ASEAN Foreign Direct Investment Trends: Implications for EU-ASEAN Relations

By Megha Mukim

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List of Acronyms

FDI: Foreign Direct Investment
IMF: International Monetary Fund
ASEAN: Association for South-East Asian Nations
R&D: Research and Development
NIEs: Newly Industrialised Economies
AFTA: ASEAN Free Trade Agreement
APEC: Asia Pacific Economic Cooperation
ARF: ASEAN Regional Forum
ASEM: Asia Europe Meeting
EALAF: East Asia Latin America Forum
EAVG: Asia Vision Group (China, Japan and Korea)
EASG: East Asia Study Group (ASEAN + China, Japan and Korea)
EAFTA: East Asia Free Trade Agreement
CEPT: Common Effective Preferential Tariff
GATS: General Agreement on Trade in Services
UNCTAD: United Nations Conference on Trade and Development
AIA: ASEAN Investment Area
APT: ASEAN Plus Three
NAFTA: North America Free Trade Agreement
ICSID: Convention on the Settlement of Investment Disputes between States and Nationals of Other States
ICC: International Chamber of Commerce
UNCITRAL: UN Committee on International Trade Law
BITs: Bilateral Investment Treaties
DTTs: Double Taxation Treaties
EC: European Community
GSP: Generalised System of Preferences
TREATI: Trans-Regional EU-ASEAN Trade Initiative
WTO: World Trade Organisation
WHO: World Health Organisation

EXECUTIVE SUMMARY

In the two decades between 1980 and 2000, global foreign direct investment (FDI) flows have nearly tripled. While up until the 1980s, FDI was viewed with considerable wariness by developing countries, owing to its potential benefits, it is now considered a substantial part of the development process.

This paper attempts to review the growing importance of investment flows to ASEAN (Association of South-East Asian Nations) countries with the objective of analysing the region's relationship with the European Union. Although investment flows between the two regions are significant, this is perhaps, more a function of general ASEAN growth and increased openness than that of a concerted effort on the part of either partner to improve investment ties. Following the Asian financial crisis, South-East Asian countries have made attempts to attract stable long-term foreign capital financing using a variety of national (domestic), bilateral, regional and international policy instruments. This paper maps, in particular, the EU's response to individual member countries' industrialisation and to ASEAN's development as a regional entity. The paper concludes with an overview of recent EU-ASEAN initiatives in order to assess the future potential for increased FDI flows.

A Brief History of ASEAN

The Association of Southeast Asian Nations (ASEAN) was formed in 1967 with the signing of the Bangkok Declaration by the five original member countries - Indonesia, Malaysia, The Philippines, Singapore, and Thailand.[1] Its formation was primarily driven by political and security motivations with a view to promoting cooperation in economic, social, cultural, technical, educational and other fields. It stood for the promotion of regional peace, stability, and security and the prevention of 'balkanisation'[2] in the face of growing insurgency movements. In this respect, the origins of ASEAN were similar to those of the European Union (EU), in that the founding countries initially came together for political and security reasons, rather than a desire to benefit from economic integration.

In the early 1980s, ASEAN integration resembled that of the EU more than that of any other integrated group of economies. However, the inter-country differences within ASEAN are far wider than those found within the EU-15. In 2003 the levels of growth ranged between 1 and 8% among ASEAN member countries (for more details on the basic make up of the Association’s member economies, see Annex Table 3). There are also stark differences in economic and financial development - for example, while Singapore is a world leader in a number of high-tech industries, Vietnam exports relatively low-tech manufactured goods, and while the former has one of the most advanced financial markets in the world and is one of the leading foreign exchange trading centres, the latter is still in the early stages of developing and opening its financial markets. In short, the level of diversity within ASEAN is considerable. This discussion will try and dissolve regional estimates into their component national elements as far as data restrictions allow.

The aftermath of the 1997 Asian financial crisis, combined with the global recession, affected ASEAN member economies adversely. The association was weakened by increasing internal division and a failure to deepen ASEAN integration. Subsequently it came under pressure to prove its relevance. However, the ‘post-financial crisis’ East Asian identity became stronger in some ways. The economic authorities within the region concluded that in the absence of financial cooperation their financial markets and institutions were insufficiently prepared to manage globalized capital flows and had thus been unable to prevent the loss of confidence that had stimulated capital flight. The crisis stimulated a change in attitudes in favour of greater regionalism, and led to the creation of the ASEAN plus Three (APT) grouping in 1999, which included Japan, South Korea and China, and multilateral summits between the 13 South-East and North-East Asian countries are

[1] Brunei joined in 1984; Vietnam in 1995; Laos and Myanmar/Burma in 1997; Cambodia in 1999.
[2] S. Rajaratnam, the then Foreign Minister of Singapore, and one of ASEAN's founding members, stated, “We want to ensure a stable South-East Asia, not a balkanized South-East Asia.”

now convened on a regular basis to explore possibilities of preventing future financial crisis and to enhance regional cooperation.

In the wake of the Asian Financial Crisis, ASEAN also began to place an important emphasis on luring foreign capital inflows. One of the causes of the crisis was the disproportionately high short-term financing of current account deficits instead of long-term financing through foreign direct investment, for example.[3] The fiscal surpluses of the mid-1990s were reversed and were replaced with large budget deficits, amounting to almost 3-11% of GDP in the crisis-affected ASEAN countries, and there was a strong demand for investible funds (Plummer 2002). At the 5th ASEAN Summit in October 1998, the Framework Agreement on the ASEAN Investment Area (AIA) was signed. This regional investment arrangement was found in direct response to the crisis, with the aim of attracting foreign direct investment flows into the region through various measures addressing investment facilitation and promotion. Increasing emphasis was also placed on technology transfer among ASEAN members through bilateral and multilateral relationships.

Trends in Foreign Direct Investment (FDI)

To evaluate the attempts, made by South-East Asian countries to attract international capital flows following the crisis, in mind, an examination of some of the theory underling such investment flows is a useful tool to help judge their potential for development. Foreign Direct Investment (FDI) can be defined as the acquisition of assets by one country in another country (the home and host country respectively) of domestic structures, equipment and organisations. The International Monetary Fund (IMF) broadly defines FDI as the establishment of substantial ownership of an enterprise in a foreign country; and in a narrower sense, as enterprises in which non-residents hold 25% or more of the voting share capital. What distinguishes FDI from portfolio investment is the intent to manage the acquired asset. Since the flow of FDI stems mainly from investors' long-term interest in a country's production activities, it has become an important source of external finance for developing countries. One can distinguish between two types of FDI – vertical and horizontal. When a multinational firm fragments the production process internationally, locating each stage of production in a country where it can be done at the lowest cost, it is referred to as Vertical FDI. In the simplest form, this could involve a firm producing a good in a labour abundant economy for different markets – domestic, source and international. Horizontal FDI, on the other hand, occurs when a multinational firm undertakes the same production activities in multiple countries. In some cases, horizontal flows are motivated by trade barriers. This is the case when these act as a substitute for international trade, in an effort to supply protected

[3] For a reading of the causes of the Crisis see Corsetti, G, Pesenti, P., Roubini, N. (1999) "What caused the Asian currency and financial crisis?," Japan and the World Economy, Vol. 11, pp 305-373.

markets. FDI can also be of two kinds: Greenfield investment, which involves the creation of productive assets by foreigners; and acquisitions, mergers and takeovers, which include the purchase of existing assets by foreigners.

Until the 1980s, a number of developing countries viewed FDI with some wariness. The presence of large multi-national corporations was viewed with suspicion owing to their penetration into small economies and their capacity to control large resources yielding them considerable influence over economic and political affairs. However, owing to the potential benefits of FDI, as discussed below, a number of countries have since adopted strategies to attract as much FDI as possible. From only $53.7 billion in 1980, FDI outflows had reached $1.4 trillion by 2000[4] (Brooks 2003).

