1999), in an examination of 58 developing countries, find each dollar invested by a TNC is associated with one extra dollar of domestic investment. Agosin and Mayer (2000) note that there may be differences by region, because FDI has “crowded in” domestic investment in Asia, while “crowding out” (displacement or pre-emption of domestic investors) investment in Latin America. Within Asia, they find FDI has “crowded in” domestic investment in Republic of Korea, Pakistan and Thailand. Neutral effects were found in China, Indonesia, Malaysia, Philippines and Sri Lanka. Braunstein and Epstein (1999), however, find that FDI has crowded out domestic investment in China as a result of intensive competition for FDI among the provinces of China.

FDI and competitive business environments

Spillovers and domestic investment are closely related to competition. To the extent that foreign firms induce local firms to become more productive, FDI contributes to a more competitive business environment. However, foreign firms, with superior technology and know-how, may also drive local firms out of business or into less profitable sectors. An ADB (2004) review of the impacts of FDI on competition, concentration and profitability finds mixed evidence, both in Asia and in general.

FDI and exports and foreign exchange

The extent to which FDI promotes exports depends on the motive for FDI. If TNCs undertake investment in developing countries to take advantage of local markets, then FDI may not contribute to exports. On the other hand, if FDI takes advantage of a host country's comparative advantage (efficiency-seeking), it will lead to increased exports. Several countries in Asia have established export processing zones (EPZs) or special economic zones (SEZs), which are in general geographic zones within a host country in which enterprises enjoy preferable economic incentives or privileges. The most common incentives in these zones are reduced bureaucracy, enhanced infrastructure and lower tax rates.

In developing Asia, efficiency-seeking FDI has led to a growth in exports, as manifested in the development of regional production networks in the automobile and electronics industries. In such networks, certain value-chain activities are undertaken in different countries, and the resulting products are then exported for another stage of processing elsewhere. For example, Toyota Motor Corporation has affiliates throughout Asia with a subregional headquarters in Singapore. Thailand's TNC-dominated automobiles industry and Malaysia's TNC-dominated electronics industry consequently saw significant increases in exports, reflecting the role of FDI in boosting exports in these countries.

In addition to exporting, foreign firms may help induce local firms to export. Local firms can expand exports by benefiting from the infrastructure, telecommunications, financial services and other improvements secured by foreign investors.

Foreign investment can generate foreign exchange if it is export-oriented. Many countries require foreign investors to generate the foreign exchange they require for imports. In some cases, FDI (especially in natural resources) may contribute to an appreciation of the exchange rate, which could dampen export competitiveness.

FDI and employment

Foreign direct investment has commonly been regarded as an important source of job creation in developing countries. Many developing countries, particularly in Asia where the bulk of investment has gone to the labour-intensive manufacturing sector, have seen a significant percentage of their labour force employed directly by TNCs, or indirectly in the firms and industries that supply TNCs. In China, TNCs employed an estimated 23.5 millions people in 2003, or 10 per cent of the workforce (UNCTAD 2006c). The indirect jobs created by TNCs often far exceed those created directly. To illustrate, Coca-Cola and its bottlers are estimated to directly employ around 14,000 people in China, while creating 350,000 jobs in the supply chains and 50,000 jobs in the distribution networks (Taube and Ogutcu 2002).

In particular, FDI has contributed to enhancing employment opportunities for women. Women make up the vast majority of workers for labour-intensive manufacturing sectors in EPZs, although their share declines as manufacturing moves to higher value-added

products. Women accounted for over 80 per cent of employment in EPZs in Indonesia, Malaysia and Sri Lanka in the mid-1990s.

Non-economic impacts of FDI

Beyond purely economic benefits and costs, environmental and social benefits and costs exist (OECD 2002a). Foreign investors may either promote socially responsible practices (e.g., efficient environmental practices and better labour practices) or take advantage of weaker environmental or labour regulations. However, it should be noted that in many developing countries foreign investors from developed countries are required to meet higher environmental and labour standards than local companies.

