



UNIVERSITI PUTRA MALAYSIA

**FOREIGN DIRECT INVESTMENT AND SUSTAINABLE DEVELOPMENT
OF FOUR ASEAN MEMBERS**

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**FOREIGN DIRECT INVESTMENT AND SUSTAINABLE DEVELOPMENT OF
FOUR ASEAN MEMBERS**

By

YASMINE MERICAN IDRIS MERICAN

**Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia, in
Fulfilment of the Requirements for the Degree of Doctor of Philosophy**

July 2007



**Lovingly dedicated to Imran, ten years old, and Wasim, five years old in the hope
that they will be excellent lifelong learners
and my parents, Sharifah Fadzlon, and Idris Merican.**



Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfilment of the requirements for the Degree of Doctor of Philosophy

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Faculty : Faculty of Economics and Management

This study attempts to answer the research question of what and to what extent are the economic (growth), social (inequality), and environmental (pollution) impacts of foreign direct investment (FDI) in the four Southeast Asian nations (ASEAN-4). The next question is how well the results of the study fit the theories of FDI from both the neo-classical cum neo-liberal theories, dependency theory, and the pollution-haven hypothesis (PHH) perspective.

Employing the time-series analyses utilizing the Autoregressive Distributive Lag (ARDL) technique suggest that the FDI does better than domestic investment at promoting growth levels in Malaysia, Indonesia but not for Thailand and the Philippines where the reverse is

true. Hence, neo-liberal theory is supported in Malaysia and Indonesia while dependency theory is supported in Thailand and the Philippines.

In terms of inequality, FDI improves income inequality in Malaysia and Indonesia but worsens inequality in Thailand and proved insignificant for the Philippines. Neo-liberalism is supported in Malaysia and Indonesia while dependency is supported in Thailand. However, Philippines is neutral to either school of thought.

Environmental wise, the PHH which postulates that lower environmental standards in host-developing nations attract FDI from their developed countries of origin is supported in Malaysia, Thailand, and the Philippines but not in Indonesia where FDI is inversely related to pollution. Hence, the neo-liberal claim that FDI via multinationals brings cleaner technology to host developing nations is contested in these three nations but could be supported in Indonesia.

The differences in the study's findings could be attributable to the differences in FDI inflows' composition itself. Malaysia's FDI inflows mainly went to the secondary and followed by the primary sector and a trickle flowed into the tertiary sector. Thailand had slightly more FDI inflows into the tertiary sector as opposed to the secondary and far less into the primary sector. Indonesia's FDI inflows mainly resided in the manufacturing sector, followed by the tertiary and primary sectors. Philippines had about equal FDI share in the primary and secondary sectors with the tertiary receiving the majority share.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Doktor Falsafah.

**PELABURAN LANGSUNG ASING DAN PEMBANGUNAN LESTARI DI EMPAT
AHLI ASEAN**

Oleh

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Kajian ini cuba menjawab persoalan penyelidikan tentang impak Pelaburan Langsung Asing (PLA) dan sejauhmana ianya memberi kesan kepada isu-isu ekonomi (pertumbuhan), sosial (ketidaksetaraan), dan alam sekitar (pencemaran alam) di empat negara Pertubuhan negara-negara Asia-tenggara (ASEAN-4). Seterusnya, kajian ini juga meninjau sejauh mana hasil kajian berasaskan teori-teori neo-klasikal, neo-liberal, “dependency”, dan perspektif hipotesis “Pollution-Haven” (PHH).

Hasil analisa siri-masa menggunakan teknik Autoregressive Distributive Lag (ARDL) menunjukkan bahawa PLA adalah lebih menyumbang berbanding Pelaburan Kasar Domestik dalam meningkatkan tahap pertumbuhan di Malaysia, Indonesia, tetapi tidak pula

di Thailand dan Filipina. Maka, teori neo-liberal disokong di Malaysia, Indonesia manakala teori “dependency” di dapati valid untuk Thailand dan Filipina.

Dari segi ketidaksetaraan, PLA memperbaiki ketidaksetaraan pendapatan di Malaysia dan Indonesia tetapi tidak di Thailand dan tiada memberi kesan di Filipina. Maka neo-liberalism adalah valid di Malaysia dan Indonesia dan “dependency” pula disokong di Thailand. Sekali lagi, Filipina tidak memihak kepada mana-mana teori.

Dari segi alam sekitar pula, PHH mengatakan bahawa tahap piawaian alam sekitar yang lebih rendah di negara-negara membangun menjadi daya tarikan bagi PLA dari negara-negara maju di mana PLA itu berasal. PHH adalah valid di Malaysia, Thailand, dan Filipina tetapi tidak di Indonesia di mana PLA berhubungkait songsang dengan pencemaran alam.

Perbezaan dari segi hasil kajian di antara negara-negara ASEAN-4 boleh dihubungkan dengan perbezaan komposisi aliran PLA itu sendiri. Komposisi PLA Malaysia menunjukkan PLA mengalir terutamanya ke sektor kedua iaitu pembuatan atau perkilangan. Thailand mengalami lebih banyak aliran PLA ke sektor ketiga atau servis dari sektor utamanya. Aliran PLA Indonesia banyak memasuki memasuki sektor kedua dan utama. Filipina mengalami aliran PLA yang agak setara di antara sektor utama dan keduanya dengan sektor ketiganya mengalami agihan yang terbesar sekali.

