UNIVERSITI PUTRA MALAYSIA

IMPACT OF FOREIGN DIRECT INVESTMENT IN SERVICES ON SERVICE TRADE IN ASEAN COUNTRIES

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By

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Thesis submitted to the School of Graduate Studies, Universiti Putra Malaysia, in the fulfilment of the requirements for the Degree of Master of Science

July 2013

DEDICATION

Specially dedicated to my beloved children

Msellem & Mudathir

Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfillment of the requirement for the degree of Master of Science

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By

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July 2013

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Since 1990s there has been tremendous increase in the movement of FDI especially to developing and emerging markets due to the rapid liberalization policies initiated by these countries. The issue of FDI continues to attract the interest of scholars and policymakers due to its anticipated spillover effects on economic growth and development of the host countries. Intense competition among emerging economies and developing countries to entice foreign capital has led to formulation of various measures as FDI stands as the most important foreign financing in these countries.

There are two main objectives of the study. First objective explores the determinants of services FDI, while the second objective examine the the impact of services FDI on services trade. There exist two conflicting arguments in respect to FDI-trade relationship. The first argues for a positive relationship meanwhile the second holds that FDI and trade are negatively related. The stated objectives were achieved using static linear panel data analysis namely; pooled OLS, random effects and fixed effects models covering data from 2000 until 2010. As for the first objective, the finding shows that market size, trade openness, human capital and the availability of quality infrastructure are important determinants of services FDI inflow for the ASEAN countries. In addition, the study finds insignificant relationship between services FDI and services trade.

Therefore, it is crucial for the ASEAN countries to invest substantially in the education sector in order to produce a quality and highly skilled workforce that are required in the services subsectors. In addition, the government and central bank should play a key role in formulating appropriate monetary, fiscal and trade policy to effectively control the rising inflation rate if they are bale to identify the main causes of such inflation. Furthermore, well-developed, reliable and quality communications infrastructure will reduce costs and increase efficiency for investors, and hence, will convince them to choose ASEAN countries, in particular, as their investment destination. The ASEAN region has to extend their ICT networks in almost all provinces or states within respective countries along with reduction of internet, mobile and telephone subscription costs.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagi memenuhi keperluan untuk Ijazah Master Sains

KESAN PELABURAN LANGSUNG ASING DALAM PERKHIDMATAN KE ATAS PERDAGANGAN PERKHIDMATAN DI NEGARA-NEGARA ASEAN

Oleh

KHAMIS MSELLEM KHAMIS

Julai 2013

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Sejak tahun 1990-an, terdapat peningkatan yang mendadak dalam aliran pelaburan asing langsung (FDI) terutamanya ke pasaran negara membangun dan pasaran baru muncul disebabkan oleh dasar liberalisasi pesat yang dilancarkan oleh negara-negara tersebut. Isu FDI terus menarik minat cendekiawan dan pembuat dasar disebabkan oleh jangkaan kesan limpahannya kepada pertumbuhan ekonomi dan pembangunan negara-negara tuan rumah. Persaingan sengit di kalangan ekonomi baru muncul dan negara-negara membangun untuk menarik modal asing telah membawa kepada penggubalan pelbagai langkah, memandangkan FDI tetap merupakan sumber pembiayaan asing paling penting bagi negara-negara ini.

Kajian ini melibatkan dua objektif utama. Objektif pertama mengenalpasti faktor-faktor yang akan menarik pelaburan asing yang berasaskan perkhidmatan, manakala objektif kedua menganalisa kesan pelaburan asing berasaskan perkhidmatan ke atas perdagangan perkhidmatan. Walau bagaimanapun, terdapat dua percanggahan pendapat berhubung FDI dan perdagangan. Yang pertama berpendapat bahawa FDI adalah pelengkap manakala yang kedua berpendapat bahawa FDI adalah pengganti kepada perdagangan; bermakna bahawa aliran masuk FDI boleh memberi kesan positif atau negatif ke atas perdagangan.

Untuk mencapai objektif kajian ini, analisis data secara panel linear statik telah digunakan iaitu; model OLS terkumpul, model kesan rawak dan model kesan tetap. Data untuk anggaran meliputi tahun 2000 sehingga 2010. Untuk model pertama, kajian menunjukkan bahawa modal insan dan penyediaan infrastruktur yang berkualiti adalah faktor penting dalam mempengaruhi FDI dalam sektor perkhidmatan untuk Negara-

negara ASEAN. Untuk model kedua, hasil menunjukkan hubungan yang positif antara aliran masuk FDI perkhidmatan dan perdagangan perkhidmatan.

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I certify that a Thesis Examination Committee has met on 17 July 2013 to conduct the final examination of Khamis Msellem Khamis on his thesis entitled "Impact of Foreign Direct Investment in Services on Service Trade in Asean Countries" in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the student be awarded the Master of Science.

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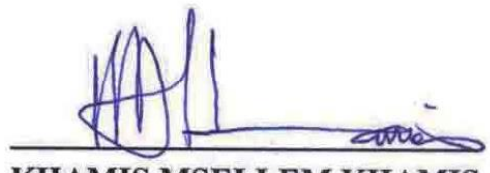
DECLARATION

I declare that the thesis is my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously, and is not concurrently submitted for any other degree at Universiti Putra Malaysia or at any other institution.