Implications

In summary, countries that have created an enabling environment for both domestic and foreign investment, including skills, infrastructure, sound competition policies and adequate environmental, labour and social standards, are the ones that have benefited from FDI.

2. Characteristics of South-South FDI: different impact on the region

To the extent that FDI represents a capital inflow, there is no difference between the impact of FDI from developed countries and developing countries. Nonetheless, notable differences in the behaivour of TNCs from different countries can lead to different impact on the host countries.

Southern TNCs may utilize processes and develop products and services that are more suitable to developing country host characteristics. Southern firms are less likely to use capital and technology-intensive investments than their northern counterparts, and to the extent that they use more labour-intensive processes, are likely to have a greater impact on increasing employment in the host country. Furthermore, to the extent that southern TNCs utilize less developed technologies, developing countries face a narrower technological gap to bridge, which would allow them to be better placed to absorb any technological or knowledge spillovers. As a result of their less capital-intensive processes, southern TNCs may provide developing host countries with products and services that are more in line with the needs of consumers in developing countries. India's Tata Group, which has assembly operations in Bangladesh, Malaysia and South Africa, produces cars that are simpler but cost significantly less than northern competitors (World Bank 2006). China's Haier, a consumer electronics company, has manufacturing activities in many developing countries, including Indonesia, the Islamic Republic of Iran, Malaysia and the Philippines which produce products tailored for domestic country needs and price meeting average consumer level (UNCTAD 2006c).

While there are potential benefits, there may also be increased negative impacts associated with South-South investment. In particular, a significant proportion of South-South investment is in the extractive sector, which with the exception of employing

a small number of employees, has had few linkages with the host economy as the extracted goods are mostly directly exported abroad. Firms from China and India are commonly cited to be most involved in investment in the extractive industries as they seek to secure raw materials to sustain economic growth. Although much of the investment from these countries has gone to countries in Africa and Latin America rich in natural resources, an important proportion remains in the region, in particular Central Asia, Mongolia and Myanmar.

Although the "enclave" nature of FDI in natural resources applies to both firms from developed and developing countries, northern TNCs are more likely to be involved in initiatives that fall under corporate social responsibility, particular in relation to environmental preservation. It is also noteworthy to note that the largest share of South-South FDI have gone to industries that face higher levels of regulation, for example infrastructure and telecommunications (World Bank 2006). Again, northern TNCs are more likely than their southern counterparts to be involved in initiatives to improve the transparency of their operations in developing countries, leaving smaller scope for corruption.

Nonetheless, in addition to the extractive industries, an important proportion of South-South investment within the Asian region has gone to research and development, which has a higher likelihood of fostering linkages with the domestic economy. Battat and Aykut (2005) note that China and India have been among the largest recipients of this type of investment from developing countries, including from Malaysia, Republic of Korea and Thailand.

3. Regional cooperation to promote FDI

The growth of the perceived benefits of FDI has been one of the drivers of increased regional cooperation to promote FDI. However, the effects of the regional cooperation and economic integration, which are mostly in the form of trade and investment liberalization, are complex to analyze because of the complementary and substitute nature of FDI and trade. Furthermore, the effect may vary depending on the motives and industry of FDI and also on each country's condition and situation.

In theory, regional integration is expected to stimulate FDI as it enables firms to access expanded markets, thus economies of scale. It is widely known that such economic integration encourages inflows of FDI from outside those areas. These FDI inflows are also expected to rise with regional integration as it makes it easier for TNCs to develop their production units in different countries across the region seeking the most effective locations for each level of production. The fact that FDI is no longer confined to between countries but increasingly between regions also makes the regional approach more attractive. Another observation is that reducing trade and investment barriers through regional integration will contribute to faster economic growth and competitiveness of local industry in the region, thus making the region more attractive for FDI. However, while economic integration would lead to greater levels of total FDI coming into the region, this does not imply that all countries in the region will receive higher FDI. Instead, there is a risk of greater concentration of FDI in countries with the best advantages in location and other conditions for FDI (Korea Institute for International Economic Policy 2004).

