Foreign Direct Investment in Cambodia, Laos and Vietnam: A Regional Overview

Nick J. Freeman

Senior Advisor

Mekong Capital Ltd.

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Introduction[1]

Cambodia, Laos and Vietnam all actively welcome foreign direct investment (FDI) activity, and have done so for a number of years[2]. FDI inflows are seen as one method of boosting economic development and growth, and assisting in the transition process – consisting of both economic reforms and business liberalization measures – underway in these three countries. On paper at least, the (still evolving) laws and regulations pertaining to FDI activity are relatively liberal: for example, permitting 100% foreign-owned business ventures across a fairly wide range of business sectors. As FDI inflows have accrued, and confidence has grown, the foreign investment regimes have continued to improve, in tandem with improvements to the wider business environment in these host countries. There is little doubt that considerable progress has been made over the last decade in the field of FDI activity in Cambodia, Laos and Vietnam.

Detailed profiles of the FDI flows and stocks in Cambodia, Laos and Vietnam are being presented at this conference by experts from these respective host countries. The authors of these papers have a much more profound understanding of the current FDI situation in their respective countries than this author. Therefore, this paper will not seek to delve too deeply into the specifics of the FDI activity in these three Indochina countries[3]. Rather, it will attempt to place this activity within four pertinent contexts: i) of history; ii) of more recent global trends in foreign investment flows and investor sentiment; iii) of the differing FDI experiences of the three countries; and iv) of the current international business environment. Hopefully, this will provide a background from which to appreciate the specific country reports that follow, and hopefully come to some shared conclusions. With the latter in mind, this paper ends with some personal suggestions as to how Cambodia, Laos and Vietnam might build on their recent successes in attracting

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[1] The comments and opinions expressed in this paper are those of the author, and do not necessarily reflect those of Mekong Capital Ltd. or the Mekong Enterprise Fund.

[2] Vietnam first began attracting FDI in 1987, and Laos followed one year later. Cambodia's current foreign investment law dates from 1994. The definition of FDI used in this paper is "an investment involving a long-term relationship and reflecting a lasting interest of a resident entity in one economy in an entity resident in an economy other than that of the investor". Lindblad, p. 1.

[3] The term 'Indochina' is simply used here as a 'short hand' collective noun to depict the three countries of the sub-region (Cambodia, Laos and Vietnam), without any political, historical or other connotation intended. The term 'Mekong sub-region' could also be used, although some regard this definition to include Myanmar, and/or Thailand, and/or Yunnan province of China.

relatively substantial FDI inflows to the sub-region, and best harness future FDI activity in the next phases of their economic development programmes.

History of FDI in Cambodia, Laos and Vietnam: a sense of déjà vu ?

When looking at FDI activity in the Indochina sub-region, one tends to focus on the inflow of foreign capital that has occurred over the last decade or so, as part of the economic transition process that the three countries have undergone since the late 1980s. Since foreign private capital was generally not permitted into these countries in the years preceding their 'opening up', the governments of the three countries have been on a steep learning curve; learning how to attract, retain, sustain, manage, harness, monitor -- and then attract yet more -- FDI inflows. This process is partly a science, and partly an art, as policy-makers in other Southeast Asian countries will testify. It is also a fairly relentless process, as the extremely competitive environment for attracting FDI flows poses ever-new challenges for aspiring host countries. However, it is worth keeping in mind that the territory that currently spans the Indochina sub-region – if not these actual states – has witnessed relatively significant foreign capital inflows before, when they were part of the French empire. Indeed, some interesting parallels between the FDI inflow patterns of today, and those of the first three decades of the 20th century[4], are worth noting briefly.

The industrial revolution helped drive the first major investment foray into 'emerging markets' – then in the form of colonial possessions – as the major European economies sought out new territories from which to source resource inputs and as markets for their manufactured products. European business activity in the emerging markets had previously been limited to relatively small-scale trading, but industrial capitalism brought the need for a greater commitment of resources, and the enactment of long-term investments in these new markets. France and its colonies were no exception. Much of the first wave of foreign investment in colonial Vietnam was oriented towards communications and mining activity, later followed by trading firms, rubber and tea

[4] "FDI in French Indochina before 1900 appears to have been utterly insignificant." Lindblad, p. 13.

plantations, processing companies, and subsequently a few textile companies.[5] Funding came from taxes on the inhabitants, some financial support from the French government, and from entrepreneurial private investment. In terms of private investment, a mixture of loan financing and equity rights issues were used to raise funding for a spectrum of business ventures.

At least in the initial period of colonial expansion into Indochina, the anticipation that Vietnam might provide a back door into the massive Chinese market was a major driving force behind the French colonial exercise.[6] The attraction of finding a land route into China was also almost certainly spurred by a nagging doubt that the commercial merits of Indochina were not very prepossessing. And although Vietnam became a viable business concern in its own right, the proximate of the mighty Chinese market persisted, as evidenced by the onerous construction of the Hanoi to Kunming railway line between 1901 and 1910.[7]

Perhaps the period of greatest foreign investment activity in colonial Indochina was in the decade leading up to the Wall Street crash of 1929. In Vietnam, "private capital flowed into the colony in an unprecedented stream, [and] Indo-Chinese securities found their way into the safes of stockholders great and small".[8] The establishment of rubber plantations, mines, banks, trading firms and real estate companies burgeoned during this

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[5] See Callis, p. 76. Other, more recent, accounts of this period include Norlund, chapters 2-4 in Lindblad, and chapter IX in Smith. Robequain dates the commencement of mining-related foreign investment in Indo-China (primarily in Tonkin) to 1888, with French investment in other business activities following at least a decade later. Investment in agricultural cultivation was relatively scarce before 1910. Robequain, pp. 158-161. Textile production (centred on Nam Dinh in Tonkin) came later, and began to compete with business interests in the metropole. But this was unwelcome by those who thought Indochina's role was to serve France – through the supply of raw commodities and as a market for French products – rather than be an alternative and competitive production base. As a result, "the French did little to promote the modernization of manufacturing industries in Viet-Nam" and after 1930, "they even allowed the traditional Vietnamese activities of sericulture and silk-spinning to decline". (Smith, p. 130.)

[6] Murray asserts that the "principal motivation [of the colonial annexation of Indochina] was France's desire for a passable route into China's Yunnan province". Murray, p. 55.

[7] Murray depicts the construction of the Yunnan railway line as "one of the most costly and laborious feats of colonization". Despite numerous cash injections, the private company mandated to build the railway was ultimately dissolved and the colonial administration took over. In addition to the financial cost, 30% of the 80,000 labourers died, as did 40 French engineers. Murray, p. 173.

[8] Robequain, p. 131.

period, with over 3,800 million francs of new capital issues recorded between 1924 and 1930, of which over 90% were funds raised by private business.[9] Within the agricultural sector, rubber plantations were the dominant focus of foreign investment, along with coffee, tea, rice, sugar cane, teak, rattan, and various other commodities. In the Mekong delta, irrigation works permitted a marked increase in paddy production, and with it, rice exports. Within northern Vietnam's mining sector, coal became the primary output, along with tin ore, zinc, phosphate, lead, iron ore and gold.[10] Industrial activities included rice milling, sugar refining, the grading and processing of various agricultural products, the manufacture of soap and dyes, cement, as well as power and transportation activities.[11] Investment conglomerates and finance corporations were formed, such as the Societe Financiere Francaise et Coloniale, which had diverse business interests that spanned tea plantations, rubber plantations, sugar refineries, paper and glass factories, power stations, coal mines, and even railways.[12] And there was the mighty Banque de l'Indochine, established in 1875, and which became the most powerful economic force in Indochina".[13] In addition to dominating the trade financing business in Vietnam and Indochina, the bank developed a remarkable spectrum of investments within the colony and further afield.