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LIST OF ABBREVIATIONS

ADB	Asian Development Bank
AEC	ASEAN Economic Community
ASEAN	Association of South East Asian Nations
EU	European Union
FDI	Foreign Direct Investment
FEM	Fixed Effects Model
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GLS	Generalized Least Square
GMM	Generalized Method of Moments
HPA	Hanoi Plan of Action
IMF	International Monetary Fund
LDCs	Least Developed Countries
LSDV	Least Square Dummy Variable
M&As	Mergers and Acquisitions
MNC	Multinational Corporations
OLS	Ordinary Least Square
REM	Random Effects Model
UNCTAD	United Nations Conference on Trade and Development

CHAPTER ONE

INTRODUCTION

1.0 An Overview

During the past two decades, there has been a massive surge of Foreign Direct Investment (FDI) inflows into developing countries. FDI is widely viewed as one of the principal vehicles for enhancing the economic growth of a country, especially the developing countries. This largely takes place through the entry of multinational corporations (MNCs) which transmit various spillover effects on the host countries. The main form of spillover is the international transfer of technology and knowledge. Transfer of technology contributes directly to the increase in productive capital stock, transfer of managerial skills and improving global market access.

In this regard, numerous theoretical and empirical literatures have addressed various issues related to FDI, namely; the conceptual or theoretical framework of FDI and MNCs, the determinants of FDI, spillover effects of MNCs on the domestic firms or host countries, productivity and employment effects as well as the growth impact of FDI inflow on the host countries. However, in the last two decades, there has been a structural shift in the flows of FDI from manufacturing towards services sector. Worldwide, services FDI has been continuously expanding at the expense of manufacturing and agricultural FDI. This development is due to the rapid internationalization of the services sector, especially since the 1990s, after the establishment of World Trade Organization (WTO) and the implementation of General Agreement on Trade in Services (GATS).

In the beginning of 19th century, foreign investments mainly involved in agricultural and extractive industries, which were producing primary commodities. This went on until 1950's when many nations were still struggling for independence. However, in the late 1970s, the political movements and post-independence period pushed most of the countries to diversify and restructure their investments from primary sector to manufacturing sector, which mostly involved small to medium industries such as textiles, electrical industries and services producing firms.

In the late 1980s, a major turning point and noticeable changes occurred in which, the foreign investment has been directed to non-manufacturing sectors such as finance, business activities and transportation which are collectively classified as service industries. The shift of FDI to services industry has brought many structural changes in

each country's economy in terms of the contribution of the services sector to gross domestic product (GDP), employment as well as the external sector (trade in services).

Since manufacturing and services FDI differ in the technology that they transfer to the host country, it is argued that the absorbing sector matters in the analysis of the trade effects of FDI. Generally, manufacturing-based FDI transfers hard technology, such as equipment and industrial processes, whereas services-based FDI transfers soft technology such as technical, management and marketing expertise, organizational skills and information. Therefore, the main critical issue with regards to this is; whether both, manufacturing-based FDI and services-based FDI have the same pull factors (determinants) and impacts on the host countries' trade performance.

Despite a voluminous literature on the determinants and spillover effects of total FDI or manufacturing-based FDI, there is a dearth of information on the determinants of FDI in services sectors and its impact on trade in services (Resmini, 2000). There are few theoretical and empirical discussions on the impact of FDI in services on developing countries (Banga, 2005). This study intends to complement the existing literature by examining the determinants of services FDI and its impact on services trade in ASEAN countries.

1.1 Background of the Study

1.1.1 ASEAN Economic Performance

The Association of South East Asian Nations (ASEAN) was formed in 1967 with the signing of the Bangkok Declaration by five original member countries namely, Indonesia, Malaysia, the Philippines, Singapore and Thailand. Thereafter, the rest of the member country joined one by one at different period with Cambodia being the latest entry in 1999. Now there are ten members in ASEAN integration. Each of the member countries differs in terms of their economic performance and level of development. Brunei is a small wealthy economy. In early 1980s, the sultanate-governed country invested on exports of crude oil and natural gas that sharply increased its revenues to account half of its GDP. In 1985, petroleum revenues decreased causing the government to run under budget deficit. This made Brunei's economy more vulnerable to petroleum price fluctuations. However, in 2000 the economy registered a positive GDP growth from $86.02 billion to $99.65 billion registered in 2007 (World Bank, 2012).

This performance was mainly caused by a combination of high petroleum prices in world markets and high domestic production. However, in 2008, the GDP marked a decline of an about $97.72 billion which is equivalent to 2.94 percent fall from 2007

registered growth. The global financial crisis that ravaged in 2008 spread its effects until 2009 as the economy accounted a further 1.76 percent slowdown. The situation was coupled with fluctuations in the price of oil, thus created uncertainty and instability in Brunei's economy (World Bank, 2012).

On the other hand, Cambodian economy maintained high economic growth of more than 10 percent for four consecutive years between 2004 and 2007. The 2008-2010 financial crisis affected the economy as well and experienced a 0.1 percent drop in the GDP growth in 2009. However, the trade dependent Cambodian economy managed to rejuvenate, as the record shows that in 2010 it recovered to 6.0 percent (World Bank, 2012). Meanwhile, the Indonesian economic performance began to gain momentum from 5 percent annually in 2003 to 6 percent that was maintained for four consecutive years until 2008. Indonesia is one of the world's emerging market economies in which market plays a significant role by owning enterprises and administers prices on goods such as fuel, rice and electricity.