The effects of regional integration on intraregional FDI are more ambiguous. FDI undertaken as a result of trade barriers may decrease as trade liberalization can make exporting a more economical means of serving the regional market. In this context, the crucial issue is whether trade and FDI are substitutes or complements. This relationship can vary by many factors including industry, and empirical studies have found different results in different regions. For example, Bhalla and Bhalla (1997) note that both intraregional trade and intraregional FDI within the European Union (EU) has expanded more rapidly and significantly than in any other regional economic bloc, whereas the North American Free Trade Agreement (NAFTA) experienced a somewhat contrary result. Intraregional FDI may increase in the case of a firm looking into regional production system as the same reason with the firm outside the region. However, in the case of subregions in Asia such as ASEAN and the South Asian Association for Regional Cooperation (SAARC), they might experience a lesser impact as only a few companies from these subregions are capable of establishing vertically segmenting production units across the region. These examples show that the impact of economic integration on intraregional FDI flows may vary from case to case and caution is needed when generalizing the impact from a single regional integration experience.

However, available evidences suggests that over the long-run, both extra- and intraregional FDIs are expected to increase if regional integration leads to efficiency gains in the form of reduced transaction costs, a more predictable investment climate, increased market size and a greater level of competition that contribute to the economic growth of member countries (Blomström and Kokko 1997). It is also noted that these economic integration efforts and agreements indirectly increase both extra- and intraregional investment by enhancing the confidence of investors in the commitment of governments to maintain open policies within the region. Economic integration can also generate synergy and other economic and industrial benefits that an individual country by itself may not be able to offer and hence be less attractive as a location for FDI.

One should keep in mind that regional cooperation on investment among developing countries is one dimension of a broader regional cooperation aimed at achieving development goals. It is therefore important to always balance and harmonize investment cooperation policies with economic, social, environmental and other cooperation policies in pursuit of sustainable development.

In the case of South, East and South-East Asia, one noticeable aspect is that there are many frameworks, groups and institutional efforts aimed at economic cooperation. Such efforts include the programmes of ASEAN; SAARC; Greater Mekong Subregion Economic Cooperation (GMS); South Asia Subregional Economic Cooperation (SASEC); Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC); BIMP-EAGA (Brunei Darussalam, Indonesia, Malaysia, Philippines – East ASEAN Growth Area); Kunming Economic Cooperation Initiative among Bangladesh, China, India and Myanmar; Asia Pacific Economic Cooperation (APEC); and many more. There is a need to streamline such frameworks and harmonize the policies and activities in the region to enhance the efficiency of regional and subregional cooperation.

Having harmonized policies on FDI may give the region higher collective bargaining power, as experienced by EU, in international markets. Yet this is not an easy task since countries should identify and agree on common objectives. Regionally coordinated policies can also avoid “bidding wars” in FDI incentives in the region which will be discussed more in the next Section. Sharing experiences between negotiators and policymakers in regard to formulating and implementing international investment agreements within and outside the region could identify best practices and lessons learnt.

Other regional cooperation to directly or indirectly promote FDI could include cooperating on infrastructure development at the regional level, conducting joint investment promotion events, cooperating on developing cross border industrial clusters, conducting research and studies related to FDI and training at the regional level.

D. Policy developments

1. FDI policies and development dimensions

As mentioned earlier, developing countries are increasingly seeing FDI as a source of economic development, income growth and employment creation. Many countries in the region have liberalized their FDI regimes and developed specific policies to attract FDI. Countries are now addressing the issue of not only attracting FDI but also maximizing the benefits of FDI, and how to link the foreign presence with sustainable growth and development of the country.

One thing that countries should keep in mind is that FDI cannot be the main source for economic growth and solving poor countries’ development problems. On average, inward FDI stocks account for about 15 per cent of gross domestic capital formation in developing countries. FDI could therefore, be a valuable supplement to local efforts and domestic investment rather than a primary source of economic growth. For that reason, it is important to focus on developing policies that would improve the overall investment and business climate which would benefit any kind of investment rather than focusing on developing policies only to attract FDI. However, in practice these two actions are not alternatives. What is good for domestic investment, in terms of investment climate, is also good for the FDI.

