Regionalisation, Foreign Direct Investment and Poverty Reduction: The Case of ASEAN

GLOBALISATION
and poverty

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BACKGROUND AND OBJECTIVES[1]

Globalisation is a contentious, complex and multi-faceted phenomenon and process.[2] One major issue is the significance of particular macroeconomic mechanisms – e.g. international trade, capital flows (including bank loans, foreign portfolio investments and foreign direct investment) and labour migration – in realising globalisation as a process. Moreover, business firms, especially transnational corporations (TNCs), play a key role in these mechanisms or processes. Another important facet is that the globalisation phenomenon is patchy and uneven in its impact. Thus, while globalisation has undoubtedly raised average world income levels over the last few decades (including reducing poverty levels in many countries), the capriciousness of the underlying processes can (and do) result in simultaneous increases and decreases of income and wealth, both at the global and local levels. Thus an understanding of the processes and a consequent construction of policies to smooth imbalances are both desirable activities. Finally, geographically, the universe within which globalisation operates is not "steady-state". There are asymmetries and irregularities created by variations in factor endowments, the actions of governments and the strategies of firms themselves, among others. Thus, for example, TNCs with a *global* value chains operate, to a considerable extent, through *local* clusters of business activities which manifest themselves at various levels, including strategies associated with the existence of (supra-)*regional* groupings such as the European Union (EU), the North American Free Trade Agreement (NAFTA) and the Association of South East Asian Nations (ASEAN).[3] Of course, such "regions" (geographically contiguous groupings of countries created by governments) are not necessarily the same as geographic regions defined by firms;

[1] The UK Department for International Development (DfID) supports policies, programmes and projects to promote international development. DfID provided funds for this study as part of that objective, but the views and opinions expressed are those of the authors alone.

[2] No attempt at a fuller discussion will be made here. The approach to globalisation adopted here mirrors that taken by the Globalisation and Poverty Research Programme, of which this project is a part (www.gapresearch.org/about/index.html).

[3] It is worth noting, however, that the relationship between transnational firms, governments and regionalisation is very complex and can be conceptually divided into at least four types: "(a) Economic development and proximal expansion (across borders) leading to integration between countries (France and Germany, say) and regional growth zones (for instance, the USA/Mexico border). This is essentially a "spillover" model with obvious similarities to the aspects of the gravity model. (b) A regional impulse might be imparted or intensified by a variety of corporate strategies, for instance, (i) TNC expansion to growth zones (some of the large inflow of FDI to "greater China" in recent years has been of a "me too" character); (ii) initial foreign direct investment in countries such as Singapore and Hong Kong, often driven by government incentives, can create the conditions for later "spillover" into nearby countries; and (iii) North American, Japanese and Asian investment in Europe from the mid-1980s - because of fears of a "Fortress Europe" after the EU's decision to establish a Single European Market (SEM) - has helped to accelerate the industrial and economic integration of the European Union. (c) Regional tendencies might be created or intensified by more specific regionalisation strategies of transnational corporations. For example, economies of scale may lead to "spillover" because the size of the national market is insufficient for efficient operations (though these do not need to be confined to the regional level); similarly, many TNCs take advantage of regional divisions of. (d) Finally, government policies, some deliberately designed to encourage regionalisation, are also important. The EU's Single European Market (SEM) and ASEAN's Free Trade Agreement (AFTA) and Investment Area (AIA) – see section 2 – are cases in point.".

however there is a considerable degree of inter-linkage and governments increasingly act to take advantage of supra-regional value chain activity.

The globalisation issues discussed above represent the foundations of this research project. The Association of South East Asian Nations (ASEAN) is widely regarded as the most successful region in the developing world in attracting foreign capital flows (at least until the Asian Economic and Financial Crisis of 1997), especially foreign direct investment (FDI), and in achieving wide-spread poverty reduction. The region can thus be seen as an exemplar or model for understanding how globalisation can play a significant role in the development process and poverty reduction. An additional aspect of interest is that ASEAN has recently enlarged to encompass four new members (Cambodia, Laos, Myanmar and Vietnam, see section 2), which are much poorer than the older member countries (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) and whose primary purpose for joining was to take advantage of the putative benefits of membership – especially in terms of encouraging inflows of FDI. This study can thus use the older-newer, richer-poorer dichotomy of ASEAN member countries to explore whether “ASEAN matters” and what newer members can learn from older member countries.