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This thesis was submitted to the Senate of Universiti Putra Malaysia and has been accepted as fulfilment of the requirement for the degree of Doctor of Philosophy. The members of the Supervisory Committee were as follows:

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DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or other institutions.

YASMINE MERICAN IDRIS MERICAN

Date: 25 August 2007

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LIST OF ABBREVIATIONS

ADF	Augmented Dickey-Fuller test
AKDN	Aga Khan Development Network
ASEAN	Association of South East Asian Nations
ASEAN-4	Malaysia, Thailand, Indonesia, and the Philippines
ARDL	Autoregressive distributed lag
BKPM	Badan Koordinasi Penanaman Modal Investment/ Investment Coordinating Board
CCPO	Climate Change Projects Office
CDM	Clean Development Mechanism
CIA	Central Intelligence Agency
CO ₂	Carbon Dioxide
D&S	Deininger & Squire
ECM	Error Correction Model
ELIFFIT	Export-Led Industrialization Fuelled by Foreign Investment & Technology
FDI	Foreign Direct Investment
FIDA	Federal Industrial Development Authority
FTZ	Free Trade Zones
GDP	Gross Domestic Product
GNP	Gross National Product
GINI	Gini coefficient Index
HOR	Horizontal
HPAEs	High Performing Asian Countries

IT	Information Technology
IBM	International Business Machines
JJ	Joint Implementation
LNG	Liquified Natural Gas
KK	Knowledge-capital
MDGs	Millennium Development Goals
MIDA	Malaysian Industrial Development Authority
MNCs	Multinational Corporations
MTDC	Malaysian Technological Development Corporation
NEP	National Economic Policy/ New Economic Policy
NICs	Newly Industrializing Countries
NIEs	Newly Industrializing Economies
OECD	Organisation for Economic Co-operation and Development
PHH	Pollution-Haven Hypothesis
PP	Philipps-Perron test
RUP	Rencana Urgensi Perekonomian/ Economic Urgency Plan
TNCs	Transnational Corporations
UN	United Nations
UNCCC	United Nations Framework Convention on Climate Change
UNCTAD	United Nations Trade and Development Conference
UNIDO	United Nations Industrial Development Organization
UTIP	University of Texas Income Inequality Project

VER Vertical
WDI World Development Indicators





CHAPTER I

BACKGROUND OF THE STUDY

Introduction

Within the span of thirty years, from 1970-2000, the success of the Association of South East Asian Nations (ASEAN)-4 economies-Malaysia, Thailand, Indonesia, and the Philippines- has often been cited as a model for the rest of the developing world to emulate. This admiration led World Bank in 1993 to commission a book called *The East Asian Miracle* that documented the progress of the “miracle” and the high-performing economies of this study with the exception of the Philippines (World Bank, 1993, Singh, 1995, Krueger, 1999). These economies are still admired today because very few nations have experienced such a dramatic structural-change and poverty eradication within a short span of time. These countries have even outperformed all regions in the world including the industrial countries in some aspects (Singh, 1995, Jomo 2001, Al-Roubaie, 2004). Apart from the existence of political stability and dynamic entrepreneurial spirit, the liberalization of finance and trade, as well as radical institutional reforms, and creation of a suitable environment for development played a pivotal role in helping these countries attain success. The creation of a suitable environment¹ includes fundamentals that were inherited institutions as well as those developed later on to allow for the process of capital formation and development enhancement to take place (Jomo, 2001, Al-Roubaie, 2004).

¹ Here a suitable environment means an environment that is conducive in helping enterprises and other members of the society to advance the cause of economic development which includes building infrastructure, providing education and training, enforcing the rule of law, facilitating credit, protecting property rights, and establishing transparent public services. All these would not be possible without good governance and accountable leadership capable of implementing programmes and policies that will result in economic growth.

The liberalization of trade and finance in the ASEAN-4 context can be traced back since three decades ago as the nations began to loosen their regulations as far as attracting foreign capital, in particular, foreign direct investment (FDI). The governments of all four ASEAN nations in this study have made considerable efforts to attract FDI into their nations. If properly managed, FDI has the potential to increase economic growth and enlarge the productive capacity of the economy by creating backward and forward linkages. In general, the spillover effects of foreign capital and technology transfer have had an impact on both demand and supply sides of the economy which in turn, have created new employment opportunities and stimulated aggregate demand (Al-Roubaie, 2004). Amongst nations in the developing world, the ASEAN-4 nations have had a significant portion of FDI inflows in the period surveyed. Hence, it warrants that a study be undertaken to examine the contribution of FDI in nations labeled by the World Bank in 1993 as “HPAES” including the economy of the Philippines which by world standards has also attained a considerable level of FDI. The study is made even more interesting by China’s alleged siphoning of the share of these nations’ FDI given its emergence as the region’s new economic powerhouse (Felker, 2003). In years to come, the ASEAN-4 nations will also have to reckon with the rise of India as the other economic power house and also a potential threat in diverging FDI away from these four nations (UNCTAD, 2003). Hence, from the perspective of neoliberalism, FDI although beneficial could be “potentially disruptive” when there are sharp reversals in inflows and hence, should be managed with appropriate policy and institutional responses in the ASEAN-4 nations (Tamajaj, 2000).

It is important to examine the impact of FDI on sustainable development of the four ASEAN nations in the last three decades of high economic growth, industrial development, urbanization, modernization, pollution, and financial liberalization.