The enabling environment for any kind of investment is generally identical with best practices for creating a dynamic and competitive domestic business environment. The principles of transparency and non-discrimination could be one of the most important elements of such an environment. Countries should strengthen their effort to fight against corruption, enhance regulatory frameworks, such as financial reporting, and promote fair competition to foster an enabling business climate.

Strengthening open policies toward foreign trade and eliminating global and regional trade barriers would also contribute to greater domestic and foreign investment, although as discussed in Section C, the short-term impacts can vary from case to case. Developing

and streamlining efficient administrative procedures and reducing red tapes for investment, consistent economic polices that allow long-term business planning, appropriate legal system, the availability of well-developed infrastructure in terms of transportation, telecommunication and financial services, and the availability of skilled and educated labour are some of the necessary conditions in fostering an enabling business environment. There are also other measures and policies that aim at attracting FDI. This would be discussed more specifically in a subsequent section.

While the economic benefits of FDI are real, they are not automatically absorbed by the host country. To maximize the benefits of FDI, host countries must undertake the basic effort to develop appropriate policies on top of creating the healthy enabling environment.

To capture the maximum benefits of foreign enterprise presence in the national economy, the availability of local human capital is crucial. Therefore a priority task for governments would be the improvement of the education system, development and strengthening of local training institutions and creation of incentives that would keep the already qualified local individuals from leaving the country.

It is important to also keep in mind the crowding out effect of FDI. This may occur from an uneven playing field, policies discriminating local enterprises and the low development stage of the local industry. However, FDI may also cause a crowding in effect inducing local investment and strengthening the local enterprise sector, and policies should be focused on strengthening such effects.

Crowding in effect is the main channel of employment creation by FDI. Foreign enterprises themselves might create numerous jobs, but it is the impact of local enterprises that leads to the greatest employment effects in the host economy as indicated earlier in the case of Coca-Cola. To maximize the benefits from crowding-in, capacity building of local enterprises is crucial. Local enterprises, including small and medium-sized enterprises (SMEs) should be ready to catch such opportunities and absorb the new technology and knowledge and make full use of the international market information available from the TNCs. A government can support local enterprises by promoting business linkages between local enterprises and TNCs in the country.

Many developing countries have been developing policies that promote export-oriented investment while protecting the local economy from imports and market-seeking investment. These policies include a sector specific negative list, setting equity limits, restrictions on land ownership, restrictions on bringing foreign staff and having to have local staff in a director or higher level and giving incentives to export-oriented investment by excluding them from such restrictions while providing fiscal incentives. Although as a result of the Trade-Related Investment Measures (TRIMs) agreement and the recent liberalization policies, the restrictions and requirements have been loosened, the basic regulatory structure for market-seeking FDI nonetheless remains.

These dualistic policies promoting export-oriented investment and restricting domestic oriented investment overlook the very benefit of FDI in development, which is, as mentioned above, technology and knowledge transfer and employment creation. Export-oriented investors often have to purchase inputs from abroad or from another foreign company in the country to meet international standards and compete in the world market. In the ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand), many of the successful export sectors are highly import driven. In some sectors, imports represent 80-90 per cent of the value of exports (OECD 1999a). However, depending on the industry sector, this could be changed over time from importing to sourcing locally. On the other hand, foreign investors oriented towards the domestic market frequently have closer links with local enterprises largely because they have to adapt their products to the specific demands and tastes of the local consumers. Since these foreign firms usually produce for the domestic market goods and services that meet international standards, they can also indirectly help the local firms to improve their standards and become more competitive in the world market.

To facilitate the technology and knowledge transfer to the local economy, many developing countries' policies concern joint venture requirements. However, studies from the past have discovered that such requirements do not achieve their objective of enhancing technology and knowledge transfer. Foreign Investment Advisory Service (FIAS 1997) notes that "limits on foreign investor ownership have also had the perverse effect of reducing investor's incentive to make a success of the project" and Moran (1998) concludes that "direct evidence is not promising on the use of joint ventures to try to enhance technology transfer, penetrate international markets, or even expand strengthen backward linkages to the domestic economy". In addition, Smarzynska (1999) finds a negative correlation of a firm's R&D spending with the form of a joint venture but positive correlation with greenfield entry.