Because of its stability, compared to other forms of capital flows, either private or public, foreign direct investment can serve as an important source of capital, technology and skill transfer for the host country, allowing higher levels of economic development and better integration with the world economy. Foreign firms are also an important source of intangible assets such as technological skills. Technological innovation has been found to be critical in creating and sustaining a competitive advantage in global markets, and not surprisingly industrialised countries spend large amounts of resources on research and development (R&D) activities. Although in recent years, some Asian countries (the newly industrialised economies (NIEs) and China) have experienced rapid increases in R&D activities, and have developed indigenous technological capabilities, the majority of Asian firms continue to be highly dependent on western advanced industrialized countries for their technology needs (Kumar 2002). There is however, an important qualification: keeping in mind the growing importance of international patent agreements and technology licensing laws, the extent of the benefits to the host country depend upon how freely foreign technology spreads to domestic firms.

International capital flows can also represent a potentially effective instrument in bringing about a net improvement in welfare in the host economy by increasing competition and increasing domestic output, leading to a reduction in domestic prices. In some cases, FDI flows have often been accompanied by increased domestic investment.[5] Thus, the presence of foreign firms could serve as a catalyst for domestic producers. The economies of scale through joint ventures and

[4] FDI data are of two kinds: *stocks* are the current accumulated book values of FDI at a given date while *flows* are the net annual increases or decreases in a firms' overseas assets/liabilities. Stock measures are more stable measures than flows and, therefore, give a better long-term picture of FDI trends. By definition, however, they do not show short-term changes in FDI positions. Hence, FDI *stock* data provides a valuable insight into the cumulative development of investment over time while FDI *flow* data shows the more volatile, short-term changes in the investment position at the global, regional, and national scales.

[5] In an analysis of panel data for 58 developing countries, Bosworth (1999) finds that about half of each dollar of capital inflow translates into an increase in domestic investment.

marketing of these firms, could also provide advantages in terms of export market access for domestic exporters.

In the case of ASEAN, where a major constraint facing Asian firms in the post-crisis period was the lack of access to adequate financial resources, FDI can aid in bridging this gap. An economy could suffer from various gaps: insufficient savings to support capital accumulation to achieve a given growth rate target, and insufficient foreign exchange to transform domestic to foreign resources. Capital inflows can guarantee foreign exchange availability for the import of inputs needed for investment. Thus, FDI flows can contribute to the development process by providing capital, foreign exchange, technology (including managerial and marketing skills), competition, and export market access. They can also stimulate domestic investment and innovation.

A number of ASEAN countries have shown notable dependence on private capital inflows to finance their capital formation (See **Error! Reference source not found.**). While Singapore, for example, displays a singularly high use of FDI to finance gross capital formation, others like Thailand have not yet fully exploited FDI inflows.

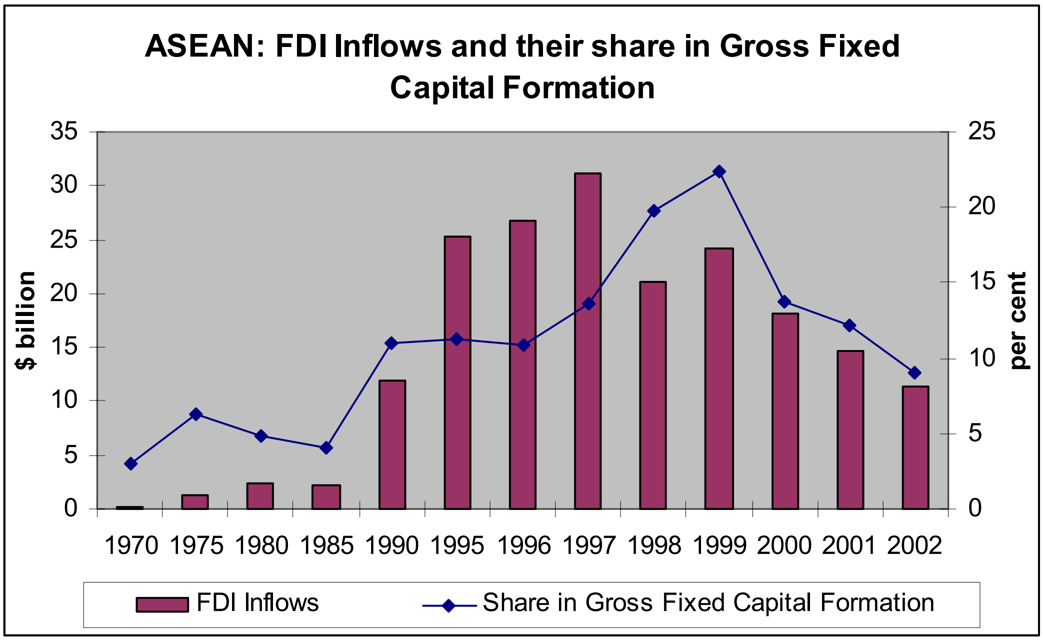
FOREIGN DIRECT INVESTMENT, NET INFLOWS (% GROSS CAPITAL FORMATION)

COUNTRY NAME	**1980**	**1990**	**1995**	**2000**	**2002**
Brunei Darussalam	…	…	…	…	…
Cambodia	…	0	31	24	6
Indonesia	1	3	7	-19	-6
Laos	0	0	21	6	...
Malaysia	14	16	11	15	14
Myanmar	…	…	…	…	…
Philippines	-1	5	9	8	7
Singapore	23	41	40	42	33
Thailand	2	7	3	12	3
Vietnam	…	22	32	14	12

Source: World Development Indicators 2004, World Bank

The region as a whole has also shown varying degrees of dependence on foreign sources of capital over the last three decades. As illustrated in Figure 1, 1997 was a peak, with 31 billion US dollars in foreign investment flowing into the region, and correspondingly, domestic financing of cross capital formation also showing positive signs. Following the crisis, however, the overall picture for the region has much scope for improvement.

Figure 1



Source: World Development Indicators 2004, World Bank. Note: Indonesia, Malaysia, The Philippines, Singapore, and Thailand (1967); Brunei (1984); Vietnam (1995); Laos, Myanmar (1997); Cambodia (1999)

As Princeton economist and New York Time columnist, Paul Krugman has pointed out – magnitudes matter.[6] The greater is the proportion of the economy, which is dependent on trade and investment, the greater the benefits of the elimination of stumbling blocks. As mentioned before, the region has taken a pro-active stance to step up foreign direct investment flows and to improve access to capital within a well-developed and stable financial sector. The drying-up of commercial bank lending due to the debt crises persuaded a number of developing countries to implement investment policies to attract foreign investment, encouraging both portfolio investment and the less volatile FDI.

It is worth noting the policy context within which FDI flows occur. A number of countries offer incentives in the form of tax concessions, tax holidays, tax credits, accelerated depreciation, export subsidies, import entitlements, and subsidised utility rates to attract foreign investors. For instance, the People's Republic of China offers income tax exemptions and reductions to foreign enterprises; countries like Thailand and Vietnam offer duty exemptions on capital imports for FDI projects located in export processing zone.[7] Others, like Cambodia and Vietnam have amended public laws and made changes to national policies concerning foreign investment to improve the transparency and

[6] Quoted in Galal, A. and Hoekman, B. (June 1996) "Egypt and the Partnership Agreement with the EU: The Road to Maximum Benefits;" The Egyptian Centre for Economic Studies (ECES).

[7] The International Labour Organization (ILO) defines Export Processing Zones (EPZ) as industrial zones with special incentives to attract foreign and domestic investors, in which imported materials undergo some degree of processing before being exported again.

predictability of the domestic climate for FDI; and Indonesia and Malaysia have further liberalised investment in different sectors (UNCTAD 2004).