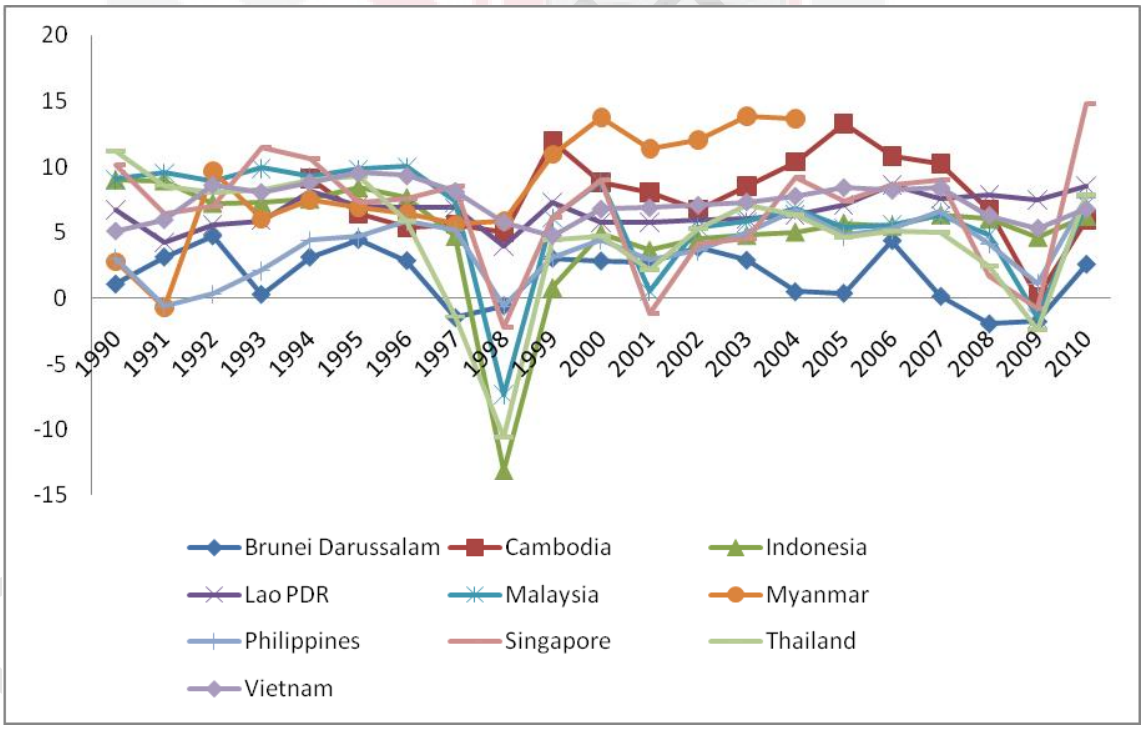

Figure 1.1 ASEAN GDP Growth (Annual percentage), 1990-2010
Source: World Development Indicators, Online Database, 2012

Following 2008 global financial crisis Indonesian annual GDP growth rate declined to 5 percent in 2009. Compared to its ASEAN counterparts such as Brunei, Malaysia,

Singapore and Thailand; Indonesia experienced only a mild effect of the global recession. The economy recovered with its growth expanded to 6 percent in 2010 due to continued strong domestic demand (Asian Development Bank, 2011).

The economy of Lao PDR is rapidly growing since mid 1980s when the government transformed the structure of its economic system. New economic mechanism created conditions conducive to private sector activity, an increase production and availability of goods. However, the Asian financial crisis that ravaged in 1997, coupled with the economic mismanagement resulted in economic instability and depreciation of its domestic currency; kip. According to World Bank (2012), in 2011, Lao PDR registered a remarkable 8.0 percent annual GDP growth.

On the other hand, Malaysia shows an inconsistent record of economic growth averaging at an annual rate of about 5 percent for the period of 2000-2010. Because of its open economy, externalities such as a 2007 global financial crisis pose intense impact on its economy. For instance, in 2009 annual growth rate declined to negative 2 percent. Following the impact, several actions were taken in order to rejuvenate the economy. High levels of investments (foreign and private) and exports of electronics and electrical products played a significant role on economic recovery. The initiatives resulted in positive outcome leading to a recovery of 7 percent annual growth in 2010 (World Bank, 2012).

The Philippines, as one of the tiger cub economies in ASEAN, has been in economic transition from agriculture dependent to manufacturing and services oriented economy. In 2000, the country's GDP grew by 4 percent despite externalities such as political instability and high oil prices. The Philippines recorded a maximum growth of 7 percent in 2004 and 2007 before dropping to 4 percent in 2008. A global financial recession in 2007 that severely affected Malaysia and Thailand allowed Philippines to register only 1 percent of GDP growth in 2009. The government introduced investment initiatives that spurred its economy and resulted in a huge increase in GDP growth of 8 percent in 2010, makes its fastest growth since 1976 (Asian Development Bank, 2012).

Moreover, Singapore has a highly developed trade-oriented market economy. The most open and least corrupt economy is a major FDI outflow financier in the world and the most inward of FDI from the global investments due to its attractive investment climates. The economy picked up in 2000 after the Asian financial crisis, with a growth rate of 9.9 percent with an actual GDP of $97.82 billion. The World Bank (2010) reveals that Singapore's economic strategy produced real growth averaging 8.0 percent from 1960 to 2000.