The points presented above suggest that it is better to improve the overall business and investment climate, with consistent and transparent rules and policies for all types of investment rather than developing discriminatory incentives and policies focused only on attracting certain FDI. In addition, improving the education and health system in the country and developing the capacity of local enterprises and industry will contribute to maximizing the benefits of FDI and in creating a positive link between FDI and development.

2. National policies for inward and outward FDI focusing on South-South investment

Liberalizing a country's restriction on FDI is no longer enough to attract and optimize the benefits of FDI. A constant effort of the host country on developing appropriate and effective government policies and implementing them in a timely manner are very important to benefit from FDI.

The case of Indonesia gives us an example of how inefficient policies might affect FDI despite other factors. Indonesia became an early recipient of FDI due to its large market size and natural resources. However, inflows have decreased rapidly during the

last recent years until 2005. According to surveys of investors, foreign firms may have left Indonesia or diminished their presence partly because of the political instability, corruption and uncertain application of legislation (Thomsen 2004)

Countries have been developing various policies and tools to attract FDI and one of the most common and widely used measures are incentives, such as tax reductions, financial inducements and regulatory derogations. Countries in South, East and South-East Asia are particularly considering these incentives in response to greater FDI inflows to China. However, as seen in Section B, more than half of the inward FDI in China comes from Hong Kong, China and Taiwan Province of China, whereas most of the inward FDI to South-East Asian countries comes from the OECD countries. Given that many foreign investors in China are medium-sized enterprises from nearby countries, and since many of these investors undertake FDI in China due to geographical proximity and cultural affinity, this investment might not have resulted in other countries regardless of whether it was undertaken in China. A number of studies also suggest that increasing FDI in China can stimulate greater FDI flows throughout the region in the long term, as Singapore has done within South-East Asia.

Keeping in mind that most investment decisions are made considering the market size, infrastructure, economic stability and overall investment and business environment, fiscal incentive programmes are unlikely to be effective unless all these conditions are even between two locations. Incentives may be effective in specific sectors for a short term (for example, many developing countries are giving incentives to labour-intensive manufacturing sector to create employment, and countries such as the Republic of Korea have incentive strategies for the high-tech industry) and it might also work in relocating the investment within the country. However, the cost effectiveness of such incentives should be carefully assessed. Incentives entail a cost that could be used in other activities such as improving the education system or developing efficient infrastructure. Furthermore, incentives could have a negative effect over the long term when it is promoted in a sector in which the host country has no comparative advantage.

A number of surveys and empirical studies have found that fiscal incentives have a small or even insignificant effect on investment (Chia and Whalley 1995). A study combining analytical research and ground level surveys commissioned by FIAS also concludes that fiscal incentives are not effective (Bergman 1999). Halvorson (1995) finds in his study of Thailand that most of the investment in Thailand would have been undertaken anyway with or without incentives. There are also different cases. For example, in 1986 Singapore began to offer incentives for companies interested in building a regional headquarters and it was successful in attracting many TNCs to Singapore. However, the same strategy was immediately followed by Malaysia, the Philippines and Thailand, which did not see the same results.

Incentives are often compared with neighbouring countries and growing FDI competition can lead to “bidding wars”, which is already happening in the region. Countries are keeping or even increasing incentives to keep up with other neighbouring countries’ incentives. This could eventually end up as a lose-lose game. Regional cooperation and

coordinated regional policy could be a way to put an end to the competitive game of fiscal incentives.