Host economies can also implement programmes aimed at promoting linkages between foreign and domestic firms so as to maximise the sharing of proprietary technology and procedures. Such programmes include the provision of market and business information; matchmaking through trade fairs or databases; and support to local enterprises through the provision of managerial and technical assistance, training, audits and, occasionally, financial assistance or incentives. For example, the Economic Development Board of Singapore has successfully encouraged foreign investors to voluntarily identify promising local suppliers and contribute to vendor development (Brooks 2003).

However, FDI policy frameworks, though important, are only one of the determinants influencing investors' decisions - see Box 1. The particular levels of FDI within a country, for instance, usually depend upon a number of varying factors, many of which are determined by the profitability of the investments themselves. Such factors include a country's institutions, which determine symmetric information, transaction costs and the quality of human resources, and a country's 'created' assets - physical infrastructure (ports, roads, power, communications), healthy financial markets, technology and innovative capacity – assets which are critical to enable firms to maintain their competitiveness (UNCTAD 1996). Thus, factors like the size and growth of markets, efficient public institutions, physical infrastructure, skilled human resources and stable macroeconomic conditions, in short, the quality of a country's immobile assets, are generally important considerations for internationally mobile factors of production. Usually, a favourable policy environment for FDI is one that combines economic and political stability, transparent rules on entry and operations, equitable standards of treatment between foreign and domestic firms, and one that secures the proper functioning and structure of markets.

Box 1

Vietnamese FDI Environment

The first Law of Foreign Investment in Vietnam was introduced in 1987 and has since been amended, the last revision made in 2003. The regulatory system in Vietnam has progressively evolved so as to reduce and ultimately remove obstacles to FDI inflows into the domestic economy. The list of domestic measures adopted include: the relaxing of currency balancing regulations; simplification of government procedures in FDI management; reduction of profit tax rates; freer worker recruitment, etc. The contribution of FDI to the Vietnamese economy has responded favourably - while in the early 1990s, foreign investments remained concentrated mainly in the oil and gas sectors, progressive periods saw a promulgation to new sectors like real estate and industry. In 1997, Vietnam experienced a sharp decline in FDI inflows as a result of the Asian crisis and owing to the slowing down of the reform process. However, following the country's renewed efforts to attract FDI, which also included the signing of the US-Vietnam Bilateral Trade Agreement in 2000, foreign investments expanded to industrial sectors such as footwear; textile and garments, electronics, computers, and supplies, and European partners like France and The Netherlands began to show an increasing interest. However, despite these important achievements, Vietnam still has a long way to go in reducing the costs of doing business and in improving the regulatory framework even further for foreign-invested enterprises in the country.

Source: Leproux (2004)

International Policy Environment

FDI is not solely influenced by domestic policy, and international linkages between the host and home country can also play an important role in promoting international capital flows. International agreements, whether regional or bilateral, have substantially increased over the last two decades.[8] Even the region of East Asia, simply on its own, looks like a virtual alphabet soup: ASEAN, AFTA, APEC, ARF, ASEM, EALAF, EAVG, EASG, EAFTA. In the case of FDI, international agreements can provide a hospitable regulatory framework for foreign investors by relaxing rules regarding market entry and ownership and improving the standard of treatment accorded to foreign firms - see Table 3 for ASEAN member country involvement in bilateral, regional and international agreements. Such agreements often feature explicit dispute resolution mechanisms, which reduce investment disputes between countries, and provide for the creation of a credible investment environment without fear of either side engaging in FDI 'confiscation.'[9]

[8] Jagdish Bhagwati has described the phenomenon as the 'Spaghetti Bowl' effect, where the number of bilateral free trade agreements (FTAs) could create regulatory complexity and confusion in trade policy, particularly in the administration of overlapping, contradictory and complicated rules of origin.

[9] Fernandez (1997) takes the case of a country, which opens its doors to foreign investment, and subsequently 'confiscates' it through the imposition of a greater regulatory or fiscal burden.

An important step forward along the path of regional integration for ASEAN member countries was the creation of the ASEAN Free Trade Area (AFTA), established in January 1992, which laid out a comprehensive programme (see Box 2) to reduce tariff barriers with a view toward integrating ASEAN economies into a single production base and creating a regional market of 500 million people (Leproux, 2004). It officially came into force in January 2002.[10] AFTA represented a form of 'open regionalism,' an outward-oriented and market-driven form of regional integration. Among others, the objectives of the Agreement were to promote the region as an international production centre so as to attract an increasing share of global foreign direct investment. It included framework agreements on the liberalisation of services, trade and intellectual property cooperation, as well as an ASEAN Action Plan on the cooperation and promotion of foreign direct investment. Over the course of the next several years, the programme of tariff reductions was broadened and accelerated, and a host of 'AFTA Plus' activities were initiated, including efforts to eliminate non-tariff barriers and quantitative restrictions, and harmonise customs nomenclature, valuation, and procedures, and develop common product certification standards.

Box 2

CEPT - Common Effective Preferential Tariff Scheme

The centrepiece of AFTA is the Common Effective Preferential Tariff (CEPT) scheme. The CEPT was the mechanism by which tariffs on goods traded within the ASEAN region, which meet a 40% ASEAN content requirement, were be reduced to 0-5%, originally by the year 2008. By 1994, this date was brought forward to 2003 and the original coverage of products was further extended. Tariff reductions were to move ahead on both the 'fast' (deadline 2000) and the 'normal' (deadline 2002-03) tracks. Currently, about 81% of ASEAN's tariff lines are covered by either the fast or normal track. Keeping the different levels of member country development in mind, the fast track deadlines were varied: Vietnam (2006), Laos (2008), Myanmar (2008) and Cambodia (2010). Sensitive agricultural products were also given an extended deadline of 2010. By 2003, the CEPT covered 98% of all tariff lines in ASEAN. The average CEPT tariff rate for products in the inclusion is approximately 2.7% in 2003, down from about 12.76% in 1993, at the start of the tariff reduction programme. In the longer term, ASEAN countries have agreed to apply zero tariff rates on virtually all imports by 2010 for the original signatories, and 2015 for the four newer ASEAN members.

Source: Dent (1998); ASEAN Secretariat

ASEAN has also employed a variety of co-operation agreements to deepen integration within the region and to increase its attractiveness as a region with greater potential to host FDI over the long-term. For example, the ASEAN Framework on Agreement of Services was signed in December 1995, with the aim of eliminating restrictions on trade in services and to improve the efficacy of domestic service suppliers. The Agreement improves market access and grants national

[10] Interestingly, the agreement came into being with little fanfare, either in the region or internationally; it was overshadowed by another regional initiative - the launch of the single currency by the European Union.

treatment for service suppliers among ASEAN countries on a GATS-plus basis. Three packages of service commitments were also concluded since January 1996, covering air transport, business services, construction, financial services, maritime transport, telecommunications and tourism (UNCTAD 2004). As mentioned briefly above, the ASEAN Investment Area (AIA) also looked to lower and remove intra-regional barriers to investment, with a view to increasing the competitiveness of the region so as to ultimately increase investment flows from ASEAN and non-ASEAN sources. Its main facets included the opening of industries to investment, national treatment to be granted to ASEAN investors, streamlining of investment processes and procedures and other investment facilitation measures. Full realisation of the AIA with the removal of temporary exclusion lists in manufacturing, agriculture, fisheries, forestry and mining is scheduled to happen by 2010 for the ASEAN-6, and by 2015 for the new members (Cambodia, Laos, Myanmar, and Vietnam).[11]

In the aftermath of the regional financial crisis, and to signal the end of confidence and liquidity problems that ASEAN plus Three (APT) countries faced, their Finance Ministers launched the Chiang Mai Initiative in May 2000. A large network of currency swap agreements were established, which allowed APT countries to swap their local currencies for major international currencies for up to six months and for up to twice their committed amount (Angresano, 2004). Hund (2003) points out that in March 2000, APT countries collectively possessed foreign reserves of over $800 billion US dollars, as compared to the Eurozone reserves of $340 billion US dollars. This initiative has contributed to greater exchange rate and financial stability in the region, by shielding regional currencies from strong and unexpected depreciations.