Initial expectations of Indochina's mineral wealth were lofty, and a first wave of 'mining fever' hit Vietnam as early as the 1890s, although much of the initial eagerness had dissipated by the early 1900s.[14] However, the mining industry in Indochina enjoyed a revival in the 1920s, and by the middle of that decade Vietnam had become the largest coal exporter in East Asia.[15] For Laos, tin mining was the only business sector that

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[9] Callis, p. 78.
[10] Thompson, p. 114.
[11] Callis, p. 80-81.
[12] Norlund, p. 80. "The principal aim of these giant firms was to seek fresh investment opportunities in the colonies, to facilitate the issue of shares and bonds on the Paris capital market, and to directly supervise the organisation of production undertaken by their multifaceted subsidiaries in the colonial territories". Murray, p. 124.
[13] Murray, p. 144. For a telling depiction of the rise and rise of the Banque de l'Indochine, see Murray, pp. 132-154. Also see Thompson, pp. 222-223.
[14] Thompson, p. 115.
[15] Ibid., p. 116.

received substantial foreign investment under French colonial rule[16], and Cambodia saw fairly vigorous gem mining activity. In total, it is estimated that France invested 7 billion francs in "profit-yielding assets of foreign companies" in colonial Indochina, up to 1938, of which the majority would have been expended in Vietnam. The scale of both state and private sector investment activity in Vietnam was so substantial that one commentator has suggested that by the 1930s, it "had become the most intensely exploited of all European colonies in Asia".[17] But it should not be assumed that all foreign investment in colonial Vietnam proved to be a profitable exercise. Between 1929 and 1937, it appears that company dissolutions worth over 500m francs were recorded, and just under 750 million francs in capital reductions were also registered, prompting one commentator to say "it is impossible not to appreciate the magnitude of the losses suffered by private investments in Indo-China".[18]

As Callis points out, "the story of foreign investments in [colonial] Indo-China is really a story of French investments."[19] Non-French investment in Indochina was deterred, through the use of tariff and non-tariff barriers and currency regulations for non-French businesses, and subsidies and assistance for French businesses. As a result, by 1937, 97% of all foreign investment in Indochina was sourced from France.[20] Indeed, these protectionist policies meant that colonial Vietnam – and Indochina as a whole – became somewhat divorced from the East Asia region in matters of trade and business. As Norlund depicts it, French colonial rule "… succeeded in detaching Indochina from the Far East and attaching it to the French economy."[21] The wave of foreign investment activity that Vietnam witnessed in the first three decades of the twentieth century began to peter out in the 1930s, as the global economic recession took its toll. Global prices for almost all the commodities exported by Indochina dropped markedly, and the value of Indochina's exports contracted by almost 60% between 1929 and 1931. Not surprisingly,

[16] Stuart-Fox, pp. 135-136.
[17] Murray, p. 131.
[18] Robequain, pp. 164-5.
[19] Callis, p. 82.
[20] Lindblad, p. 14 and 19.
[21] Norlund, p. 89.

the 'Indochina index' on the Paris bourse plummeted from 106 in 1929 to just 22 in 1933.[22]

Trends in FDI flows and investor sentiment: no more bull markets for Indochina ?

Let us now move to more recent events. Although the trend in substantial FDI flows to Southeast Asia began more than twenty years ago (led by Singapore's pioneering work in the early 1970s), the 're-opening' of Indochina to foreign investment, in the late 1980s and early 1990s, coincided with a particularly strong 'bull market' period in most forms of private capital flows – FDI, portfolio investment and commercial bank lending -- to the emerging markets in general (see figure 11). And within the emerging markets universe, Southeast Asia was a major recipient of private capital inflows, buoyed by a consensus view that the region was a particularly fertile ground for investors seeking attractive risk-adjusted returns. In 1990, for example, Southeast Asia attracted 36% of all FDI flows to developing countries, and the region exceeded China's FDI inflows by more than three-fold.[23] (See figures 1 and 2.)

Another 'class' of emerging market countries attracting foreign investor excitement at this time was the transitional economies of the former Soviet Union, Eastern Europe and Asia. Therefore, as transitional economies located in Southeast Asia, it is not surprising that Indochina stimulated considerable foreign investment appetite, when the sub-region opened its doors to private capital inflows in the early 1990s. The Indochina countries not only stood at the nexus of the emerging markets and transitional economies growth 'investment stories', they were also well-positioned to capture the beginnings of a substantial intra-Southeast Asian FDI flow phenomenon. The domestic corporate sectors of Malaysia, Singapore and Thailand had started to generate fairly significant FDI outflows of their own in the 1990s, until the Asian financial crisis brought a sudden end to much of this activity (with the exception of Singapore). It is worth noting that Southeast Asian countries are ranked as the top investors in all three Indochina countries

[22] Murray 1980, p. 201. Also see Thompson, p. 176.
[23] This relative position was steadily diluted during the 1990s, and by 2000 Southeast Asia's FDI inflows were less than 6% of global flows to developing countries and were just a third of China's inflows.

(as measured by approved pledges): Singapore in Vietnam, Malaysia in Cambodia, and Thailand in Laos.

Therefore, Indochina's 'debut' on the international investment stage was fortuitously timed, and explains in part why fairly considerable FDI flows were registered, as foreign investors sought to capture new business opportunities in the under-developed sub-region. Push factors, as well as pull factors, were involved in this process. For example, for major corporates in those home countries that had missed out on Southeast Asia's economic rise, Indochina's opening presented an opportunity to 'get in on the ground floor' of what they hoped would be a similar high-growth story.[24] And although we are focusing on just FDI, relatively substantial commercial bank lending and equity portfolio flows supported this FDI inflow trend. For example, between 1991 and 1995, roughly ten investment funds pertaining to Indochina were launched, raising in excess of US$500m of portfolio money – with insufficient thought given to exactly how all this money could be sensibly invested.[25] Investor appetite for exposure to Indochina was high in the first half of the 1990s.

Indeed, the rush of FDI inflows into the Indochina sub-region would probably have been even more intense in the early 1990s, had it not been for the lingering effect of various business restrictions (such as the US investment embargo on Vietnam). Instead, the sub-region saw a more phased inflow of foreign investors, as these business restrictions were lifted, one by one. The FDI inflows were also phased in terms of their sectoral patterns, and in ways very similar to the sectoral flow patterns seen during the first thirty years of the twentieth century. For Vietnam's FDI inflows, the inflection point came in 1996, when foreign investor sentiment – which had become much too lofty in the first half of the decade – began to dissipate, and concern began to increase within the business community that economic reform momentum had been lost. Foreign business perceptions of the risk-reward ratio radically altered. Straight-line growth projections for

[24] This was arguably true of some Australian and French companies in particular.

[25] And despite holding a large proportion of cash assets, avid portfolio investor appetite for exposure to Vietnam in particular meant that the listed funds traded at a substantial premia to their net asset values (NAVs), prior to 1996. In general, the shares of listed closed-end funds tend to trade at slight discounts to their NAVs.

the sub-region's domestic economy and market were exposed as being overly optimistic. And a better appreciation of the kinds of obstacles that foreign investors faced in generating attractive, risk-adjusted rates of returns was forming. Finally, the onset of the Asian financial crisis in mid-1997 caused investor sentiment to deteriorate even more, and FDI inflow pledges contracted further.[26] (See figures 3 to 5.)

So what is foreign investor sentiment towards Indochina like today ? There are some indications that foreign investor sentiment towards the Indochina sub-region has improved markedly since around mid-2000. A number of developments have been perceived by the international business community as leading indicators that economic reform momentum has been regained, and that Indochina's economies have survived the Asian financial crisis in relatively good shape. But if investor sentiment has improved over the last two years, why has that not translated into a substantial pick-up in new FDI inflow pledges to the sub-region ? Part of the answer clearly lies with the fragile state of the global economy, on which Indochina has little influence. Also, the extremely propitious conditions that existed in the early 1990s no longer exist: although FDI flows to global emerging markets have held remarkably steady since the financial crisis of 1997, commercial bank lending flows have been reversed, and portfolio flows to Asia and emerging markets remain fairly anaemic. In this respect, the ebb and flow of FDI activity in the Indochina sub-region during the 1990s – as depicted in figures 4 and 6 -- has a number of parallels with the 1920s. But part of the answer also lies in the need for the sub-region to improve its understanding of the changing international business environment, its current position in the global business network, and the way in which foreign investors' host country needs are evolving. These are discussed in a later section of this paper.