Policies attracting FDI from developing countries are not that much different from policies attracting FDI from developed countries. This goes together with the underlying principle of FDI policies that investors should be treated the same, whether from developed or developing countries. However, keeping in mind that the developing countries are more likely to invest in other developing countries, developing countries can use this as an opportunity and focus more of their activities in attracting investors from the South and especially from the same region where there is more potential that the activities might lead to an actual investment. Countries can focus on improving specific investment climate that would increase the attractiveness of the country to other developing countries' investors. Countries can also focus more of their marketing activities in the neighbouring developing countries and lower the minimum investment required to attract investors from the developing countries with less resources compared with the investors from developed countries.

As mentioned earlier, a number of developing countries are also promoting outward FDI. As firms might be more interested and comfortable in investing in other developing countries in the same region, IPAs can focus and target developing countries in the same region for outward FDI promotion to enhance the effectiveness of the activities.

Regional cooperation could play an important role in this context. Two activities going on at the same time, namely activities to attract South-South investment and activities promoting outward FDI to developing countries, has been observed. Therefore it would be helpful to share information and exchange experiences on both activities to shape and tailor their activities in the region to meet the needs of the other side and enhance effectiveness. Furthermore, IPAs from different countries can develop activities together such as study tours, match-making events and workshops in the region. However, we should also keep in mind the earlier findings of effectiveness of IPAs' functions in Section B and prioritize the activities. We have seen that policy advocacy is the most effective function of IPAs since it is directly related to improving the investment climate. Most IPAs are in a strategic position to carry out policy advocacy because of their interface between the public and private sectors in the country. In this regard, IPAs can share information related to investors in their country and cooperate on identifying the real and most important problems that foreign investors face in each country.

There is no doubt, for both inward and outward FDI, ensuring a better environment for business and improving competitiveness of local enterprises would increase the country's ability to host FDI and promote outward FDI. This is the general level of policy direction that may suit all countries. However, since there is a long list to fulfill in order to create an enabling business climate and since each country has a different situation and expectations from FDI, countries should continuously conduct their own research and studies to precisely analyze their situation and select priority areas to maximize the foreign presence in their country. An example of such an analysis carried out by a country is given in table 3.

Table 3. Republic of Korea's FDI-related policies: assessment and future policy tasks

	Objectives and Current Status	Policy Tasks
Foreign investment environment	"Identifying mid to long-term tasks to improve investment and living environments" (86 tasks completed out of 151 tasks) → Yet to meet demands of foreign investors → Further improvements in labour, administrative transparency and financial deregulation required	"Improving fundamental investment environment" ■ Becoming an advanced trading nation earlier than the target date ■ Multi-track FTAs with advanced economies aimed at upgrading the economic system ■ Intensive efforts to make fundamental improvements in the key areas such as labour and administrative regulations
Sector by sector FDI attraction strategy	"Stepping up efforts to attract FDI in close link with industrial policies" – Boosting quality of manufacturing FDI such as parts and materials – Diversifying incentives including cash support → Feeble FDI in services aimed at establishing a North-East Asian hub – Weak services market – Incentives over-concentrated in manufacturing	"Maximizing benefits from FDI" ■ Diversifying FDI target industries with a view to upgrading the overall economy – designating target FDI attraction industry for advancing services – adjusting incentives offered to FDI in services ■ Facilitating foreign invested companies to strengthen cooperation and network based economic activities – encouraging networking with domestic companies at each level of corporate value chain
Effectiveness of FDI policies	"Establishing comprehensive measures to lure more FDI" – Designating FEZs and Jeju Special Self-Governing Province. → Need time to integrate the outcome of FDI-related policies before making full assessment. → Customized support for FDI unsatisfactory. → Custom-made support for FDI is lacking and there is no focal point organization for FDI support and facilitation.	"Underpinning policy consistency" ■ Implementing FDI policies in a stable and prompt manner. ■ Fostering pro-FDI environments in a decisive manner duly reflecting policy target and underling philosophy. – re-examining incentives and regulations in FEZs and foreign investment regions.