Participation in regional arrangements with larger markets such as North America or the EU, has also been an approach taken by developing countries to indicate low cost barriers to potential investors. The provisions of some regional trading agreements provide preferential member access to the markets of larger trading partners and could be a function of increased investor interest in the region. For example, the then President of Mexico, Salinas, stated[12] that a factor pushing Mexico towards entry into the North American Free Trade Agreement (NAFTA) was the fear that European investment would be diverted into Eastern Europe once it integrated with the European Community.

Member countries can also guarantee irrevocable commitments by accepting the jurisdiction of existing institutions. Surveys of European firms looking to invest in Morocco, for example, showed that a major proportion had reservations over the lack of dispute resolution

[11] www.us-asean.org
[12] Salinas said, “What we want is closer commercial ties with Canada and the United States, especially in a world in which big regional markets are being created. We don’t want to be left out of any of those regional markets.”

mechanisms and the lack of legal recourse on government contracts (Page, 1996). Hoekman (1999) points out that certain integration agreements, such as NAFTA for example, have used 'credibility enhancing' institutions to settle disputes. These include the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID), the International Chamber of Commerce (ICC), or the UN Committee on International Trade Law (UNCITRAL). The agreement also has a separate chapter on investment (Chapter 11), which deals with the rights and measures of protection for investors and investments in NAFTA countries. Thus, partnership agreements can support a favourable climate for incoming FDI from partner countries, and can also improve the general perceptions of third party FDI with regard to government commitment to the rights of investors in the country.

In the case of South-East Asia, countries like Singapore and Thailand have been extremely pro-active in signing international agreements containing trade, investment or service provisions with their more developed counterparts. In addition, these and other ASEAN member countries, such as Malaysia and Burma/Myanmar have also initiated bilateral or regional agreements with other developing countries within the South-Asian region. As an organisation, ASEAN, has been involved in no less than five international arrangements in 2003-2005 alone, with such arrangements spanning preferential, bilateral and regional agreements (Table 3). Importantly, in November 2004, ASEAN members and China agreed to create a Free Trade Zone by 2010, which would encompass a market of 1.8 billion consumers (Freundenberg, 2004).

Investment treaties have also been concluded between developing countries as a way to ensure the security of foreign direct investments. International policy instruments for the protection and promotion of FDI, such as Bilateral Investment Treaties (BITs) and bilateral treaties for the avoidance of double taxation - Double Taxation Treaties (DTTs) - have gained increasing popularity: by the end of 2002, 2,181 BITs and 2,255 DTTs were in effect. [13] BITs typically include provisions on the scope and definition of foreign investment; admission of investments; national and most-favoured-nation treatment; fair and equitable treatment; guarantees and compensation in respect of expropriation and compensation for war and civil disturbances; guarantees of free transfer of funds and repatriation of capital and profits; subrogation on insurance claims; and dispute settlement, both State-to-State and investor-to-State. In recent years, some bilateral treaties have added new provisions relating to the transparency of national laws, performance requirements, entry and stay of foreign personnel, general exceptions, and extension of national and most-favoured-nation treatment to the entry and establishment of investments. DTTs, on the other hand, usually identify measures to

[13] UNCTAD, BIT/DTT database (www.unctad.org/fdistatistics)

avoid double taxation of the investor by the host and home economies.[14]

Table 1 illustrates that ASEAN member countries have not been passive in signing bilateral treaties with other countries, and have taken a number of initiatives with a view to channel foreign investment into desired locations and while extending protection to foreign investors.

Table 1

BILATERAL INVESTMENT AND DOUBLE TAXATION TREATIES (2002)

ASEAN Member Country	DTTs*	BITs**
Brunei Darussalam	2	2
Cambodia	0	13
Indonesia	52	56
Laos	1	19
Malaysia	53	67
Myanmar	4	3
Philippines	43	34
Singapore	50	24
Thailand	53	37
Vietnam	29	40

Source: UNCTAD, BIT/DTT database (www.unctad.org/fdistatistics)
* Double Taxation Treaty
** Bilateral Investment Treaty

It appears from the above discussion that ASEAN, the region as a whole, and its individual member countries have taken certain steps in recent years to increase and sustain investor interest. It will be worthwhile to evaluate whether the region and its countries have been successful in this regard. Although ASEAN as a region performed better in terms of FDI inflows, which rose by over 50% from $13.5 billion US dollars in 2002 to $20.3 billion US dollars in 2003 (see Table 4), intra-country performance has been varied, with member countries showing an uneven pattern of distribution. As Figure 2 illustrates, Singapore accounted for almost 60% of all FDI inflows into the region in 2003, while countries like Indonesia saw a drop of 3% from the previous year. In its World Investment Report 2004, UNCTAD points out that the Inward FDI Performance Index[15] for East and South-East Asia, showed an increase in the 1990s: 1988-1990 - 1.73; 1993-1995 - 3.25, but then showed a marked drop in 2001-2003 to 1.54. There is also some variation within ASEAN member country rankings. Not surprisingly, countries like Singapore have ranked 6th out

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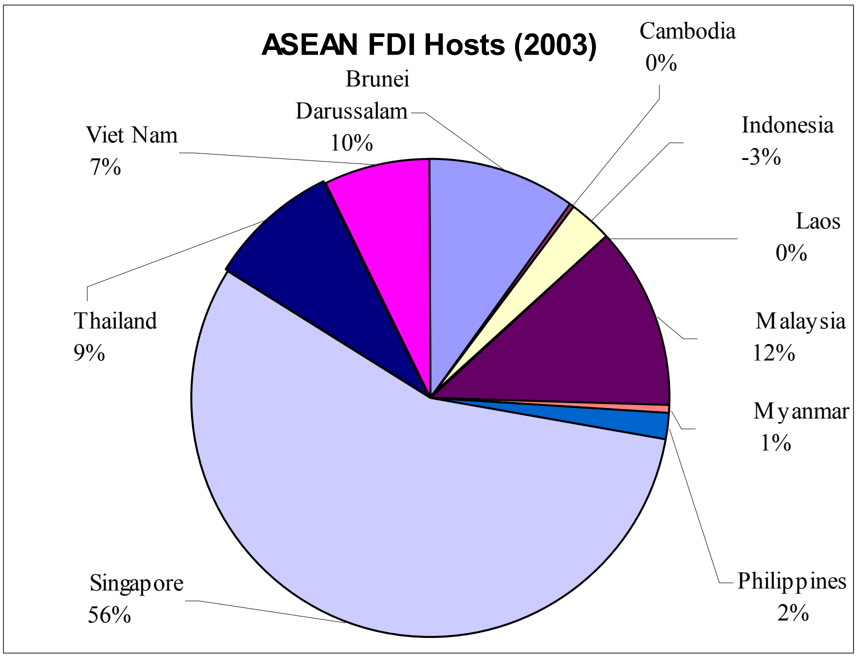
[14] UNCTAD (2000) Press Release; Available from: http://www.unctad.org/Templates/webflyer.asp?docid=2655&intItemID=2023&lang=1

[15] The UNCTAD *Inward FDI Performance Index* is a measure of the extent to which host countries receive inward FDI. The Index ranks countries by the amount of FDI they receive relative to their economic size, calculated as the ratio of a country's share in global FDI inflows to its share in global GDP. A value greater than one indicates that the country attracts more FDI in proportion to its economic size, a value below one shows that it receives less.

of 140 countries included in the index; however other countries like Malaysia (75th), Indonesia (139th), The Philippines (96th) and Thailand (87th) rank poorly on the index.[16] The report blames the persistence of political and financial uncertainty following the Asian financial crisis, as a possible cause.