However, the economic slowdown in the United States, Japan and the European Union had caused a 2001 decline in economic growth to a negative 2.0 percent. However, in 2001 the economy expanded by 2.2 percent, but was not maintained, thus in 2003 dropped to 1.1 percent due to the outbreak of Severe Acute Respiratory Syndrome (SARS)[1]. A major turnaround occurred in 2004 by registering a significant recovery of 8.3 percent before it cooled to 7.9 percent in 2006. The island nation of Singapore marked a 14.5 percent GDP growth in 2010, slightly lower than earlier estimates of 14.7 percent (World Bank, 2012).

In 2000, the Thai economy recovered to an annual rate of 5 percent from 2 percent in the previous year. According to the Bank of Thailand (2003) this positive growth was mainly attributed to the increase in both domestic and external demands particularly in private spending and exports of goods and services, respectively. The economy continued to register annual growth of 5 percent in 2005 in which private investment and private household consumption became major driving forces.

However, in 2008 the performance deteriorated when the slowdown marked a mere 2 percent growth. The World Bank (2008) argued that political unrest was the major factor that led to adverse effects on both manufacturing and services industries. The report further documented that the manufacturing industries suspended productions and tourism services industry witnessed cancellations of trips to the country as a result of the unrest. The 2009 global financial recession did not spare South East Asian countries, leaving Thailand with the worst record. The great uncertainty and difficulties in financing private and household consumptions resulted in the negative 2 percent growth. However, following expansion in private investments and restored political atmosphere, the economy registered the quickest recovery in 2010 at the rate of 8 percent (World Bank, 2012).

The genuine process of Vietnamese economic reforms toward a full-functioning market economy started in 1995. In 2000 the national economy grew at an average rate of 6.9 percent and accelerated to 8.4 percent in 2005. For the whole period of review, the export-oriented Vietnamese economy continues to expand, and now becomes one of the fastest growing in the world. Even though Vietnam is attributed with small and medium enterprises (SMEs), but nowadays the economy is globally integrated, thus expands its exports worldwide including to United States and Japan. This pushes high output and leads to high exports. However, the effects of global economic downturn caused the slowdown in economic performance to 5.3 percent before it showed a significant recovery to 6.8 percent in 2010 (World Bank, 2012).

[1] The SARS is an epidemic viral respiratory disease. The outbreak began in 2003 and is believed that about 33 people died.

As a whole, the Asian Development Bank report (2012) revealed that economic performance in 2012 across the South East Asia expanded to 5.2 percent after a weak growth of 2.9 percent in the last quarter of 2011. The strong growths registered by the Philippines and Thailand contributed to the improvement whereas the more open economy of Malaysia posted slower growth. Private consumption, consumer confidence and retail sales in Indonesia, Cambodia, the Philippines and Vietnam remained strong and helped to sustain the robust growth. Thailand's continued rapid recovery also boosted the region's growth as the government spent 4.2 percent of GDP for flood-relief and reconstruction. As a result, Southeast Asian economies are expected to post faster growth of 5.6 percent in 2013.

1.1.2 ASEAN Services Sector Performance: GDP, Employment and Trade

ASEAN consists of a heterogeneous group of countries with varying levels of development. The inflow and magnitude of the services growth and its contribution to the employment differ due to differing levels of economic development, trade intensities and resource endowments as well as policies and incentives toward foreign investments. Nevertheless, in aggregate, the services sector is gaining importance and becoming a continuous expanding component of GDP and employment within ASEAN (refer to table 1.1). For instance, the share of services to GDP increased from 42.3 percent in 1985 to 44.87 percent in 2010, whereas its shares to employment was 46.7 percent in 2010 compared to 35.4 percent in 1985 (World Bank, 2012). Looking at the increasing share of services sector's contribution to GDP, we could say that ASEAN countries are depended on services sector besides manufacturing sector for their economic development. In 1995, the services sector accounted for the largest share in the GDP compared to agriculture and manufacturing sectors. In this particular year, Philippines led its counterpart members by hitting 66.5 percent. The least in the grouping was the Indonesia whereby it accounted for just 25.0 percent. The sector's contribution to GDP by all remaining countries ranged from 41.0 percent to 49.7 percent, by Cambodia and Singapore, respectively with exceptional to Brunei and Malaysia at 35.5 percent and 30.1 percent, respectively.

Table 1.1 Share of economic sectors to GDP (Annual %)