Differing FDI experiences in Indochina

Before identifying the differences that exist in the FDI experiences of Cambodia, Laos and Vietnam, it might be salutary to first recognize some of the basic similarities. All

[26] As an indicator of how low investor sentiment dropped after 1996, by 1998 the listed Indochina funds were trading at the steepest discounts to NAV in the entire emerging markets universe for closed-end funds.

three countries broadly opened up to foreign investment at very roughly the same time, issuing (and subsequently improving) quite liberal foreign investment laws and implementing regulations. And this has been reciprocated with *relatively* substantial expressions (and actions) of interest from the international business community, albeit prone to changing moods. Foreign capital was relatively quick to respond to the promulgation of foreign investment laws in the three countries, and aggregate FDI inflows have been quite admirable. Tables 1 and 2 show FDI stocks per capita for the three countries compared (in 2000) and FDI stocks as a percentage of GDP during the 1990s compared, respectively.

However, all three countries have seen much of the FDI activity cluster in a relatively few geographical locations and business sectors, and have had only mixed success in their attempts to better disburse this FDI activity, partially through the use of incentive schemes and industrial zones.[27] All three countries are members of the Association of Southeast Asian Nations (ASEAN), and are committed to various initiatives that relate, directly or indirectly, to foreign investment activity, including the ASEAN Free Trade Area (AFTA) and the ASEAN Investment Area (AIA). These regional initiatives will have some influence on the overall FDI profiles of the three Indochina countries, to a greater or lesser extent, and partially drive future FDI policies, such as in the field of national treatment. Other agreements relating to economic reform and business liberalization efforts – for which external assistance is being provided, or on which subsidized loans are dependent -- should also help the Indochina countries tackle some of the host country obstacles that foreign investors often identify.

Another similarity in Indochina's FDI experience relates to foreign investment data itself. Although great strides have been made in improving the foreign investment data in the sub-region (and Southeast Asia as a whole), it remains quite difficult to get an accurate

[27] In the case of Vietnam, roughly 60% of all FDI stock is located in Ho Chi Minh City, Hanoi and Dong Nai province. Although it is not surprising that some of the more distant rural provinces have missed out on Vietnam's FDI inflow phenomenon, even cities like Haiphong and Danang have seen less FDI activity than one might expect for such major urban centres. The success of export processing zones and industrial zones has been decidedly mixed.

and up-to-date profile of FDI activity in Indochina.[28] The disparity between the lofty approved / pledged FDI inflow figures – typically recorded by the relevant licensing body in the host country -- on the one hand, and the more humble disbursed / committed FDI inflow figures – often captured in the balance of payments data -- on the other, are quite considerable (particularly in Laos, where a handful of mega-projects have been approved but not yet implemented), and yet this important distinction is not always made clear to the casual observer. Just capturing and collating 'normal' FDI data can be tricky, if multiple agencies are given the authority to issue FDI licences, as is the case in Vietnam.[29] But things get even more blurred when one considers: FDI activity that is funded through re-invested earnings; joint venture projects (where the local equity contribution – commonly in the form of land use rights -- is often included); funding assistance through local bank loans or inter-company loan components; stalled FDI projects that have their licences revoked; exaggerated equity contributions by investors; and in particular, the informal, small-scale investment activity enacted by overseas nationals that often goes unlicensed. These sorts of data limitations are by no means unique to the Indochina sub-region, but they are common to all three countries in the sub-region, and make it quite difficult to get anything more than a broad impression of FDI patterns.[30]

The Indochina countries also share a paucity of FDI activity in the business sector that largely dominates their domestic economies – agriculture, for a variety of reasons.[31] This feature, along with the clustering of FDI activity in a handful of locations, means that foreign investment activity does not directly impact on a large proportion of Indochina's

[28] This section of the paper draws in large part on work conducted by Curt Nestor's analysis of Vietnam's FDI statistics, to be published in a forthcoming book chapter. See Freeman and Nestor. While Nestor's analysis focuses on Vietnam alone, the issues raised are broadly applicable to Cambodia and Laos.

[29] In Vietnam, some major cities, provinces, and some export processing zones and industrial zones, now have the authority to license certain FDI projects located within their territory, and within certain limits. Nestor estimates that by end-2000, around 50 different agencies in Vietnam had issued investment licences to foreign investors.

[30] It should be recognized that the difficulties of collecting, collating and interpreting FDI data are a perennial problem for most countries, including advanced ones. For example, see 'Hong Kong's $64bn question', *The Financial Times*, 29 March 2001. As Lindblad states, "Patterns of FDI can only be identified if FDI is measured properly and that is often more easily said than done." Lindblad, p. 6.

[31] These reasons include the low rate of return often associated with agriculture-related businesses, and restrictions on FDI activity in some areas of agri-business.

population (slightly under 100 million), although some indirect impact will undoubtedly have been felt. Relative to other measures of FDI activity, foreign capital's role as a major source of employment in Indochina still remains fairly modest. The Indochina countries have also found it quite difficult to attract private capital into major infrastructure projects, despite the assistance of such initiatives as the GMS programme.[32] Some FDI activity has been oriented towards serving the domestic market, particularly in the early part of the 1990s, but a considerable element has been attracted to the Indochina countries as platforms for export-oriented production. In this regard, the FDI profile in the Indochina sub-region broadly conforms to the 'Southeast Asian model' seen in Indonesia, the Philippines, Singapore and Thailand. Where the Indochina countries differ from most other countries in Southeast Asia is that their FDI has not occurred in tandem with -- or supported by -- foreign (equity) portfolio investment in the host country's stock markets. Neither Cambodia nor Laos have ever had an equity market, whilst Vietnam's two year-old equity market remains small and effectively closed to foreign institutional investors.[33]

However, the business sectors in which FDI activity has been most prominent have differed in the three Indochina countries, largely in conformity with the perceived resource strengths and comparative advantages of the respective host economies. In Laos, for example, less than ten individual FDI projects related to energy generation (primarily hydropower) have dominated the country's aggregate FDI inflows, as measured by capital pledged, thereby making the country's annual FDI statistics quite 'lumpy' and volatile.[34] It is no coincidence that the two years in which Laos recorded 'bumper' FDI inflow pledges were the two years when a number of large power projects were approved.[35] Conversely, years when no power projects were approved tended to be

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[32] The Greater Mekong Sub-Region (GMS) programme has been promoted by the Asian Development Bank for a number of years, and has included an attempt to enact infrastructure projects in partnership with the private sector.

[33] At the time of writing, 17 companies were listed on the Vietnam stock market, with a market capitalization of below US$200m. Total foreign ownership in shares of a listed company is capped at 20%, with single foreign institutions not permitted to hold more than 7% of total shares.

[34] Just seven FDI projects – all relating to energy generation -- account for over 65% of total FDI inflow pledges in Laos.

[35] In 1991 two power projects were approved, and in 1994 three power projects were approved.

much leaner years for total FDI inflow pledges in Laos. In Cambodia, more than half of the FDI projects in the manufacturing sector relate to garments projects, and garment-related FDI accounts for almost a quarter of total FDI inflows, thanks to large garment quotas for some export markets. The other manufacturing sector to have seen substantial FDI activity in Cambodia is wood and wood products, accounting for over 20% of total foreign investment. In Vietnam, the distribution of FDI activity across sectors is more widely distributed, with fairly substantial foreign investment activity recorded in such areas as: oil and gas, construction, tourism, garments and footwear.

The home country sources of FDI in Indochina have also differed quite substantially in the three Indochina countries. (See figures 8 to 10 for the top ten home country sources of FDI inflows in the three Indochina countries.) Only Taiwan features in the top three sources of FDI of more than one country of the sub-region. As the major 'capital exporter' in Southeast Asia, it is no surprise that Singapore features in the top ten ranking of FDI sources for all three Indochina countries.[36] The other home countries that feature in the 'top ten' ranking of FDI sources for all three Indochina countries are Taiwan, South Korea, Thailand, Britain, and the sub-region's former colonial ruler -- France. It is worth noting, that despite being neighbours with close fraternal ties, no Indochina country ranks amongst the largest investors in another country of the sub-region. In other words, close political affinities have not yet translated into substantial long-term equity-related business synergies, and intra-Indochina business relations remain largely – but not exclusively -- at the trading and contract level.[37] Not only are there relatively few business synergies that currently exist between domestic firms in the sub-region, but the three countries are competing with each other to attract FDI inflows in certain business sectors.