Figure 2

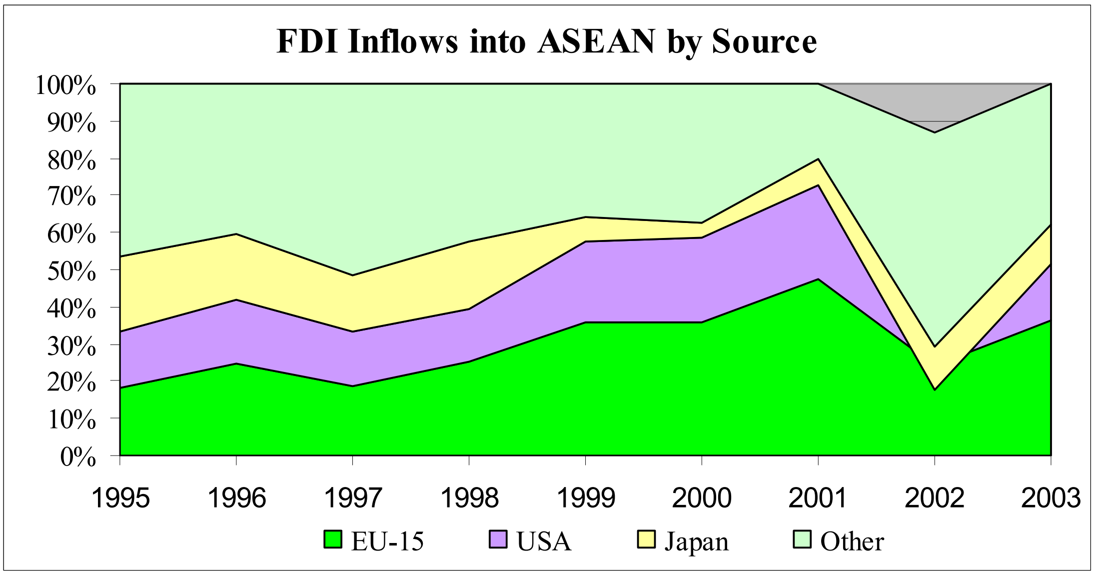


Source: UNCTAD Foreign Direct Investment Database

From the point of view of the region as a whole, it has been its developed country partners, which have served as an important source of investment flows for ASEAN - the biggest contributors being the EU, Japan and the United States. The following figure illustrates that the European Union (EU-15) has generally accounted for between 20-35% of total FDI inflows into ASEAN countries. Thus, from the point of view of ASEAN, the European Union has been a relatively stable source of investment flows to the region. As compared to countries like the United States and Japan, the extent of the commercial presence of European firms has grown in the last few years, particularly in the industrial goods sector (van der Geest, 2004). The remainder of this discussion will focus on the link between EU-ASEAN relations and what lessons this may have for the flow of investment from the former to the latter.

[16] As foreign investments are lumpy in nature, the ratios are computed using the averages for three years.

Figure 3



Source: ASEAN Statistical Yearbook 2004

EU-ASEAN Relations

Ties between Europe and South-East Asia have a long history, moving from initial trading contacts, the colonial relationship, and then a protracted period of withdrawal to form the basis of current links. With the creation of the European Community (EC) in 1958 and the establishment of the Association of South-East Asian Nations (ASEAN) ten years later, the first basis was laid for region-to-region contact. Relations between the two parties have since mainly focussed on economic layers.

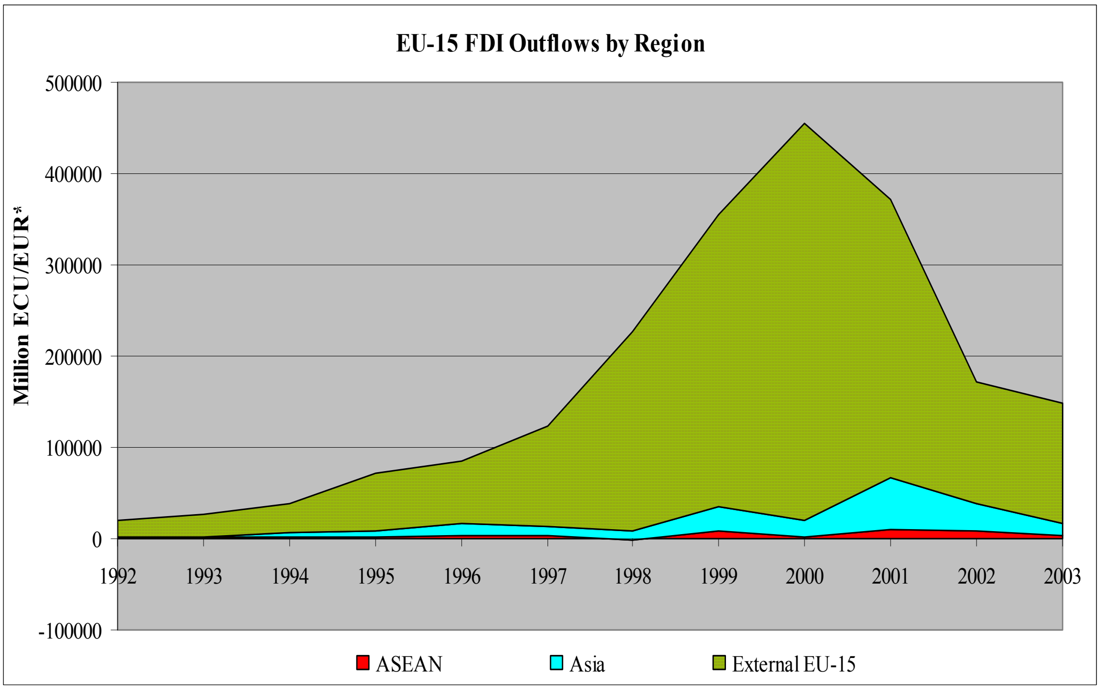
Owing to their value and their strategic regional nature, trade and investment flows between the regions have been of critical importance. At the start of regional interaction between the two, ASEAN was a fast growing supplier of primary products and an emerging market of 250 million consumers. To regulate the emerging trade relations, the groupings first flexed their muscles under the broad framework of the EU-ASEAN Cooperation Agreement signed in 1980. The 1990s saw a broadening of ASEAN membership, and a deepening of Europe's institutional arrangements with the signing of the Maastricht Treaty. These changes marked a growing confidence in the ability of the two regional organisations to develop strategies to pursue their interests at various levels - economic, political and institutional. However, economic interests remained the driving force of the relationship (Forster 1999).

In the first half of the 1990s, the South-East Asian economy grew 44%, and ASEAN developed a trade surplus with the EU. Since trade remained at the forefront of EU-ASEAN relations, second-generation economic issues such as investment were not always given adequate attention. Although trade had seen significant growth as a result of the

Co-operation Agreement and the Generalised System of Preferences (GSP) Scheme, EU investment in the region in the early 1990s amounted to a paltry 1% of EU outflows, and 13% of FDI levels. This was despite a range of measures including the creation of Joint Investment Committees in each ASEAN capital in 1987, the promotion of small-scale joint ventures and a programme of EC International Investment Partners (Forster, 1999).

The picture remained gloomy over the following years - See Figure 4. In 1995, ASEAN accounted for a mere 3% of total EU-15 direct investment abroad, while 1998 saw a sharp drop. Recent years have shown little improvement and ASEAN's importance as a host destination for EU FDI flows has hovered around 3.6% for the last three years now.