	1985			1990			1995		
Country	Agriculture	Industry	Services	Agriculture	Industry	Services	Agriculture	Industry	Services
Brunei	1.2	71.8	27.0	1.0	61.6	37.5	1.2	54.3	44.6
Cambodia	28.6	30.8	40.0	43.7	18.9	37.3	49.6	14.8	35.6
Indonesia	23.2	35.8	40.9	19.4	39.1	41.5	17.1	41.8	41.1
Lao PDR	34.1	25.8	39.1	61.2	14.5	24.3	55.7	19.2	25.1
Malaysia	19.9	38.5	39.5	15.2	42.2	42.6	12.9	41.4	45.6
Myanmar	48.2	13.1	38.7	57.3	10.5	32.2	60.0	9.9	30.1
Philippines	24.6	35.1	40.4	21.9	34.5	43.6	21.6	32.1	46.3
Singapore	1.0	33.3	65.7	0.3	31.9	67.8	0.2	33.3	66.5
Thailand	15.8	31.8	52.3	12.5	37.2	50.3	9.5	40.7	49.7
Vietnam	40.2	27.4	32.5	38.7	22.7	38.6	27.2	28.8	44.1
	2000			2005			2010		
Country	Agriculture	Industry	Services	Agriculture	Industry	Services	Agriculture	Industry	Services
Brunei	1.0	63.7	35.3	0.9	71.6	27.5	0.8	66.8	32.5
Cambodia	37.8	23.0	39.1	32.4	26.4	41.2	36.0	23.3	40.7
Indonesia	15.6	45.9	38.5	13.1	46.5	40.3	15.3	46.9	37.8
Lao PDR	45.2	16.6	38.2	36.2	24.6	39.2	32.7	31.8	35.5
Malaysia	8.6	48.3	43.1	8.3	46.4	45.4	10.4	41.1	48.5
Myanmar	57.2	9.7	33.1	58.6	9.8	31.6	57.9	9.7	32.3
Philippines	14.0	34.5	51.6	12.7	33.8	53.5	12.3	32.6	55.1
Singapore	0.1	34.5	65.4	0.1	31.6	68.4	0.0	27.5	72.5
Thailand	9.0	42.0	49.0	10.3	44.0	45.8	12.4	44.7	43.0
Vietnam	24.5	36.7	38.7	21.0	41.0	38.0	20.6	41.1	38.3

Source: World Development Indicators, Online Database, 2012

As the services sector continued to record roughly 44.3 percent share to GDP in 2000, the agriculture and manufacturing sectors accounted for 35.4 percent and 21.3 percent, respectively. The declining importance of agricultural sector was observed in all countries; with Malaysia showing a substantial decline to just 8.5 percent. The highest share of agriculture was apparent in Myanmar with a record of 57.2 percent followed by Lao PDR which registered 45.16 percent. Despite the drastic fall in almost all countries, Thailand has recorded a slight decrease to 9.0 percent within from 9.5 percent in previous five years.

As for contribution to employment, the agriculture sector contributed to employment an average of 33.1 percent throughout the period of review. However, the sector contribution to employment showed a decreasing trend. The 39.8 percent average in 1985 declined to 32.0 percent and 25.6 percent in 1995 and 2005, respectively. However, in 2010 the sector registered the average contribution to 30.8 for the entire region (refer to table 1.2).

The manufacturing sector which contributes 21.4 percent throughout the years under review has also fallen since 1990 from 21.1 percent to 20.9 percent in 2010. The performance of this sector to employment in Thailand show a remarkable increases throughout the period of review. For instance, in 1985 the record was 13.1 percent then in 1995 surged to 19.8 percent to 20.6 in 2010. The employment shares of manufacturing sector in Philippines fluctuate in a sense that the sector increases in one year of review and falls in the following. For example, the record shows a slight increase in 1995 to 15.6 percent from 15.0 percent in previous period. The following period of 2000 it increased to 16.2 percent which then declined to 15.6 percent in 2005.

The ASEAN drew a steady increase in employment for services sector from an average of 34.3 percent in 2000 to 51.1 percent in 2005 and declined to 44.7 percent in 2010. Indonesia and Thailand showed that despite the increase in services sector's contribution to labour force, the countries are still dependent to agricultural sector for employment opportunities compared to manufacturing and services sectors. However, its contribution to total employment declined subsequently throughout the periods being reviewed.

For instance, between years 1985 to 2010 the share of agriculture to total employment in Indonesia has declined from 54.7 percent to 38.3 percent, respectively. At the same time, services sector recorded an increase from 31.8 percent to 42.3 percent in the same respective periods. For Thailand, in 1990 the agriculture recorded 64.0 percent as its contribution to employment which later declined to 42.0 percent in 2005, while the similar case to services shows an increase from 22.0 percent to 37.1 percent in same periods.

Table 1.2 Employment in sectors of economy (% of total employment)

	1985			1990			1995		
Country	Agriculture	Industry	Services	Agriculture	Industry	Services	Agriculture	Industry	Services
Indonesia	54.7	13.4	31.8	55.9	13.7	30.2	44.0	18.4	37.6
Malaysia	30.4	23.8	45.8	26.0	27.5	46.5	20.0	32.3	47.7
Philippines	49.6	13.8	36.5	45.2	15.0	39.7	44.1	15.6	40.3
Singapore	0.7	35.2	64.1	0.7	35.6	63.8	0.2	31.0	68.8
Thailand	63.8	13.1	23.1	64.0	14.0	22.0	52.0	19.8	28.3
	2000			2005			2010		
Country	Agriculture	Industry	Services	Agriculture	Industry	Services	Agriculture	Industry	Services
Indonesia	45.3	17.4	37.3	44.0	18.7	37.2	38.3	19.3	42.3
Malaysia	18.4	32.2	49.5	14.6	29.7	55.6	13.3	27.6	59.2
Philippines	37.1	16.2	46.7	36.0	15.6	48.5	33.2	15.0	51.8
Singapore	0.9	25.4	69.9	1.1	21.7	77.3	31.4	22.1	76.6
Thailand	48.8	19.0	32.2	42.6	20.2	37.1	38.2	20.6	41.0

Source: World Development Indicators, Online Database, 2012

On the other hand, Singapore led fellow members on employment to services industry as it delivers 64.1 percent in 1985 compared to recorded average of 76.6 percent in 2010. In fact, it holds the highest position over all members for the entire period under review. Thailand was making progress though not highly satisfactory; it had an average increase of 30.2 percent throughout the years under review.