In both Cambodia and Laos, a small number of home country sources appear to dominate FDI activity, as measured by capital pledged. In Laos, Thailand accounts for almost half

[36] A proportion of FDI accredited to Singapore as the home country will actually be investment by 'real' Singapore firms, and some will be FDI by non-Singapore MNEs that have regional headquarters located in the city-state.

[37] One exception would be the Lao-Viet Bank, a joint venture bank headquartered in Vientiane, primarily designed to provide financing for trade flows between Laos and Vietnam.

of total inflow pledges, and just five countries – Thailand, the US, South Korea, France and Malaysia – together account for over 93% of total FDI inflows. In Cambodia, Malaysia accounts for over forty percent of total FDI inflow pledges, and although not quite as extreme as in Laos, a handful of home countries dominate the sources of FDI inflow pledges. Vietnam, in contrast, again appears to have a better (ie. more diverse) distribution of FDI inflow sources, with no single home country accounting for more than 19% of total inflows. This more diverse 'spread' should make Vietnam's aggregate FDI inflows less vulnerable to an economic downturn occurring in just one or two countries or regions.

As in the first thirty years of the twentieth century, Vietnam has had the lion's share of FDI flows to the Indochina sub-region during the 1990s (see figure 6). And as a country with a population of roughly 80 million people, Vietnam's market size should continue to attract FDI activity that seeks to serve the domestic market. And this large domestic market -- at least in terms of numbers, if not yet spending power -- helps keep Vietnam on the global FDI 'radar screen'. Cambodia and Laos, however, are likely to have a slightly more peripheral position on the global FDI radar screen, due to their much smaller domestic markets. However, as Laos has found, having a small economy means that a single large FDI project can have a potentially substantial impact on its entire economy, even adding whole percentage points to national GDP. Put another way, a small economy may only need a peripheral position on the global FDI 'radar screen', by focusing on niche sectors in which it can attract strong foreign investor interest. (And the growth of cross-border production networks is breaking down production into smaller incremental steps, which means that the range of potential niches is increasing.)

In marked contrast to Vietnam, Laos has achieved a degree of integration between its FDI inflows and its privatization programme for state-owned enterprises, with a number of 'flagship' former state enterprises having been partially divested to strategic foreign investors over the last decade.[38] And in contrast to both Laos and Vietnam, Cambodia

[38] For example, the country's telecommunications company and the Beer Lao brewery. Indeed, equity in the latter has been sold to foreign investors on two separate occasions.

has implemented a very attractive tax regime in its bid to attract FDI inflows, with a low standard corporate income tax rate, and an even lower rate for export-oriented FDI projects.[39]

Today's international business environment: linking transitionals and transnationals

> A striking feature of the new context is how [transnational companies] are increasingly shifting their portfolios of mobile assets across the globe to find the best match with the immobile assets of different locations. … The ability to provide the necessary immobile assets[40] thus becomes a critical part of FDI – and competitiveness – strategy for developing countries.
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> Lall (2000), p. 3.

The impressive economic growth trajectory of Southeast Asia over the last twenty years or so has been due in part to significant FDI activity.[41] It therefore comes as no surprise that the transitional economies of the Indochina sub-region have sought to emulate this, and harness the considerable inputs that foreign investment can bring to developing and transitional economies, as part of their own economic development drives. Such FDI inputs go well beyond just funding, and can (potentially at least) span a range of other non-financial attributes: new technology, skills and design, organizational and management techniques, overseas market information and access, and so on.[42] It could even be argued – as Yasheng (2001) has done for China – that FDI activity can play the role of an ersatz private sector for a transitional economy, when the domestic private sector is not yet sufficiently robust to make much macroeconomic impact, and the state

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[39] The standard corporate income tax rate is 20%, but can be as low as 9% for eligible companies. Cambodia's policy conforms with Bergsman's assertion that small and "otherwise less attractive countries that have potential as export platforms may need to have effective rates not higher than 10 or 15 percent, or maybe even less for exporters, if they hope to get a lot of FDI". Bergsman, p. 7.

[40] Such immobile host country assets include: skills, infrastructure, services, supply networks and strong institutions, property rights, etc. Cheap labour, natural resource wealth and protected markets are immobile host country assets that appear to be gradually losing their allure.

[41] See Jomo, chapter 1.

[42] See Campos and Kinoshita for an interesting discussion of the impact that FDI has had on the economic growth of transitional countries in Eastern Europe and the former Soviet Union.

sector remains lethargic.[43] In such a context, welcoming FDI is rather like importing a ready-made private sector, capable of having a fairly immediate and positive impact on a transitional country's macro-economy. In Vietnam in particular, it is hard to envisage the recent economic reform process without the presence of a growing community of foreign investors, as evidenced by their role in the country's industrial production growth and corporate tax receipts. At their zenith in 1996, Vietnam's FDI inflows as a percentage of GNP were the second highest in the world. And across the Indochina sub-region, the presence of foreign-invested projects is particularly visible in various export-oriented business sectors, where they now account for a considerable proportion of total foreign currency earnings and export volumes.

The above notwithstanding, it could be argued that the degree of coordination and integration between FDI policies and other elements of the economic reform and business liberalization process in Indochina has not been as strong as it might have been.[44] For example, the anomaly of slight increases in the scale of the SOE sector in Vietnam during the 1990s comes as a surprise to many observers. How could the SOE sector be increasing, at a time when a major element of the economic reform process has been to consolidate this sector, through 'equitization' and other means ? The answer presumably lies with FDI, and the joint ventures that have been established between foreign investors and state enterprises, and which have buoyed the local partners.[45] In this particular case, it might appear that FDI activity in Vietnam is working at a tangent to other elements of the economic reform process. Yet experience shows us that FDI policies should not operate independently or in a vacuum, but rather "in conjunction with … macroeconomic and other policies to create a country's investment environment. …[If not,] bad macroeconomic conditions can easily overwhelm liberal investment policies."[46] And conversely, inappropriate FDI policies can undermine good macroeconomic conditions.

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[43] Yasheng (2000) argues that "China's FDI is not a sign that its economy is strong and healthy. Rather, it underscores some fundamental distortions".

[44] A notable exception would be state sector divestment in Laos, and the role played by strategic foreign investors.

[45] During the 1990s, joint ventures with private companies in Vietnam accounted for less than 2% of total FDI activity. In the initial period of FDI activity, foreign investors were encouraged to establish joint ventures with state enterprises.

[46] Iboshi and Plummer, p. 19.

It is not only the transitional economies of Southeast Asia that are going through major changes. International business activity is also undergoing considerable transformation.[47] Forces of globalization and advances in technology are driving this transformation process, with production processes becoming increasingly 'internationalised', and companies and countries becoming increasingly specialized in what they produce. This impacts on the kind of FDI activity that occurs: where it comes from, where it goes to, in what form it is enacted, the size and pattern of flows, and so on. The implications are potentially profound, and are as important to policy-makers and local companies in developing and transitional economies as they are to business executives working inside large multinational enterprises. For example, Buckley argues that investment agencies in Southeast Asia need to better understand the hub and spoke strategies of multinational firms, their dynamic market entry strategies, and their reliance on networks and clusters, amongst others. (No longer does FDI simply seek access to natural resources and new markets, as today's foreign capital also attempts to tap comparative advantages that come from placing specific business assets on a specific host country platform.)

The 'bad' news here is that these changes demand that host countries have a more detailed understanding of how (increasingly complex and fluid) international business activity is evolving. The 'good' news is that policies aimed at improving the host country business environment for foreign investors are likely to reap more wide-ranging rewards for the local business community too, as the artificial dividing line between FDI and domestic business increasingly evaporates. The factors that make for a good enabling environment for local companies are increasingly becoming the same factors behind a good environment for foreign investors, and vice versa.