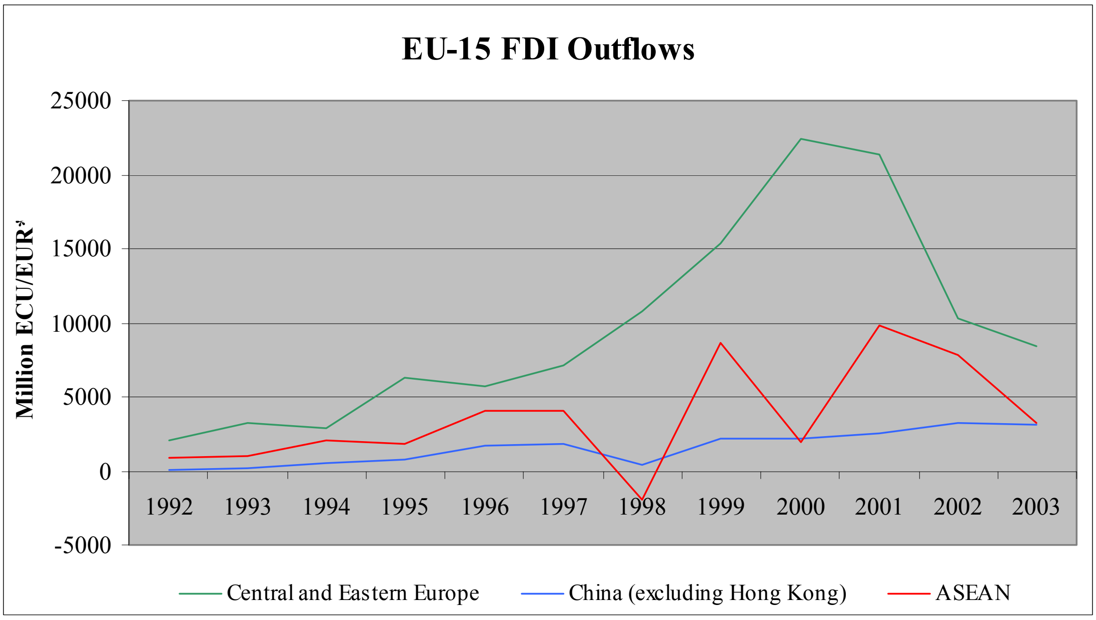
Figure 4



Source: Statistical Office of the European Communities: Eurostat
*Million ECU/EUR (ECU till 31.12.1998, and EUR thereafter)

A number of factors may have contributed to weak relations between the two regional groupings. In contrast to American and Japanese counterparts, for many European countries, the South-East Asian market may seem to be at a greater distance and too complex to pursue. Restrictions on investment inflows within the region cannot be of much help. The dampening effects of the Asian crisis also cannot be underestimated. Certain Southern European industries such as textiles, shipbuilding and light electronics, may also, in fact, be competing with those of the Asian newly industrialised economies (NIEs). In addition, a substantial part of European attention has also been focussed on expanding business with the Central and Eastern European countries, and more recently on large emerging markets such as China - see Figure 5. Interestingly, the EU has also had to rely, almost entirely, on the WTO to improve its trade/investment relations with ASEAN, since there has been a notable lack of initiatives for a trade-bloc between the two. This is a subject, which could be of considerable interest for future research.

Figure 5

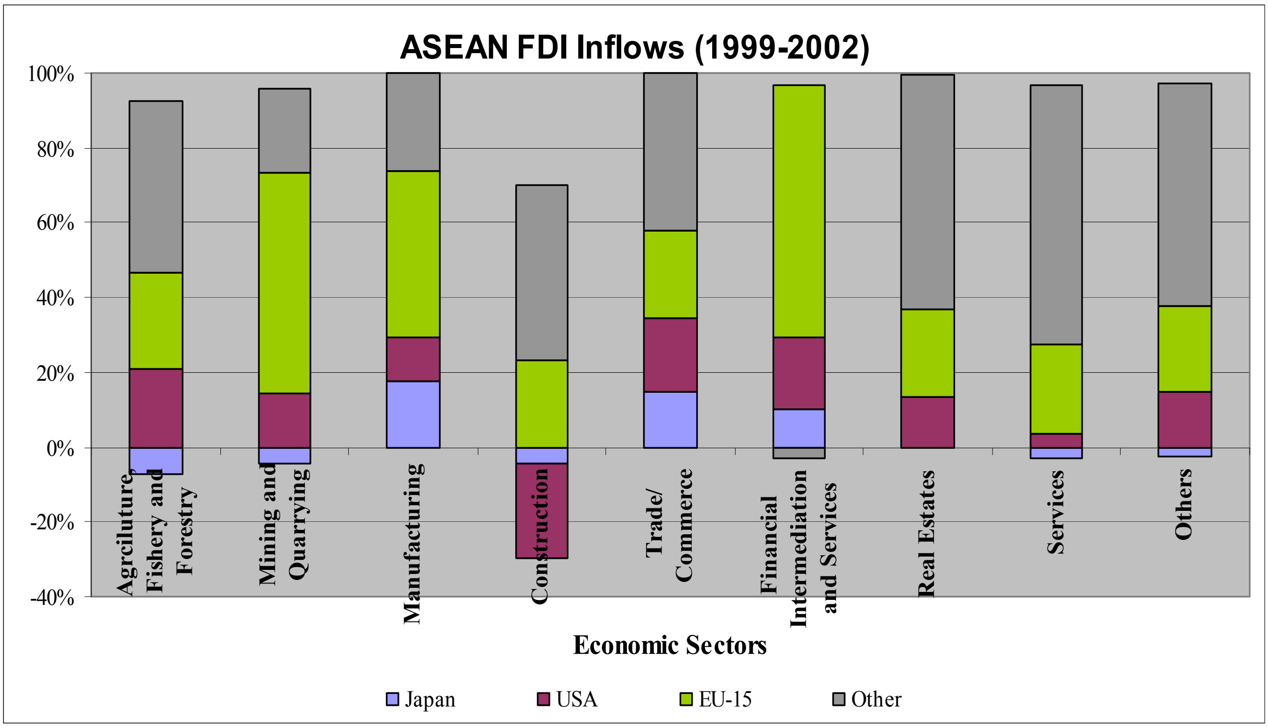


Source: Statistical Office of the European Communities: Eurostat
*Million ECU/EUR (ECU till 31.12.1998, and EUR thereafter)

For some individual ASEAN member countries, however, the outlook has not all been doom and gloom; Singapore, Malaysia and Brunei, for example, have received substantial FDI inflows from Europe in the last few years (see Table 5). In Singapore, for example, 80% of chemical export to the EU originated from firms with majority EU ownership (van der Geest, 2004). Brown (1998) also provides a detailed explanation of the role played by foreign investment and transnational companies in the development of the country's electronics industry. Singapore has been extremely successful in attracting foreign investment and exploiting the same for wider economic development through material linkages between foreign-owned companies and domestic suppliers based on the island. The region's other rich micro-state, Brunei, has also been an important regional hub for financial and other business services. With regards to the profile of European investment in Thailand, FDI was formerly concentrated in the manufacturing industry, but has, in recent years, shifted towards export-oriented, construction and financial sectors. The services sector, in fact, has been one of growing importance for the region as a whole as shown by the following figure.[17] This is primarily because these economies are becoming increasingly service-oriented and are creating efficient infrastructure for such services as finance, telecoms and commerce. Tourism has also been an important industry in countries like Cambodia and Thailand (UNCTAD 2004).

[17] This trend is not simply restricted to ASEAN and its ubiquity is perhaps best captured by UNCTAD's 2004 World Investment Report, entitled "The Shift Towards Services."

Figure 6



Source: ASEAN Statistical Yearbook 2004

Alexander and Myers (1999) have carried out an analysis of European retailers' international expansion into South-East Asia. The impressive and sustained economic growth of the early 1990s, brought the markets of the region into sharp focus. Singapore was host to 42 European retailers by 1994, with numbers on the rise, and the country was used as a base for European retailers' general expansion in the region. Corresponding numbers for Thailand (24), Indonesia (19) and Malaysia (22) supported the view that the European retail industry was indeed concentrating its efforts within other East-Asian markets after the first wave of inward FDI.