Besides its significant contribution to GDP and employment, services sector's performance in external sector has been also becoming more prominent, especially for developing countries. Since the mid-1980s, many services which were previously considered non-tradable[2] are now have been actively traded. The rapid increase in traded services is closely related to the globalization of the world economy and technological progress made in the information and communication services (OECD, 2002). UNCTAD (2002) defined tradability of services as the possibility for the cross-border delivery of final services or of individual components in the services-production chain without the movement of the producer or the customers. Sampson and Snape (1985) and Bhagwati (1988) proposed a view on service trade, which was later formalized into World Trade Organization's (WTO) General Agreement on Trade in Service (GATS). GATS came up with classifications that are based on four modes of supply; namely mode 1, mode 2, mode 3 and mode 4 (refer to table 1.3).

Table 1.3 Trade in services and mode of supply

Modes of Supply	Description
Mode 1 Cross border supply	The possibility for non-resident service suppliers to supply services cross-border into the Member's territory e.g. international telephone calls.
Mode 2 Consumption abroad	The freedom for the Member's residents to purchase services in the territory of another Member (e.g. tourism)
Mode 3 Commercial presence	The opportunities for foreign service suppliers to establish, operate or expand a commercial presence in the Member's territory, such as a branch, agency, or wholly-owned subsidiary e.g. foreign banks setting up its offices/branches in other member country
Mode 4 Movement of natural persons	The possibilities offered for the entry and temporary stay in the Member's territory of foreign individuals in order to supply a service.

[2] The intangibility and non-storability characteristics of services imply that in order to become tradable, services have to be embodied in objects, information flows or persons.

With reference to table 1.4 below, the share of services export for the ASEAN is 17.1 percent in the period under review. Among the ASEAN, Lao PDR has the highest record as its services export accounted 24.9 percent, whereas Indonesia is the least services exporter in the grouping as it had exported only 7.9 percent throughout years being reviewed. For the shares services imports to total trade, throughout the period being reviewed, ASEAN have recorded 17.5 percent. Although they may have increased their import throughout these periods, it was still not competitive enough when compared with the efforts done by other countries in the world. However, the records show that ASEAN are better importers of services than exporters.

Table 1.4 Share of services trade (% of total trade), 1985-2010

	Exports						Imports					
Country	1985	1990	1995	2000	2005	2010	1985	1990	1995	2000	2005	2010
Brunei	-	-	-	-	-	-	-	-	-	31.85	44.02	40.77
Cambodia	-	-	-	-	-	-	-	-	13.67	14.47	14.09	12.52
Indonesia	4.36	8.49	10.33	5.94	8.99	9.57	26.28	22.01	24.86	27.92	24.09	17.04
Lao PDR	28.44	23.14	23.74	23.47	27.76	23.16	15.40	12.46	16.25	7.44	4.23	11.32
Malaysia	11.26	11.81	13.92	12.41	12.13	14.32	25.51	17.27	17.25	17.75	16.81	16.97
Myanmar	17.69	29.58	27.89	22.34	6.40	4.65	8.38	12.13	12.19	13.15	22.20	15.79
Philippines	32.56	28.38	-	8.29	10.10	16.47	14.33	12.61	-	10.80	10.88	15.55
Singapore	16.82	18.98	17.14	15.74	19.32	21.89	13.85	13.30	14.63	17.79	21.98	23.63
Thailand	22.43	21.96	21.12	16.96	15.39	16.57	18.04	17.59	22.90	21.58	20.16	21.76
Vietnam	-	-	-	-	-	-	-	6.63	20.81	18.77	11.31	11.37

Source: UNCTAD, Online Database, 2012

Brunei marks its highest shares of services imports compared to its counterpart members. The record reveals that in year 2000 the services import to its economy was 31.8 percent, and then increased to 40.77 percent in 2010. The record of Indonesia's services import shows unstable trend, it began with a 26.2 percent that dropped to 17.4 percent in 2010.

1.1.3 Trends of FDI Inflows into ASEAN

For the past three decades, foreign direct investment (FDI) has been playing a leading role in many of the economies around the world. A sharp increase in FDI inflow has been witnessed since mid-1980s and early 1990s. The global FDI inflow continued to increase in both output and share until the year 2008 when the world economy experienced an economic downturn. The sudden and quick effects of the 2008 global financial crisis caused a sharp fall in global flow of FDI to all economic groupings, developed, developing as well as the transition economies.

Back in the year 1972, ASEAN recorded $539 million net FDI inflow. One decade later (1982), it had a tremendous growth of over 500 percent that reached $343095.85 million. The earnings continued to increase and reached $14.737 billion in 1993. Major turning point occurred in 1997/1998 when Asia went through the financial crisis. Its initial effect was a decline in inflow by 23 percent in which managed to improve in 1999 to $9.4 billion. This improvement was largely contributed by investment from the United States. The ASEAN recorded the highest FDI inflow of $13.7 billion and $20.2 billion in 2002 and 2003, respectively (ASEAN, 2004).