This author would suggest that there is still a general impression in Indochina, and arguably much of Southeast Asia as a whole, that FDI activity entails foreign firms establishing 'greenfield' projects in the sub-region, in order to bring new production capacity. But in a global environment of over-capacity in many business fields where

[47] See Borrus et. al, and Buckley.

FDI activity in Southeast Asia has been vigorous, this kind of FDI activity is in short supply. Rather, multinational enterprises are seeking to create cross-border production networks with local companies in developing countries, sometimes with equity links and sometimes without. The global 'FDI growth story' of recent years has largely been a story about cross-border mergers and acquisitions (M&A)[48], not of greenfield projects. And in this regard, it could be argued that the Indochina countries are not very well prepared, as current laws and regulations make such cross-border activity difficult to enact. Notably, foreign investment directly into existing local companies, rather than as joint ventures or wholly foreign-owned projects, is severely constrained by various regulations. In the case of Vietnam, for example, local companies may currently only issue shares to foreign investors if they operate in one of 35 business sectors.[49] Even then, the approval of the prime minister's office is necessary before a foreign investor may take even a minority equity stake in a local firm.[50] This potentially constrains the aggregate scale of FDI inflows, and hinders local companies in tapping foreign capital and other non-financial inputs from overseas investors.

Conclusion: building on recent success

> The most important step that host governments in developing countries and economies in transition can take to foster their own development is to get the fundamentals right. In other words, they should provide a stable, non-inflationary, micro and macroeconomic environment, with appropriate legal and regulatory infrastructure, that rewards both domestic and foreign investment.
>
> Moran (1998), p. 29.

The foreign investor community in a developing host country can often appear to be a forceful and intimidating grouping. Members of the community often consist of

[48] M&A activity can be particularly volatile, and is often driven by developments in a particular business sector.

[49] Under Decision 260/2002/QD-BKH, issued by the Ministry of Planning & Investment, in May this year. (This decision up-dates a previous list, issued in June 1999, which identified just 12 business sectors in which foreign investors could acquire stakes in local firms.) The current list of permitted business sectors differs from the list of sectors permitted for FDI activity in the form of joint ventures or wholly foreign-owned projects.

[50] In Vietnam, a foreign investor may acquire up to 30% of a local, unlisted company, if approved by the relevant authorities.

multinational enterprises that individually generate global annual revenues that far exceed the annual GDP of some host countries, and have the trans-continental balance sheets to match. Well capitalised, they can call upon a diverse range of resources to support their business efforts. In a sense, this is why developing host countries seek to attract such foreign investors, for both the financial and non-financial inputs that such companies can potentially bring to the host country and inject into the economy. And increasingly, multinational enterprises operate global production and distribution networks that developing countries wish to see their domestic corporates 'plugged' into.[51] It is perhaps for this reason that foreign investors get treated comparatively well by many developing host countries. For example in Vietnam, foreign investors currently face standard corporate income tax rates that are below those for domestic companies, and are potentially eligible for additional – and not inconsiderable -- tax incentives and holidays.[52]

Such a situation often comes about, in large part, because the host country is competing directly with other developing countries trying to attract FDI inflows, and feels it must at least match the corporate tax rates and fiscal incentives offered by others to foreign investors. But this can become a vicious, cyclical 'beggar thy neighbour' exercise -- as countries respond and counter-respond to each others' latest incentives, resulting in a deadly spiral effect, mutually nullifying each others' incentives -- with insufficient thought given to the actual merits of doing so; quantifying the additional business activity gained as a result of sector- or location-related fiscal incentives offered, versus the tax receipts foregone.[53] One alternative is to more clearly identify specific areas in which

[51] Some of the most valuable non-financial inputs they can provide, such as advanced technology, are kept as proprietary knowledge within the closed equity networks of multinational firms.

[52] At the time of writing, the standard corporate income tax rate for local companies in Vietnam is 32% (plus a 25% surcharge on after-tax income), compared with a standard rate of 25% for foreign investment projects. However, it has been suggested that these differing tax rates are to be merged into a single corporate income tax rate in the relatively near future. On fiscal incentives, foreign investors appear to be eligible for more attractive incentives than local companies in some areas, such as export-oriented production.

[53] It should be noted that evidence to support the utility of incentives in attracting FDI inflows is less than wholly convincing, at best. For example, a recent study by Beyer (2002), of the transitional economies of Eastern Europe and the former Soviet Union, found no relationship between tax incentives offered and FDI levels. Although it is agreed that, all things being equal, incentives may work in attracting

one has competitive advantages -- something that foreign investors have arguably been more adept at doing than host country investment agencies -- and then try to leverage more closely on these. In the case of Vietnam, these areas are likely to relate to the country's large and relatively well-educated labour force, its burgeoning community of entrepreneurs and private SMEs, easy access to coastal ports, and its industrial zones and export processing zones. In the case of Cambodia, low unit labour costs, favourable export quotas to the US and EU markets, and high tourism potential come to mind. And for Laos, the country's natural resources, energy and tourism potential are perhaps its greatest strengths.

In other words, rather than *competing* head-on with numerous other countries, across numerous business sectors and host country attributes, there may be more mileage in differentiating oneself instead. It could be argued that the Indochina countries have not yet really identified what intrinsic qualities differentiate their economies and business profiles from other Southeast Asian countries, and how they might use these to best effect.[54] When FDI inflows were substantial – and arguably greater than the host economies could absorb -- in the first half of the 1990s, this may have seemed less important, but as inflows have failed to revive markedly since the mid-1990s[55], and as international competition for FDI becomes increasingly more intense, then perhaps greater efforts should be focused in this direction. As Michalet has noted: "Multinationals, even in this age of globalization, are not seeking to invest in all countries in the world. Rather, they seek to establish a presence in a small number of countries,

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FDI inflows to one country ahead of another, rarely are things equal. Bergsman (1999) argues that despite their popularity, FDI incentives "in most countries are simply not effective. They attract very little additional investment. And they have costs: they are a drain on the Treasuries of the countries that grant them, they are sometimes counter-productive because they make investment procedures too complex, and they sometimes lead to significantly greater corruption". He concedes, however, that they may have some public relations effect, particularly for "a country that wants to change its image from one that seems unfriendly or unwelcoming to investors, to one that is welcoming and is ready to facilitate private business in general and FDI in particular…". Bergsman, p. 1 and 7.

[54] Intrinsic qualities would not include temporary windows of opportunity that might subsequently close, such as advantageous trade quotas for specific export products into specific overseas markets. Michalet (1997) provides an analytical checklist of country attractiveness (page 24), although this checklist should be extended to capture some other features of a host country's attributes.

[55] In the first half of 2002, Vietnam's FDI approvals were down over 55% on the previous year. *Saigon Times Daily*, 1 July 2002.

with world-competitive facilities that together strengthen their regional or world-wide competitive advantages."[56]

This situation can also stem from having a FDI policy approach that is not sufficiently integrated with other economic and industrial development objectives, and therefore FDI policies are not consistent with – let alone support – other macro-economic, industrial, corporate and other reform policy agendas. Ideally, a host country's FDI policy agenda should dovetail with its policies towards developing the domestic corporate sector (including state sector divestment in transitional economies), as well as a spectrum of other social and economic development agendas. This should help avoid contradictory policies emerging, and hopefully ensure that all pertinent organisations (local and central government, local and foreign businesses, domestic and overseas financial institutions) are all pulling in roughly the same direction. Indeed, it could be argued that this is the next big agenda for the Indochina countries in the field of FDI promotion. As they now stand, the FDI laws and regulations are very liberal and continue to improve, the incentives offered are quite generous, and foreign investors are, at least in some ways, treated better than domestic investors. Nonetheless, FDI inflows continue to contract, or at least not return to the highs of the early-mid 1990s. As we have noted above, some of this is due to global and regional shifts in the international business environment, which the Indochina countries have no control over. But my sense is there is relatively little more that the Indochina countries can do in the specific field of FDI promotion, as diminishing returns have started to set in for FDI regulatory reform.[57]

Instead, policy focus may need to shift towards bringing greater consistency to the business environment for both local and foreign investors (á la Singapore[58]), and tackling constraints to business development in general, for local SMEs and large multinational

[56] Michalet (1997), pp. 31-32.