The general distribution of EU FDI in the region has shown some noteworthy winners and losers. The following list ranks countries with ASEAN by the level of FDI flows. Countries like Brunei and Vietnam have improved their ranks thanks to greatly improved economic conditions and better investment climates.

Rank	**1995**	**2003**
1.	Singapore (50%)	Singapore (49%)
2.	Malaysia (16%)	Brunei (42%)
3.	Indonesia (13%)	Malaysia (9%)
4.	Vietnam (6%)	Vietnam (7%)
5.	Thailand (4%)	Thailand (0%)
6.	Philippines (4%)	Myanmar (0%)
7.	Brunei (4%)	Laos (0%)
8.	Myanmar (3%)	Cambodia (0%)
9.	Cambodia (0%)	Indonesia (-3%)
10.	Laos (0%)	Philippines (-%5)

Source: Table 6

In general, on a country-to-country basis, links between the two regions are strongest, where post-colonial ties exist: Burma/Myanmar, Malaysia, Singapore and Brunei with Britain; Vietnam, Laos and Cambodia with France; Indonesia with the Netherlands and Portugal; the Philippines with Spain and the US. Importantly, however, Germany remains an important partner for a number of countries within the region (Dicken, 2003). For data on selected country-country FDI flows see Table 6.

Conclusion

Both EU and ASEAN are aware of the potential benefits that increased co-operation could bring in the field of trade and investment. In an effort to revive and strengthen relations between the two groupings, a number of initiatives have been taken in the last decade with a view to fully exploit their potential (see Box 3).

Box 3

ASEM – Asia Europe Summit

Leaders from the European Union and the APT met at the inaugural Asia Europe Summit (ASEM) held in March 1996 in Thailand. The process brought together heads of State and Governments of ten Asian countries (Brunei, China, Indonesia, Japan, South Korea, Malaysia, the Philippines, Singapore, Thailand, and Vietnam) and of the fifteen Member States of the EU, as well as the President of the European Commission. The summit established an ongoing process, based on summit-level meetings every second year, regular ministerial meetings (Foreign, Economic and Finance), and more frequent meetings at the senior-official and working level. The 5th Summit was held in Hanoi, Vietnam in October 2004, and incorporated 39 leaders, including the 10 new EU members states and the presence of Laos, Myanmar and Cambodia.

Owing to its informal institutional structure, ASEM has offered a timely means of redefining contact and cooperation in the region, with new economic, political, socio-cultural and security concerns added when required. In terms of economic initiatives, an Asia-Europe Business Forum was established to address trade and investment policy concerns; Small and Medium size Enterprise (SME) centres and electronic resources were established to deal with the former's concerns. Initiatives in other fields have included the establishment of Asia-Europe University programmes to improve links between the two regions in higher education and joint efforts in the field of eCommerce and Internet security.

For more information on ASEM see:
http://europa.eu.int/comm/external_relations/asem/intro/

The focus of this paper has been mainly on foreign investment flows into ASEAN, noting the important role played by the European Union in the region's past and current history. However, this paper also highlights the immense potential that increased efforts on the part of both sides could have for their future relations. In the flurry of bilateral and regional initiatives involving the US, Japan, China and Eastern

Europe, it is in the interests of both parties to reinforce each other's position in a global context.

For ASEAN to maintain its attractiveness in a fast-changing global environment, ensuring a favourable investment climate for domestic and regional players would go a long way in establishing its mark in the international arena - a good strategy to attract international FDI may be to increase intra-ASEAN FDI.

This is also where the EU experience, as the most successful regionally integrated body could offer a number of lessons to ASEAN:

- East Asian financial systems, for example, could implement reforms relating to transparency, capital requirements, financial regulation and surveillance, as has been practised in the Eurozone. In general, with the possible exception of Singapore, most service sectors within ASEAN are subject to high FDI restrictions pertaining to foreign equity limits, input and operations and control and management.

- Partnership arrangements between the two sides could help ensure technical assistance from the EU to enable smooth integration in ASEAN-wide harmonisation of the FDI policy environment. This could be comprised of a joint promotion of FDI, information and technical services and means to enhance links between potential partners and contacts.

- Increasing partnership issues to cover topics such as competition policy, intellectual property rights and the harmonisation of standards and codes could go a long way in improving and sustaining EU-ASEAN investment flows.

- The European Commission has suggested that it will consider the establishment of a so-called Trans-Regional EU-ASEAN Trade Initiative (TREATI) as a new initiative for economic co-operation on a region-to-region basis. TREATI would involve dialogue and co-operation covering various areas such as trade facilitation, market access and investment issues between the EU and ASEAN.[18]

Despite the recent increase in European FDI flows into ASEAN member countries, substantial potential to increase FDI flows remains. ASEAN's efforts to date have been noteworthy in this regard. Its member countries have progressively lowered trade restrictions and FDI issues have been given growing importance. However, it can also safely be said that the increasingly important role of the EU as a source of FDI to the region has been more a function of ASEAN efforts in general, rather than a concerted effort on behalf of the EU to jump start

[18] For more information on TREATI see: http://www.delmys.cec.eu.int/en/eu-asean-asem-asia/eu_asean_partnership.htm

these flows. Thus, the question as to how large the potential jump in FDI flows that could follow a determined EU-ASEAN partnership effort remains to be answered.

Megha Mukim is a Research Officer, World Health Organization (WHO) and a Former Consultant to the World Trade Organization (WTO), Geneva, Switzerland. This Issue Paper is written in her personal capacity. The views expressed are those of the author and do not necessarily reflect the decisions or stated policies of the World Trade Organization or the World Health Organization.

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Annex Tables

Table 2

ASEAN - BASIC INDICATORS

ASEAN Member Country	Population 2002	GDP (current US$) 2003	GDP growth (annual %) 2003	GDP per capita (constant 1995 US$) 2003	Exports of goods and services (% of GDP) 2002	Imports of goods and services (% of GDP) 2002	Gross fixed capital formation (% of GDP) 2002	Gross domestic savings (% of GDP) 2002	Central Govt debt (% of GDP) 2001	Real effective exchange rate index (1995 = 100) 2003	Aid per capita (current US$) 2002	External debt (DOD, current US$) 2002	Labor force 2003	Corruption Perception Index 2004*
Brunei	351,000	..	..	..	..	..	..	..	..	..	-5	..	164,579	
Cambodia	13,172,000	4,299,164,672	8	418	59	67	23	14	..	..	37	2,906,899,968	6,794,622	
Indonesia	211,716,000	208,310,501,376	4	1,090	36	29	20	22	..	..	6	132,207,599,616	106,377,616	2.0
Lao PDR	5,530,000	2,035,501,568	5	490	..	..	..	..	..	..	50	2,664,499,968	2,720,762	
Malaysia	24,305,000	103,161,053,184	5	4,965	114	97	23	41	..	97	4	48,557,101,056	10,590,885	5.0
Myanmar	48,786,000	..	..	..	..	..	..	..	..	..	2	6,556,100,096	26,522,202	1.7
Philippines	79,944,000	80,573,849,600	5	1,239	49	49	19	19	65	86	7	59,342,499,840	35,111,492	3.5
Singapore	4,164,000	91,342,282,752	1	27,270	..	..	26	44	99	94	2	..	2,081,650	9.3
Thailand	61,613,000	143,162,998,784	7	3,182	65	57	23	31	30	..	5	59,211,501,568	37,766,528	3.6
Vietnam	80,424,000	39,157,407,744	7	438	56	60	30	28	..	..	..	13,348,599,808	42,486,564	2.6

Source: World Development Indicators 2004, World Bank
*Transparency International Corruption Perceptions Index 2004