PROCESS AND METHODS

It was acknowledged that this was a major undertaking, which had to assess both macro and micro phenomena, and that the investigation had to be conducted coherently. With this in mind, it was determined at an early stage that the following were the key questions that needed to be answered:

- Has FDI contributed to poverty reduction in ASEAN countries? Mostly this question had to be directed at older member countries and at a macro level.
- Under what circumstances, mechanisms and contingencies has FDI reduced poverty? This question had to be addressed at the macro and micro (firm) level.
- Does ASEAN matter? In other words, would the member countries have received FDI in any case, or has the existence of the regional grouping increased the likelihood of inward investment in individual countries, perhaps because of a “halo” effect, a larger market or easier establishment of cross-border production networks? For newer member countries are these types of effects resulting in new investment flows from outside ASEAN or intra-ASEAN flows of FDI?
- What can the newer member countries of ASEAN learn from the older member countries of ASEAN (e.g. in terms of government policies encouraging particular types of firm engagement with the local economy)?
- What are the implications of the above for national and regional policies?

These questions were then simplified into six guiding hypotheses that were tested in two sub-projects, one looking at the macroeconomic impact of FDI inflows (macro study) and one investigating firm/TNC characteristics, strategies, conduct and performance in ASEAN countries (micro study). The hypotheses and coverage by sub-project are detailed in table 1.

Fuller details of the methodologies utilised in both sub-projects are given in the accompanying “Main Report”. The *Main Report* is divided into six sections. The first introduces the project and its purpose. Section 2 provides a background on ASEAN and its member countries, examines the characteristics of FDI flows into the region, explains the choice of ASEAN countries and industries investigated in the study and details salient characteristics of the electrical/electronics and textiles/garments industries. Section 3 reports on the results of the macroeconomic analysis (sub-project 1) of the impact of FDI on growth and poverty reduction, especially in ASEAN. Sections 4 and 5 deal with the firm-level study: section 4 consists of a literature based discussion of the interface between TNCs and host economies, whereas section 5 is devoted to analyzing the responses of firms interviewed in this sub-project. The respective methodologies for the two sub-projects are outlined in sections 3 and 4; section 4 also integrates sub-projects 1 and 2 in a single framework. Section 6 concludes with recommendations.

Table 1 The Project's Guiding Hypotheses

Hypothesis Number	Hypothesis	Subproject dealing with hypothesis
1	FDI reduces poverty via higher economic growth	Macro study
2	FDI reduces poverty through a direct impact on local factors of production	Macro study & Micro study
3	The impact on national economies and poverty depends on the nature and characteristics of capital flows	Macro study & Micro study
4	The impact on national economies and poverty depends on the nature and characteristics of the investing TNCs	Micro study & Macro study
5	TNCs are creating regional networks because of the regional division of labour (the "weak" "ASEAN matters" hypothesis)	Micro study
6	TNCs are creating regional networks because of dedicated national and regional policies (the "strong" "ASEAN matters" hypothesis	Micro study

FINDINGS

There is a strong concurrence between the results of sub-projects 1 and 2. In ASEAN FDI is strongly poverty reducing.[4] Among the ASEAN-5 countries[5], both sub-projects find a large direct FDI effect on poverty reduction, transmitted through employment and training. In addition there is an indirect effect, transmitted through growth (according to sub-project 1) and, more precisely (according to sub-project 2), through (a) the supply chain multiplier, (b) the consumption multiplier and (c) a

[4] FDI in the ASEAN region is poverty-reducing and this effect is stronger there than elsewhere (there is a poverty reducing marginal impact of 0.32, i.e. each dollar of investment has reduced poverty by 32 cents). Further, there appears to be something special about these relationships in ASEAN, since it is only in these five older member countries of the regional grouping that we find a direct relation ship between FDI and poverty reduction. On average, in our sample for ASEAN, roughly 40% of the poverty-reducing effect of FDI arises through economic growth and the other 60% from a direct impact.

[5] Singapore, Malaysia, Thailand, Indonesia and the Philippines - the original member countries of the Association. All 5 were included in the analysis in sub-project 1 and the first 3 in sub-project 2.

variety of spillover effects. (The chain of complex routes of transmission between FDI, growth and poverty are fully detailed in section 4 of the main report: however a visual summary is supplied in figure 1.) The indirect effect is not as strong as the direct effect according to sub-project 1 and the results of sub-project 2 seem to bear this out:

- The supply chain multiplier and spillovers associated with backward linkages are weakened by (a) more than two-thirds of inputs being purchased from abroad; (b) a large proportion of locally-sourced inputs being purchased by foreign-owned suppliers; and (c) the fact that most inputs bought from indigenous suppliers are low technology or secondary products. (On the other hand there has been an appreciable improvement in the skills and performance of locally-owned suppliers, whose initial strategy should arguably be to improve the capability of their manufacture of components/inputs before branching out into new products.)