[57] This is not only true for Indochina. As UNCTAD noted in its 1998 World Investment Report (pp. xxvi-xxvii), "diminishing returns has set in [for the liberalisation of FDI frameworks] and liberal FDI policy is increasingly losing its effectiveness as a locational determinant of FDI", as "adequate core FDI policies are now simply taken for granted".

[58] In many respects, Singapore stands as Southeast Asia's example of best practice in most policy issues pertaining to FDI, including host country promotion.

enterprises alike.[59] In other words, the future policy agenda for promoting FDI in Indochina may actually shift outside the direct sphere of the foreign investment regime per se. This notion is supported when one looks at the sorts of issues that foreign investors usually cite as the main obstacles they face when conducting FDI projects in Indochina, most of which pertain to the wider host country business environment. They include: excessive regulation and red tape, inadequate legal infrastructure and weak enforceability, poor physical infrastructure, weak banking and financial markets, privileges still enjoyed by state-owned firms, inadequate service providers, poor and/or expensive communications, high land costs, corruption, high tax rates (although not in Cambodia), inadequate property right protection, currency controls, etc. Arguably, the Indochina countries have made slow progress in this realm, and may explain why FDI inflows are not picking up sufficiently. Although some FDI-specific policy measures, such as offering tax holidays, may act as a temporary palliative to mitigate these sorts of problems, they still need addressing in the long-term. And if the FDI policy agenda is no longer focused on entirely FDI-specific issues, this means that a wider range of government agencies will need to coordinate their efforts to improve the host country environment.

Of course, the added attraction in tackling these sorts of issues is that any gains made should be of benefit to more than just foreign investors, but to the wider business community as a whole. Besides, as international business forms mutate, and cross-border production networks proliferate, making a clear distinction between the two (local and foreign firms) is becoming increasingly difficult. The following quote dates from 1994, but is still very valid:

> The ASEAN experience provides important lessons for other developing countries. Importantly, it is not necessary for countries to produce an elaborate set of investment incentives to lure welfare-enhancing [FDI]. Rather, providing a good business environment and competitively priced

[59] For example, regulatory consistency could be established in the following areas: (lower) corporate income tax rates for local and foreign-invested companies; (more selective and targeted) fiscal incentives for local and foreign-invested companies; (higher) foreign equity caps for listed and unlisted local companies; (more) business sectors that are open to foreign investment in existing local companies and conventional forms of FDI activity (eg. joint ventures).

> factors of productions, as well as removing bottlenecks and disincentives, are more essential.
>
> Iboshi and Plummer (1994), p. 19.

Host country investment agencies may also benefit from becoming more cognisant of the international business environment, and a more advanced understanding of their economies' and corporate sectors' competitive strengths. In other words, where do Cambodia, Laos and Vietnam best fit into the 'global food chain'. With perhaps some exceptions, I would suggest that there is little utility in generating lengthy and diverse lists of projects in which a host country wishes to see FDI input.[60] It has to be recognized that FDI flow patterns are driven as much by 'push factors' as they are by 'pull factors'. The industrial revolution in Europe did much to push FDI activity into the 'emerging markets' of colonial possessions in the latter part of the 19th century and the first three decades of the 20th century – French Indochina included. Another mini-revolution is perhaps underway in the field of international business today, which will have an impact on the kinds of FDI activity we are likely to see in developing economies, Southeast Asia and the Indochina sub-region in the coming years. My sense is that this is not very well appreciated in Indochina, as the recent distractions of the Asian financial crisis have served to temporarily cloud the more long-term factors influencing FDI flow patterns to the region. As a consequence, the Indochina countries may be 'marketing themselves' to the international business community as attractive host country destinations for kinds of foreign investment activity that are no longer prevalent. And this may explain, in part, why the improvement in general sentiment towards the sub-region in recent years has not translated into improved FDI inflows.

Finally, current excitement surrounding China's continental-sized economy is obliging all Southeast Asian countries to reassess their relative merits in attracting FDI inflows.[61] In the late nineteenth century, the initial driving force behind French investment in Indochina was a hope that the sub-region would provide an avenue into that great, elusive China market. Might Cambodia, Laos and Vietnam provide an equivalent economic

[60] Vietnam's latest list of (228) projects seeking FDI input are contained in Decision 62-2002-QD-TTg, also known as 'Decision 62', dated 17 May 2002.

[61] It will be critical for Southeast Asia's policy-makers to make a clear distinction between business sectors in which China may have an absolute advantage, but does not enjoy a comparative advantage.

‘avenue’ in the near future ? Or put another way, rather than competing with China in attracting FDI inflows, are there ways in which the three Indochina countries can seek to ‘ride the China growth story’ immediately to the north ? Ultimately, of course, China is likely to become a substantial source of FDI for the Indochina sub-region. Indeed, the activity of Chinese investors in Cambodia and Laos has become much more pronounced since 1997, partly taking advantage of the vacuum left by the withdrawal of other Southeast Asian investors from the sub-region. However, it will probably take time for China’s FDI inflows into Indochina to gain real momentum.

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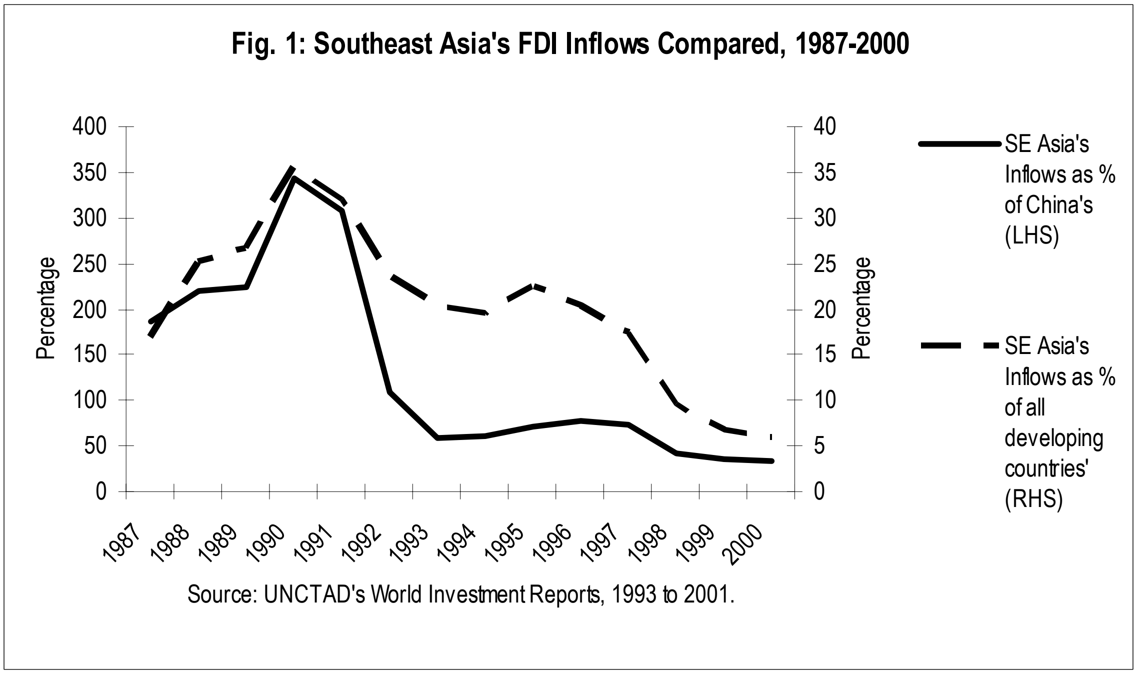


Fig. 1: Southeast Asia's FDI Inflows Compared, 1987-2000
400
350
300
250
200
150
100
50
0
Percentage
40
35
30
25
20
15
10
5
0
Percentage
SE Asia's Inflows as % of China's (LHS)
SE Asia's Inflows as % of all developing countries' (RHS)
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
Source: UNCTAD's World Investment Reports, 1993 to 2001.