Table 3. *(continued)*

	Objectives and Current Status	Policy Tasks
Effects from attracting FDI	"Outstanding performances of foreign invested companies" – Facilitating investment increase. – Encouraging desirable business activities of foreign invested companies via M&As. → Negative perception on foreign investment prevails.	"Active customer management" ■ Bolstering after-investment services such as addressing foreign investors' difficulties. ■ Enhancing foreign investors' confidence in Republic of Korea and nurturing nationwide awareness of the importance of FDI.
Balanced regional development	"Over-concentration of FDI in the Seoul metropolitan area" → High concentration of FDI in the Seoul metropolitan area both in manufacturing and services. → Lack of industrial base for a regionally balanced attraction of FDIs.	"Establishing an FDI Model with inter-regional cooperation" ■ Early establishment of industrial bases in regions. ■ Differentiated development strategy per region. – abolishing regulations in the Seoul metropolitan area. – expanding support system in regions.

Source: *Republic of Korea Economic Bulletin 2006*, Ministry of Finance and Economy.

3. The role of TNCs

The previous sections examined government investment policies and how to maximize the benefit of FDI through appropriate policies and enabling environment. Although these policies are very important, they are not usually precise and practical enough to cover every detail of the business and investment situation that can have an impact in the host country. Only companies, the actual foreign investors, are in a position to know what laws, regulations and policies mean for their daily operations and implement them into their management practices. Therefore, the companies' actions and management strategy are an important compliment to the governments' roles to optimize the benefit of FDI.

Experience shows that responsible corporate behaviour can play a positive role in linking FDI to sustainable development. TNCs can often act as a role model for good governance, particularly in areas related to environmental, health and safety, labour and employee benefits and such a role becomes more important if the host country lacks civil society organizations that can freely voice their opinions or has weak legal and administrative systems. International standards and guidelines for responsible corporate citizenship also become more useful in providing a framework for corporate responsibilities in countries where the political and legal framework is not providing reliable guidance for companies. In addition, with globalization and the emergence of the global value chains, TNCs are now expected to adhere to international standards and code of conducts which might be much sever and comprehensive than those of the host country.

There are many reasons for TNCs to implement corporate social responsibility (CSR) into their business strategy and it is certainly more than ethical reasons. Ensuring CSR in their business operations reduces operational and legal risk, expands access to funding, improves reputation and brand image and enhances productivity and quality, which all contributes in increasing the competitiveness of the firm in a sustainable way to compete in the global market. Recent studies have found that CSR has become a global phenomenon and there is not so much difference in interest in CSR between developing country TNCs and developed country TNCs in general. In the United Nations Global Compact, for example, 45 per cent of business participants are from developing countries. In fact, some of the leading companies in the field of CSR are from developing countries. However, a study done by OECD (2005a) reveals significant inter and intraregional variations in practice.

Among Asian countries, India and Malaysia appear to be the most active players in promoting and implementing CSR. However, according to the same study, companies in Asia are behind in implementing various corporate policies and management systems related to CSR, such as anti-corruption management systems, published codes on fighting corruption and promoting business integrity, policies and management systems regarding non-discrimination and reporting systems on health and safety, among others.

As the increasing South-South investment is mostly intraregional, Asian firms' behaviours and actions could be one of the vital factors in maximizing the benefits of FDI in the region, and actions not respecting responsible corporate behaviours might lead to a negative effect of FDI. For example, as observed earlier, developing country TNCs tend to worry less about political stability and transparency. This can give greater opportunities for developing countries to attract such FDI, although over the long term, it may have a negative effect as no effort is made to improve the situation, and even restricting the growth of local enterprises and industry by creating an unfair playing field. On the other hand, the active implementation of CSR by foreign firms can be a useful and cost effective mechanism to benefit from FDI and contribute to development.

There are a number of guidelines introducing broadly accepted CSR principles that companies can use to structure their own CSR policy. The United Nations Global Compact promotes 10 basic principles related to human rights, labour standards, environmental protection and anti-corruption. The OECD Guidelines for Multinational Enterprises provides recommendations aimed at ensuring that the operations of enterprises are in harmony with government policies, so as to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to sustainable development made by multinational enterprises. The ILO's Tripartite Declaration on Multinational Enterprises and Social Policy is based on universal principles contained in international labour standards and provides a framework for multinational enterprises, domestic businesses, governments and employers' and workers' organizations to set common expectations, maintain dialogue and sustain the partnerships necessary to maximize the potential of FDI to create decent work. The Principles for Responsible Investment (PRI) launched by the United Nations

Secretary General provides a framework for investors to integrate environmental, social and governance issues into investment decision making. There are also other guidelines related to this matter from other international institutions.