- Forward linkages related to the surveyed industries are, if anything, weaker. Two-thirds of output is exported; very few of the surveyed companies directly control sales and distribution; and much of the sales/exchange in the local economy is to other foreign industrial companies. Consumer electronics are the primary source of good news inasmuch as they are sold in local markets and result in support and knowledge transfer to local distribution and sales firms. (Having said this, the more important forward linkages are likely to be with the sales subsidiaries of consumption good orientated companies; these were not a part of the survey in sub-project 2.)

- There are very few locally-owned direct competitors of any note, although they are improving in terms of competitiveness (according to the surveyed companies). (Moreover, there is evidence of market entry through new entrants – e.g. a conglomerate previously in other areas, often services – and spin-offs.)

- A highly trained pool of skilled labour now exists in the ASEAN-5 countries, especially in Malaysia and Thailand, but there have only been limited spillovers in terms of spin-offs and mobility to indigenous firms. (This is one of the areas requiring priority attention by host country governments.)

Having recognized all this, we should not lose sight of the considerable poverty reduction in the ASEAN countries in the 1980s and 1990s; a boon which continues today in the ASEAN-5, as a whole[6]; and increasingly in ASEAN-4[7] countries, such as Vietnam and Cambodia. Moreover, the war against poverty is not yet over. Apart from the poverty reducing effects of FDI, there has been considerable growth, engendered by TNC activity in the ASEAN-5 and ASEAN-4 countries. This has been due to direct, multiplier and spillover effects and it is essential to better utilise these effects to generate more growth and further reduce poverty.

The key is to tap more fully into the spillover effects. Following on from this last point, it should be said that ASEAN countries are significant and special. Only in the ASEAN-5 economies (according to sub-project 1) is there an unambiguous direct link

[6] Albeit allowing for some rise in poverty, following the Asian Economic crisis, both in the poorer, badly hit ASEAN-5 countries such as Indonesia and the countries examined in this study, including Thailand.
[7] The 4 newer, poorer member countries of ASEAN, i.e. Cambodia, Laos, Myanmar and Vietnam.

between FDI and poverty reduction. The reasons for why this is the case for these countries is essential to improving the net benefits from FDI for other developing countries, not least for the ASEAN-4. Within the ASEAN-5, some countries have done better (in terms of poverty reduction, growth, utilization of spillover effects etc.) and can be used as “role models” for ASEAN-4 countries (or, indeed, developing countries elsewhere).

In both sub-projects Malaysia and Thailand[8] stand out as exemplars and table 2 summarises their experience with FDI effects – and therefore the types of lessons that other countries can learn. Of course, the precise nature of the lessons will depend on the circumstances of each country and a whole variety of contingencies. For example, the following factors, among many others, were found to matter in terms of the scale and quality of FDI impact: industry, market orientation, size, source country, government education and human resource training policies etc. Many complexities need to be taken into account, but the experiences of ASEAN countries such as Malaysia and Thailand are a good place to start.

Finally, table 3 summarises the study’s findings with respect to the original guiding hypotheses in table 1. In general, ASEAN does matter in terms of the relationship between FDI, growth and poverty reduction (compared to other developing countries) and the findings are generally consistent with the hypotheses. Of course, qualifications apply, as always. However further work (based on the data already collected) is necessary to fully understand how “ASEAN matters” in terms of TNC regional networks (hypotheses 5 and 6).

DISSEMINATION

A number of papers have already been presented at seminars and conferences by all the co-researchers in the UK, as well as in Bangkok, Manila and Hanoi. Both the Hanoi and Bangkok events were wholly or partly dedicated to the dissemination of the DfiD Globalisation Programme results. The Hanoi event was the “DfID Workshop on Globalisation and Poverty in Vietnam”, organised by John Thoburn. Three papers from this study were presented by Axèle Giroud, Nick Freeman and Hafiz Mirza. The Bangkok event was the annual conference of the Euro-Asia Management Studies Association (EAMSA) which was organised by the International Business team in Bradford. Three papers were presented by Hafiz Mirza, Axèle Giroud and Hossein Jalilian in a special session devoted to this research project. It is important that the results of the research have this far been disseminated in ASEAN countries, all of which are included in the study.