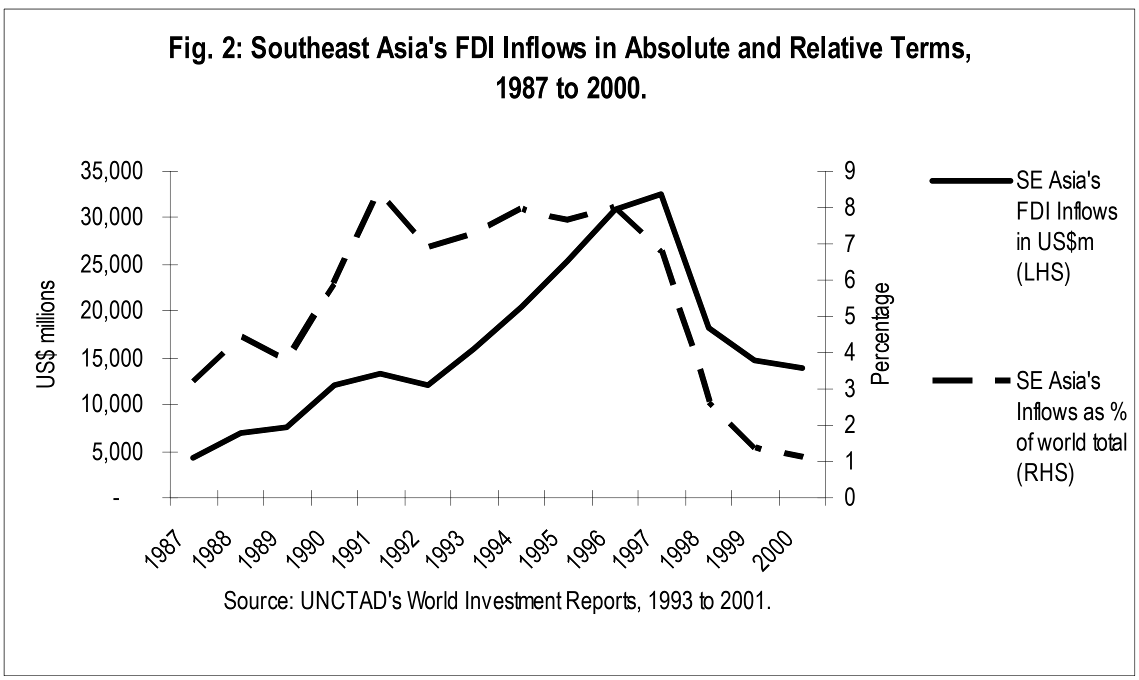
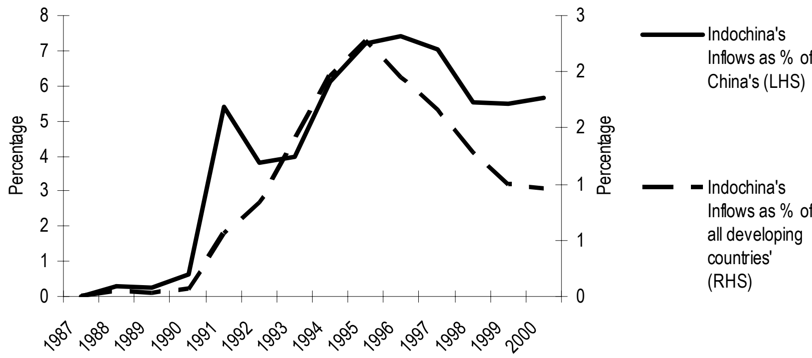


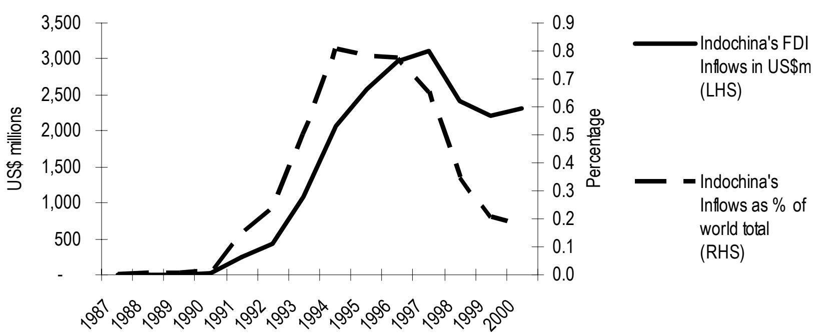
Fig. 2: Southeast Asia's FDI Inflows in Absolute and Relative Terms, 1987 to 2000.
35,000
30,000
25,000
20,000
15,000
10,000
5,000
-
US$ millions
9
8
7
6
5
4
3
2
1
0
Percentage
SE Asia's FDI Inflows in US$m (LHS)
SE Asia's Inflows as % of world total (RHS)
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
Source: UNCTAD's World Investment Reports, 1993 to 2001.

Fig. 3: Indochina's FDI Inflows Compared, 1987-2000



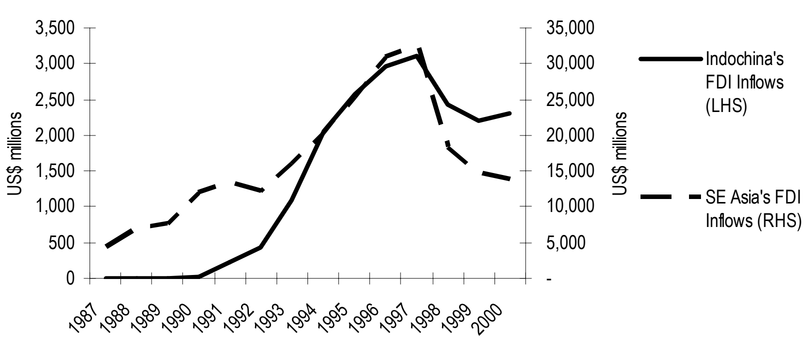
Source: UNCTAD's World Investment Reports, 1993 to 2001.

Fig. 4: Indochina's FDI Inflows in Absolute and Relative Terms, 1987 to 2000.



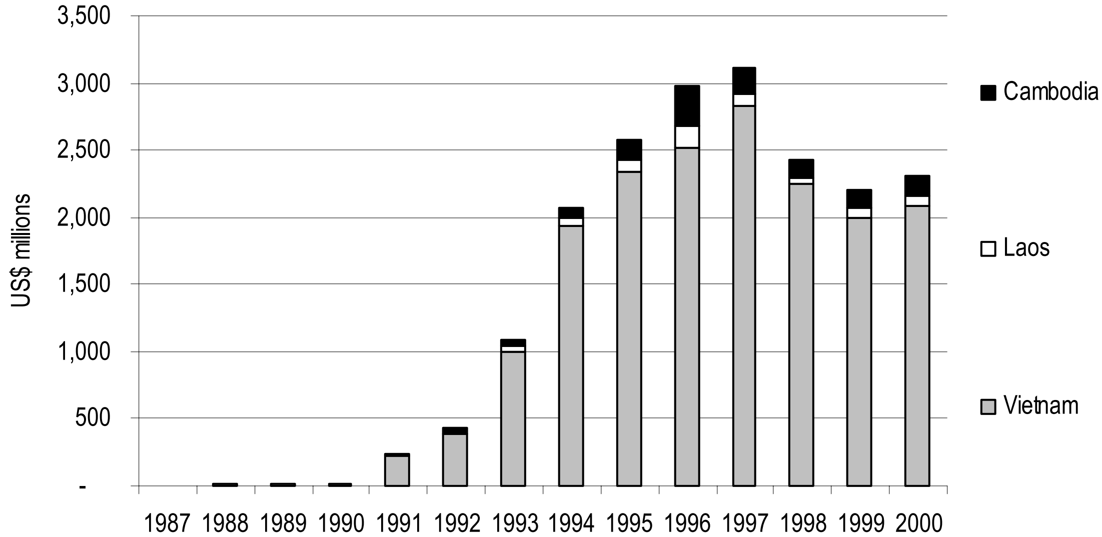
Source: UNCTAD's World Investment Reports, 1993 to 2001.