FDI inflow to these countries surged since 1990 in which all countries realized a remarkable growth. On average, the inflow was pouring consistently to almost all ASEAN until 2007. In 2009, countries were expected to recover from the economic crisis, but instead all registered a marked drop (World Bank, 2012). The figure 1.2 also shows that from the beginning of review, Singapore attracted more FDI than any of its ASEAN counterparts. For instance, it began to receive FDI inflow at 5.4 percent in 1985 to 24.6 percent in 2010. The least recipient of FDI was Philippines, closely followed by the Indonesia.

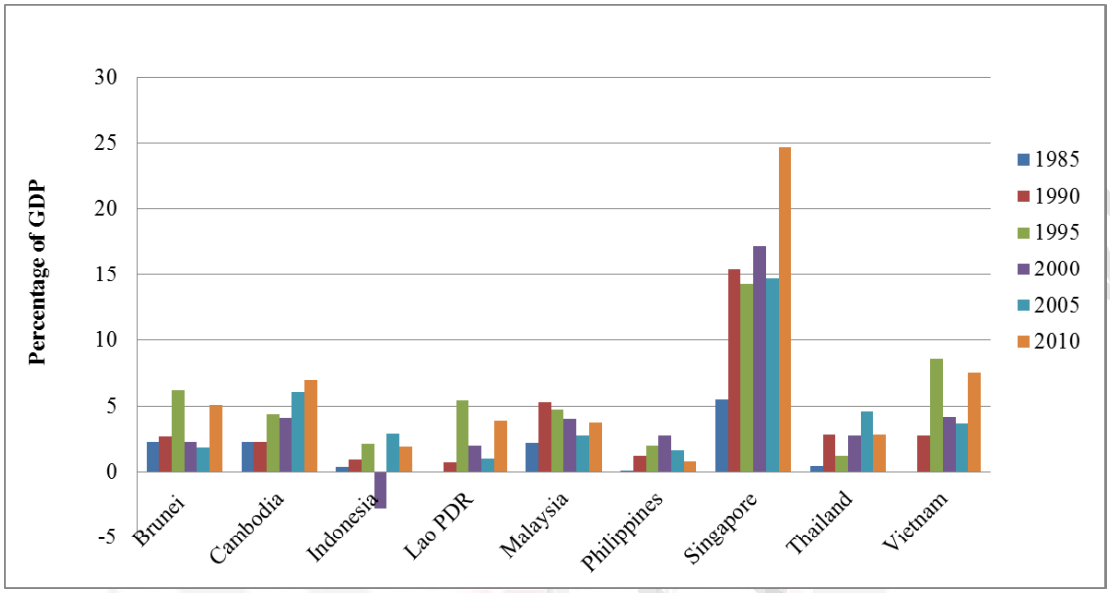

Figure 1.2 Trend of FDI inflow to ASEAN (% of GDP) from 1985-2010
Source: World Development Indicators, Online Database, 2012

On the other hand, Malaysia records a declining inflow trend. It began with 2.18 percent in 1985 followed by an increase to 5.2 percent; later on it registered a drop from 4.7 percent to 3.7 percent in 1995 and 2010, respectively.

On sectoral basis, FDI inflows to all three economic sectors, namely manufacturing, primary and services have shown a random walk throughout the period 2000-2010 (refer to figure 1.3). In 2002, inflow of manufacturing FDI dropped sharply before it began to resurge in 2003 and 2005 with inflow amounting to $7113 million and $15371 million, respectively (refer to table 1.4). In 2006, inflow of FDI to manufacturing industry declined to $13461 million.