Further dissemination will include further conference presentations, journal articles and a book (negotiations are taking place with Routledege-Curzon). It is also intended to cooperate closely with other projects in the programme in joint events similar to the workshop in Hanoi.

[8] Leaving aside Singapore whose economy differs so significantly from the ASEAN-4 that comparisons are not so meaningful.

Table 2 Summary of Malaysia and Thailand's Experience of FDI Effects on the Economy, Growth and Poverty Reduction (based on this research study).

Type of FDI Effect		Degree of Impact	Comments
Direct Effects	Employment	High	Very high levels of FDI in both countries means that large numbers of people are employed by manufacturing TNCS. Many subsidiaries are large, resulting in a big direct impact on the economy, growth and poverty reduction. A very high proportion of workers are women and from poorer provinces.
	Training, Human Capital	High	Relatively advanced segments of value chains transferred to both countries, the quality of local products has to be high in order to meet expectations of international markets, many subsidiaries assigned strategic roles (e.g. related to R&D) or autonomous. High expenditures on HRD and many days devoted for training.
	(Reinvestment)	Middling	Primary source of future FDI expansion in these economies. TNCs need to be convinced to reinvest more
Consumption Multipliers	Consumption	High	High rise in employment and wages led to this and the growth of ancillary industries from real estate to retail services. Local conglomerates grew on the back of this expansion.
	Taxes	High	Facilitated the improvement of social benefits, infrastructural development, education and training etc. (Note careful urban planning in Malaysia as opposed to Thailand.)
	Net Exports	High	Import of consumption goods low compared to exports
Value Chain Multipliers	Suppliers	Middling	Import of inputs from abroad; many local foreign-owned suppliers
	Distributors & Sales Orgs.	Low to Mid	Most output shipped overseas or to manufacturing TNCs in each country.
	International links	High	Results in high exports, but a source of concern when too large a share is imported. Key issue is to improve the local supplier base. Opportunities for regional value chains, especially taken up by ASEAN TNCs and Consumer Electronics firms (among others).
Spillover Effects (training, competitive effects, demonstration effects and human mobility)	Suppliers	Middling	Still not enough spillovers in high-tech goods, but international supply chains mean that "world standard" technology, knowledge and expertise is imparted or seeps to suppliers. A half of subsidiaries maintain supplier partnership schemes in Malaysia; a third in Thailand.
	Distributors & Sales Orgs.	Low	As above. Sales subsidiaries related to imported consumption goods might be significant in spillover effects (but not surveyed).
	Competitors	Low to Mid	Direct competitors few, but improving. However, exemplars of more robust competition provided by entrants (e.g. locally-owned conglomerates which have grown wealthy because of consumption multipliers) and spin-offs.
	Human Capital	Low to Mid	Still only a minimal flow of skilled labour to locally-owned suppliers and manufacturers. Spin-offs minimal. Loss of skilled women workers back to provinces and other occupations?

Figure 1. The Impact of FDI on a Developing Host Country: An Integrated Model of the Principal Direct, Multiplier and Spillover Effects

