Asian Economic and Financial Review, 2013, 3(12):1670-1680

Asian Economic and Financial Review

journal homepage: http://aessweb.com/journal-detail.php?id=5002

REGIONAL INTEGRATION AND FOREIGN INVESTMENT: THE CASE OF ASEAN COUNTRIES

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ABSTRACT

The importance of regional integration in stimulating foreign direct investment cannot be overemphasized. With a special focus on the ASEAN countries, this research paper investigates the role of regional integration in attracting foreign direct investment. We bring a novelty to this paper by dividing foreign direct investment into Inter-and Intra-ASEAN to see if both are determined by the same set of factors. If economic integration drives intra-ASEAN FDI we would expect such FDI to be unrelated to macroeconomic fundamentals in each country, while we would expect Extra-ASEAN FDI to be determined by macroeconomic fundamentals. We employed panel data model in the analyses and the findings show that FDI from rest of the world are determined by macroeconomic fundamentals especially market size (GDP) and exchange rate, while inter-ASEAN FDI is not significantly related to macroeconomic fundamentals but depends on previous investments in the region. This implies most investments in ASEAN from ASEAN are motivated by economic integration.

Keywords: Economic integration, Foreign investment, Panel data, Macroeconomic.

JEL Classification: C33, E22, F16, F21, P33.

1. INTRODUCTION AND RESEARCH PROBLEM

Regional integration has been on for more than four decades now, and countries have used it to pool their resources together to forester their political, economic and social interests. The idea behind regional association is that countries can better advance their common interest when they come together as a single bloc because what is difficult for an individual country to achieve may not be so when more countries pursue such interest collectively. Zhenqiang (2006), writing on the rational for East Asia regional association states that Asian nation could effectively address their economic and political challenges by pooling their resources together for faster and sustained growth. The European Union has often been cited as the world's most successful regional association with the credit of using its strength achieve such goals of economic prosperity, peace and political stability in European states.

The (Association of Southeast Asian Nations Secretariat, ASEAN) was formed on August 8, 1967 by five member countries, namely, Indonesia, Singapore, Malaysia, Philippines and Thailand. Today, membership of the regional association has grown to ten with the joining of Brunei, Cambodia, Laos, Burma, and Vietnam. At its inception, the force behind ASEAN was politics, which is prevention of external interference in the internal affairs of member countries and nonsupport to opposition movements. As the first regional association in the East Asia region, ASEAN was able to promote better understanding among member countries and beyond, attracting more other five countries in its membership. The joining of the association by Brunei, Laos, Burma, and Vietnam makes ASEAN one of the most important regional associations in Asian continent today. With a population of over 500 million people and combined Gross Domestic Product exceeding $1trillion (Lohman and Kim, 2008), what is happening in ASEAN countries is not only important to Asian continent and European nations but to the entire global community.

However, for nearly one and half decades after the declaration it appears not much has been achieved by the organization in the fulfillment of the objectives of the vision 2020. Lohman and Kim (2008) argue that despite its pledges, however, ASEAN economic integration remains more aspiration than reality.

2. EVOLUTION OF FOREIGN DIRECT INVESTMENT IN ASEAN

The phenomenon of South-South FDI flows, particularly those arising from China and India, has generated significant interest from policymakers, academia and the popular press in recent times (Hattari, 2008). The rapid expansion of FDI from ASEAN countries has also been well documented by earlier studies, and the inter-regional interactions of these flows have equally been identified in the literature (Hiratsuka, 2006). Suffice it to note that the history of Intra-ASEAN FDI dates back to the East Asia financial crisis of 1997 which was characterized by serious region-wide depression and recession. Several economic processes of the ASEAN countries were also affected by the crisis. These include currencies, asset prices, stock market indicators, output and inflows of capital across ASEAN member countries. According to (Thangavelu, 2007), the experience of the ASEAN countries showed a drastic decline of net FDI inflows to about US$12 billion between 1997 and 1998. Consequent upon the wave of liberalization in the mid-1980s, the ASEAN economies adopted free trade policies, capital account openness and a free market economy, thus, becoming an attractive haven for investment inflows between 1987-1994.For example, following the ASEAN Statistical Yearbook (2004), the FDI inflows into ASEAN countries grew from an annual average of $8 billion in 1986-1991 to $25.5 billion in 1997.