Fig. 5: Southeast Asia and Indochina's FDI Inflows Compared, 1987 to 2000.



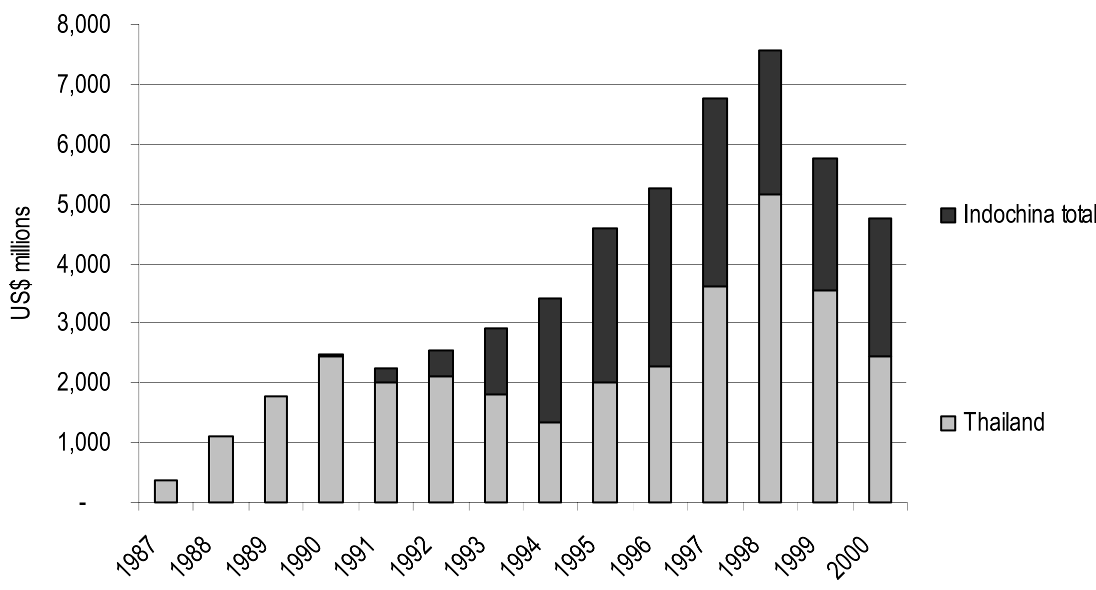
Source: UNCTAD's World Investment Reports, 1993 to 2001.

Fig. 6: Breakdown of Indochina's FDI Inflows, by Country, 1987 to 2000.



Source: UNCTAD's World Investment Reports, 1993 to 2001.

Fig. 7: FDI Inflows in Thailand and Indochina Compared, 1987 to 2000.



Source: UNCTAD's World Investment Reports, 1993 to 2001.

Fig. 8: Vietnam's Top Ten FDI Sources, by capital pledged (as at end-2000)

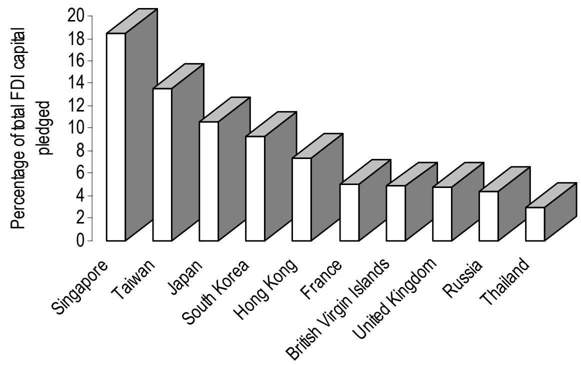


Fig. 9: Laos's Top Ten FDI Sources, by capital pledged (as at end-1999)

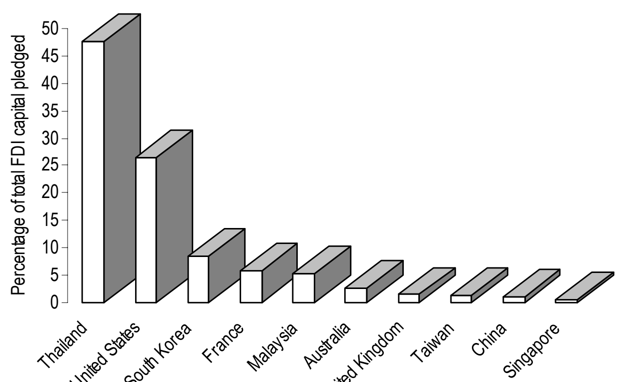


Fig. 10: Cambodia's Top Ten FDI Sources, by capital pledged (1995 to 2000)

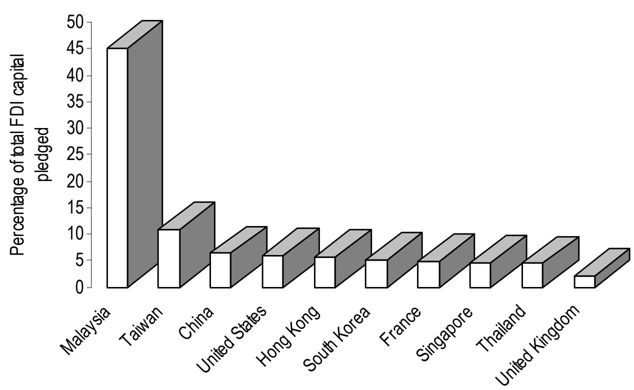


Fig. 11: Capital Flows to Developing Countries, 1970 to 1999.

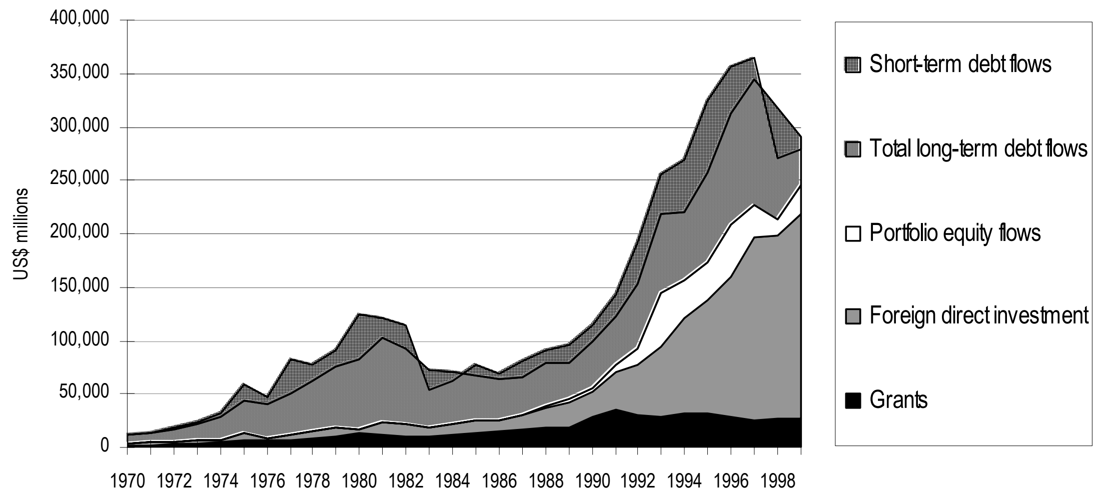


Table 1: FDI stock per person compared, in 2000 (US$):

Malaysia	2,341
Thailand	388
Indonesia	286
China	271
Vietnam	225
Philippines	167
Laos	122
Cambodia	62

Sources: Calculated from UNCTAD and ESCAP figures.

Table 2: Inward FDI stock as percentage of GDP compared, 1990-1999.

	1990	*1995*	*1999*
Cambodia	13.4	17.0	19.4
Laos	1.4	11.9	42.8
Vietnam	3.6	31.1	55.6
China	7.0	19.6	30.9
Indonesia	34.0	25.0	46.2
Malaysia	24.1	32.9	65.3
Philippines	7.4	8.2	14.9
Thailand	9.6	10.4	17.5

Source: UNCTAD.