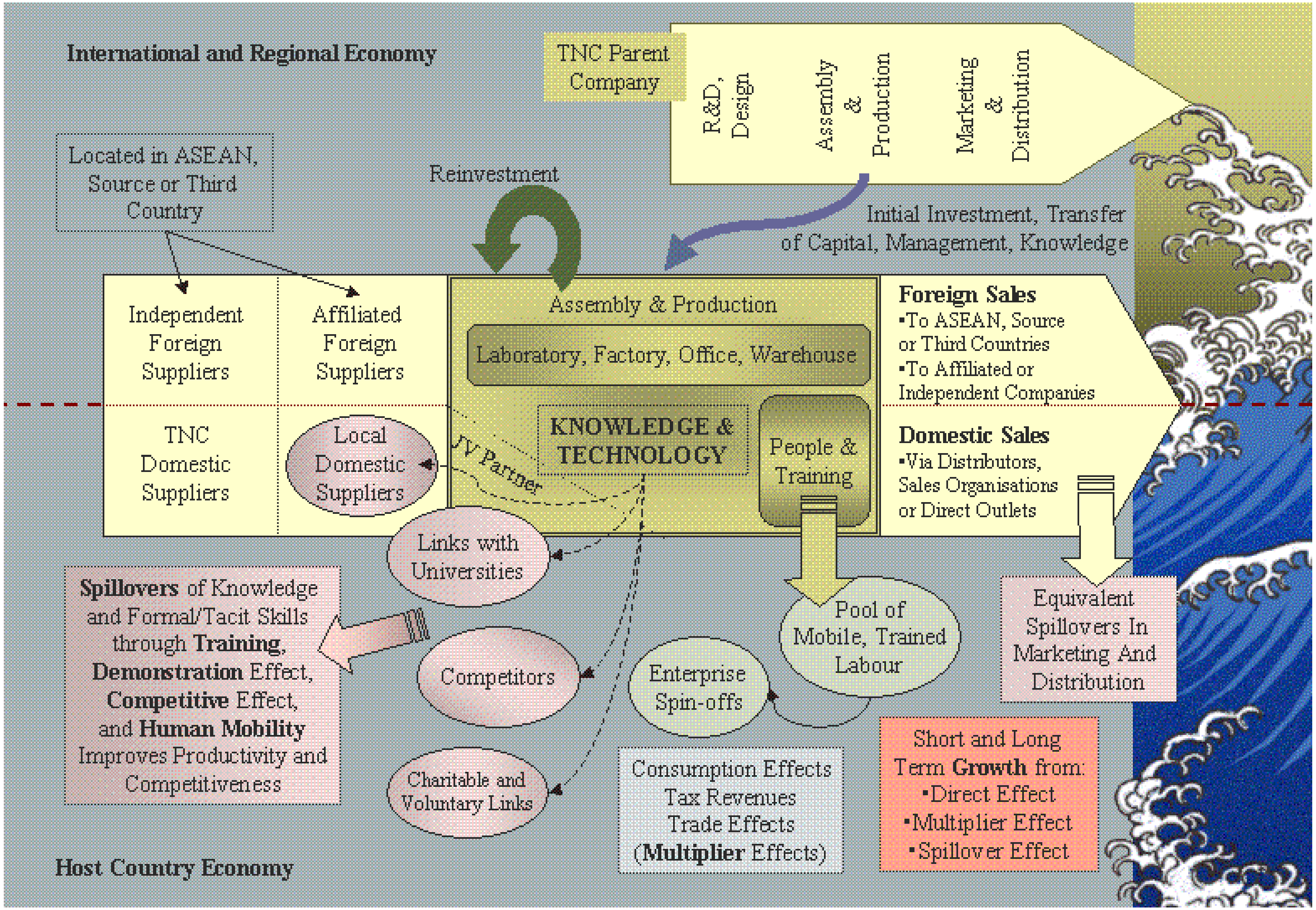

Table 3 The Project's Guiding Hypotheses – Study Findings

Hypothesis Number	Hypothesis	Study Findings
1	FDI reduces poverty via higher economic growth	The study findings are consistent with this hypothesis, but ASEAN is special: in general the relationship between FDI and poverty reduction is more ambiguous (because FDI has costs as well as benefits). Only 40% of poverty reduction thus far is from growth, but this share may increase as spillover effects become stronger.
2	FDI reduces poverty through a direct impact on local factors of production	The study findings are consistent with this hypothesis. About 60% of poverty reduction has been due to increased employment (of the poor) and human resource development.
3	The impact on national economies and poverty depends on the nature and characteristics of capital flows	The study findings are consistent with this hypothesis, but there are many contingencies because of the complexity of flows. For example, the study reveals very strong industry effects.
4	The impact on national economies and poverty depends on the nature and characteristics of the investing TNCs	The study findings are consistent with this hypothesis, but there are many contingencies because of the complexity of TNC characteristics. For example, suppliers seem more likely to improve their performance (i.e. spillovers are greater) when working for USA TNCs, as opposed to firms from other countries (many factors are involved).
5	TNCs are creating regional networks because of the regional division of labour (the "weak" "ASEAN matters" hypothesis)	This appears to be happening to a degree, for example with TNCs in consumer electronics and ASEAN TNCs investments in Vietnam and Cambodia (e.g. because of the attraction of cheaper labour or quotas).
6	TNCs are creating regional networks because of dedicated national and regional policies (the "strong" "ASEAN matters" hypothesis)	Little evidence of this was found directly. However, the effect of this might be "invisible" in the sense that TNCs take advantage of the consequences of these policies – but do not need to know the details. For example, in the past, Malaysian and Thai policies towards FDI were strongly influenced by Singapore (both in terms of style and content, i.e. recognising a particular regional division of labour), but TNC investors only observed an impact on national investment climates. AFTA and the AIA have, arguably, had a similar in recent years (both Cambodia and Vietnam acceded to these agreements).