Table 3

ASEAN/ASEAN MEMBER COUNTRY AGREEMENTS CONTAINING FDI PROVISIONS

AGREEMENT	MEMBER COUNTRIES	YEAR	TYPE
Bangkok Agreement	Laos, Bangladesh, India, Republic of Korea, Sri Lanka, China	1976	Preferential Arrangement
Global System of Trade Preferences among Developing Countries (GSTP)	44 countries including Indonesia, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam	1989	Preferential Arrangement
AFTA (ASEAN Free Trade Agreement)	Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Thailand, Singapore, Vietnam	1992	
	Japan - Singapore	2002	Services Agreement
	Singapore - European Free Trade Association (EFTA)	2003	Services Agreement
	ASEAN - China	2003	Preferential Agreement
	Singapore - Australia	2003	Free Trade/ Services Agreement
	Singapore - USA	2004	Free Trade/ Services Agreement
	Thailand - Australia	2005	Free Trade/ Services Agreement
Framework for Comprehensive Economic Partnership between ASEAN and Japan	ASEAN - Japan	2003	Bilateral Arrangement
Framework for Comprehensive Economic Partnership between ASEAN and India	ASEAN - India	2003	Bilateral Arrangement
Framework Agreement for Establishing Free Trade Area Between India-Thailand	Thailand - India	2003	Bilateral Arrangement
Framework Agreement on the BIMST-EC Free Trade Area	Thailand, Myanmar, Bhutan, India, Nepal, Sri Lanka	2004	Regional Arrangement
	ASEAN - Republic of Korea	Under Consultation	Regional Arrangement
ASEAN - CER	ASEAN, Australia, New Zealand	Under Consultation	Regional Arrangement
	Singapore - Bahrain	Under Consultation	Free Trade Agreement
India-Singapore Comprehensive Economic Cooperation Agreement	Singapore - India	Under Consultation	Bilateral Arrangement
	Singapore - Republic of Korea	Under Consultation	Free Trade Agreement
Sri Lanka-Singapore Comprehensive Economic Partnership Agreement	Singapore - Sri Lanka	Under Consultation	Bilateral Arrangement
	Thailand - USA	Under Consultation	Free Trade Agreement

Source: World Trade Organization (http://www.wto.org/english/tratop_e/region_e/region_e.htm); UNCTAD World Investment Report 2004, Annex Table A.II.1

Table 4

FDI INFLOWS INTO ASEAN

US $ million

ASEAN Member Countries	1995		1996		1997		1998		1999		2000		2001		2002		2003	
	Total	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**
Brunei Darussalam	583	2	654	2	702	2	573	3	748	3	549	2	526	3	1,035	8	3,123	15
Cambodia	151	1	294	1	168	0	243	1	232	1	149	1	149	1	145	1	87	0
Indonesia	4,346	15	6,194	21	4,678	14	-356	-2	-2,745	-10	-4,550	-19	-3,279	-17	145	1	-596	-3
Lao PDR	88	0	128	0	86	0	45	0	52	0	34	0	24	0	25	0	19	0
Malaysia	5,815	21	7,297	24	6,323	19	2,714	12	3,895	14	3,788	16	554	3	3,203	23	2,473	12
Myanmar	318	1	581	2	879	3	684	3	304	1	208	1	192	1	191	1	128	1
Philippines	1,577	6	1,618	5	1,261	4	1,718	8	1,725	6	1,345	6	982	5	1,111	8	319	2
Singapore	11,503	41	9,303	31	13,533	40	7,594	34	16,067	58	17,218	74	15,038	78	5,730	42	11,431	56
Thailand	2,070	7	2,338	8	3,882	11	7,491	33	6,091	22	3,350	14	3,886	20	947	7	1,869	9
Viet Nam	1,780	6	1,803	6	2,587	8	1,700	8	1,484	5	1,289	6	1,300	7	1,200	9	1,450	7
ASEAN	**28,231**	100	**30,210**	100	**34,099**	100	**22,406**	100	**27,853**	100	**23,380**	100	**19,372**	100	**13,732**	100	**20,303**	100

Source: ASEAN Statistical Yearbook 2004

Table 5

FDI INFLOWS INTO ASEAN FROM THE EU

US $ million

ASEAN Member Country	1995		1996		1997		1998		1999		2000		2001		2002		2003	
	Total	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**	**Total**	**%**
Brunei Darussalam	225	4	252	3	265	4	272	5	659	7	526	6	504	5	652	17	2,987	42
Cambodia	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Indonesia	636	13	2,165	29	2,582	41	597	11	-1,073	-11	-1,094	-13	-462	-5	-566	-15	-207	-3
Lao PDR	1	0	2	0	3	0	2	0	3	0	4	0	2	0	3	0	2	0
Malaysia	799	16	1,923	26	552	9	878	16	1,263	13	1,290	15	135	1	726	19	665	9
Myanmar	176	3	302	4	492	8	295	5	217	2	69	1	56	1	53	1	10	0
Philippines	217	4	255	3	165	3	142	3	262	3	581	7	104	1	20	1	-345	-5
Singapore	2,515	50	2,170	29	1,826	29	2,330	42	6,939	71	6,316	75	8,319	91	2,898	76	3,449	49
Thailand	180	4	168	2	360	6	912	16	1,368	14	510	6	188	2	-440	-12	15	0
Viet Nam	301	6	124	2	88	1	125	2	157	2	186	2	332	4	446	12	508	7
ASEAN	**5,050**	100	**7,361**	100	**6,333**	100	**5,553**	100	**9,795**	100	**8,388**	100	**9,178**	100	**3,792**	100	**7,084**	100

Source: ASEAN Statistical Yearbook 2004

Table 6

COUNTRY-COUNTRY FDI INFLOWS

ECU/EUR million

2003	**Belgium**	**Denmark**	**Germany**	**France**	**Ireland**	**Italy**	**Luxembourg**	**Netherlands**	**Austria**	**Finland**	**UK**
Indonesia	7	..	-62	-305	0	1	5	28	3	-4	-145
Malaysia	-5	..	-729	107	c	-1	-1	-60	-1	-16	341
Philippines	1	..	-103	-5	-1	0	-1	-166	1	0	64
Singapore	4406	..	-90	454	c	2	120	67	18	-53	856
Thailand	23	..	-38	-166	0	2	1	248	7	8	178
ASEAN	4434	..	-1018	63	-1	5	123	88	30	-66	649
2002											
Indonesia	-5	..	-146	240	c	0	-3	222	11	c	76
Malaysia	18	22	-11	-13	c	0	0	56	-4	c	727
Philippines	-112	-10	-114	2	c	1	1	-50	0	c	-194
Singapore	-487	c	449	112	c	3	282	2739	45	69	2314
Thailand	-14	c	20	220	0	6	0	362	9	c	13
ASEAN	-594	c	204	590	c	9	235	3339	62	94	2654
2001											
Indonesia	..	c	95	99	c	0	..	-572	-3	-4	-50
Malaysia	..	c	93	26	0	4	..	275	8	c	-516
Philippines	..	c	95	-4	c	1	..	1	0	c	196
Singapore	..	-13	990	39	c	11	..	-74	-47	c	2703
Thailand	..	c	102	-32	0	3	..	80	10	c	278
ASEAN	..	c	1394	167	c	20	..	-289	-31	98	2985
1995											
Indonesia	..	..	653	..	..	..	..	49	7	0	..
Malaysia	..	..	46	..	..	..	..	27	0	0	34
Philippines	..	..	19	..	..	..	..	32	1	0	46
Singapore	..	..	202	..	..	..	..	144	1	4	-57
Thailand	..	..	48	..	..	..	..	208	3	2	296
ASEAN	..	..	986	..	..	..	..	434	10	7	310

Source: Statistical Office of the European Communities: Eurostat; c = confidential