It is important that both home and the host countries promote the adoption of such international principles and best practices to capture the full benefit of FDI. Governments, the civil society, consumer organizations, trade unions and the business sector can all play an important role in promoting and increasing awareness of CSR in the region. ESCAP as a regional commission can also play a vital role in sharing best practices and distributing tools and guidelines, promoting public-private dialogue and facilitate regional cooperation in promoting the benefit of CSR.

E. Conclusions

The rise of South-South FDI, particularly among the countries of South, East and South-East Asia, is providing opportunities in terms of increased and diversified capital and know-how flows that may well be suitable to the developing host country in many ways.

As indicated in this paper, FDI can substantially contribute to economic growth and development if the host country is in a position to absorb the potential benefits of FDI. To this end, countries should concentrate on improving the overall investment climate, focusing on local capacity rather than diverting resources to FDI attraction. Developing countries may obtain minimal benefits or even negative effects if incentives incur heavy expenditures or opportunity costs while failing to foster an enabling business environment.

As most developing countries face a wide range of issues in creating an enabling business environment in different economic and social contexts, they should continuously undertake research and studies to identify their main problems and prioritize the areas to focus on. Once the country develops appropriate policies to improve the business climate, it is very important to implement them in a timely manner. Improvement should always be considered an ongoing process to cope with the dynamic and fast changing world.

Regional cooperation can assist and reinforce the efforts of countries to realize the benefits of FDI. This is all the more important as competition for FDI has increased, opening up the possibility of “bidding wars” for investment as well as a “race-to-the-bottom” scenario whereby countries compete in lowering environmental, social and labour standards to attract investment. Various regional cooperation initiatives are already underway but their scope and level of commitment appears to be insufficient. In particular, there is a need to review the investment agreements signed by developing countries in the region and identify room for improvements. It would be also important to streamline the existing frameworks and arrangements related to investment to harmonize the policies and activities in the region to enhance the efficiency of regional and subregional cooperation. To better inform these initiatives and agreements, it is crucial to create a system in developing countries, especially in the LDCs of the region, to collect reliable and comprehensive data on FDI.

Policies attracting FDI from developing countries are not that much different from policies attracting FDI from developed countries. However, keeping in mind the rising opportunity of the South-South investment, developing countries can focus more of their activities in attracting investors and especially from the same region where there is more potential that the activities might lead to an actual investment. Cooperation among IPAs in the region can play an important role in this regard. By sharing information related to investors in their country and information on their inward and outward FDI promotion activities, IPAs can tailor their strategies and activities to better meet the needs of their target investors from nearby developing countries. However, as the policy advocacy seems to be the most effective function of IPAs, developing countries should focus on improving the investment climate using their IPAs as one of the tools rather than spending resources on expensive promotions. The improvement of the investment climate will not only attract greater FDI inflows but will also enhance the effectiveness of other activities of the IPA.

As the actual behaviour of TNCs can make a positive or negative impact on development, it is important to engage the private sector, both domestic and foreign, in dialogue on development and investment issues. Public-private partnerships for development based on dialogue can be an important means of making sure that countries maximize the benefits of FDI. In this connection, ESCAP as the UN’s regional arm can play a critical role in hosting and fostering such public-private dialogues, in promoting regional cooperation and in sharing good practices arising from the region.

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For more information, please contact:

Director
Trade and Investment Division
Economic and Social Commission for Asia and the Pacific (ESCAP)
United Nations Building
Rajadamnern Nok Avenue
Bangkok 10200, Thailand
Tel.: +662 288-1234
Fax: +662 288-3066, 288-1027
E-mail: Trade_inf.unescap@un.org