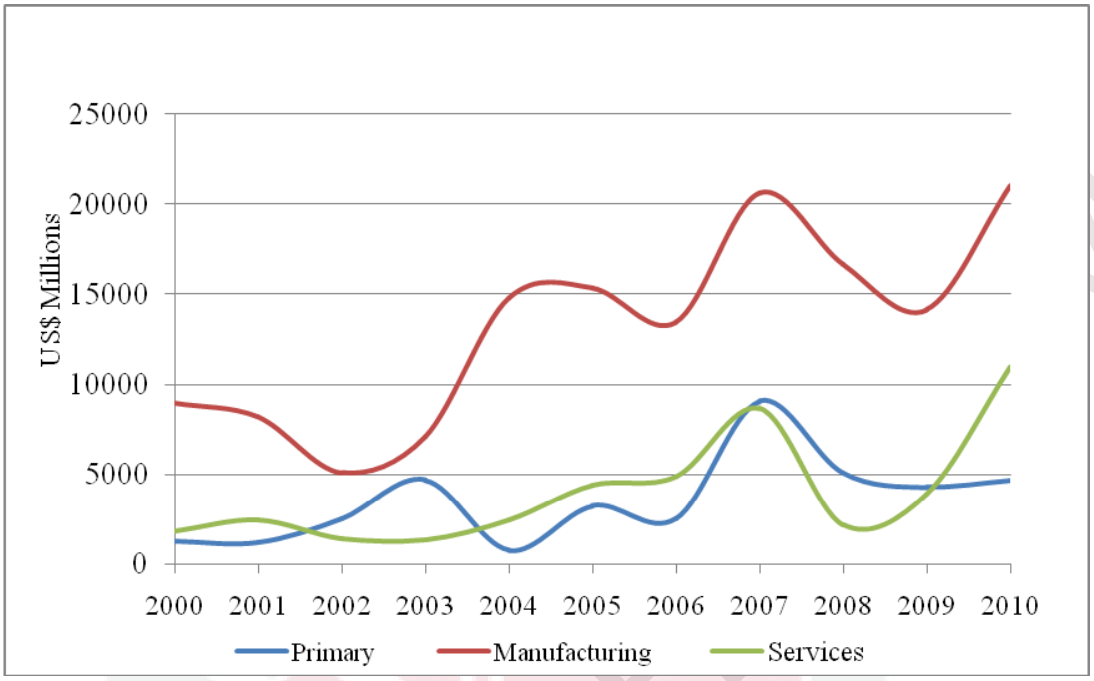

Figure 1.3 ASEAN FDI inflows by economic sectors
Source: ASEAN Secretariat, ASEAN FDI Database, 2011

Following the global recessions in 2007, ASEAN registered a huge drop in manufacturing inflow from $20619 million accounted in 2007 to $16674 million and $14143 million in 2008 and 2009, respectively.

The services based FDI inflow also shows a remarkable unstable trend. Record in 2000 shows that registered inflow amounted to $1798 million was followed by an increase to $2451 million in 2001. A decline to $1431 million and $1353 million in both 2002 and 2003 was registered respectively. It then showed a dramatic increase from $2458 million in 2004 to $8672 million in 2007. ASEAN experienced a huge drop in inflow of services direct investment in 2008 to $2183 million. This dramatic fall provides evidence of the impacts of financial crisis on foreign investment in ASEAN. However, the region recovered and as a result received huge sector's FDI inflow amounting to $10944 million in 2010.

On the other hand, the inflow to the construction subsector seems not to highly attract investors. For instance, in 2002 it received the lowest $174 million when compared with other services, namely, trade/commerce, financial and real estate. For instance, inflow to trade/commerce sectors began with $2319 million inflow to its highest $10566 million in 2000 and 2007, respectively. In addition, the best performing sector is the financial intermediation and services. The sectors attracted inflow amounting $4365 million in 2000 to $16490 million in 2010. Furthermore, FDI inflow to ASEAN also

continues concentrate in the primary sector. The investment in this sector (comprises of agriculture, mining and quarrying) recorded an increase in its inflow. In 2002 and 2003, a registered increase amounting to $2530 million sharply dropped to $781 million in 2004. Since the primary sector is important to both ASEAN and foreign investors, the inflow resurged until it reached the highest recorded amount of $9066 million in 2007. After a huge drop that occurred in 2008 and 2009, FDI inflow to the primary sector experienced a slight resurgence in 2010 amounting to $4678 million.

Table 1.5 FDI inflow by Sector/Industry in ASEAN, 2000-2010 (US$ million)

Sector/Industry	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Primary Sector	1298	1227	2530	4700	781	3241	2529	9066	5062	4287	4678
Agriculture, fishery and forestry	133	-1441	526	186	223	198	325	4780	693	37	546
Mining and quarrying	1165	2668	2004	4514	558	3043	2204	4286	4369	4250	4132
Manufacturing Sector	8977	8188	5106	7113	14805	15371	13461	20619	16674	14143	21018
Services Sector	1798	2451	1431	1353	2458	4379	4864	8672	2183	3894	10944
Construction	-208	-248	174	119	-65	63	355	720	1751	533	532
Trade/Commerce	2319	2398	1056	3370	4170	5518	8992	10566	5830	367	7353
Financial intermediation and services	4365	6357	4285	5072	10440	6629	18012	14234	7777	6270	16490
Real estate	722	644	1019	825	1127	1354	3141	8165	5516	7378	12847
Others	3215	-544	1686	1718	2661	3486	3698	2641	1974	776	1031

Source: ASEAN Secretariat, ASEAN FDI Database, 2011

1.2 Problem Statement

Since the 1990s, there has been tremendous increase in the movement of FDI especially to developing and emerging markets due to the rapid liberalization policies initiated by these countries. The issue of FDI continues to attract the interest of scholars and policymakers due to its anticipated spillover effects on economic growth and development of the host countries. Intense competition among emerging economies and developing countries to entice foreign capital has led to formulation of various measures as FDI stands as the most important foreign financing in these countries. In addition, in recent years, services industries, which were initially regarded as non-tradable are becoming more internationalized especially with the establishment of first multilateral framework for the liberalization of services sector under the auspices of WTO. This has remarkably enhanced the rise of services FDI and service-based multinational corporations (MNCs) in both developing and emerging economies.

Over the past decades, it has been noted that developing countries have taken steps to liberalize their services industries at an even more rapid pace than the developed countries. FDI in services has been growing rapidly and become an increasingly important factor in various economies, especially Association of Southeast Asian Nations (ASEAN) within the last two decades. According to ASEAN (2011), the inflow of services FDI surged from $1798 million in 2000 to $10944 million in 2010. This implies that inward services FDI to the ASEAN steadily rose by 608.67 percent. However, the FDI inflow to ASEAN, in general, has declined slightly to 13 percent in 2008 because of the global financial crisis and economic slowdown that eventually affected the growth of the ASEAN countries (UNCTAD, 2010). The decline in the growth performances of the ASEAN countries, to some extent, indicates that these countries do very much depends on FDI for the stability and sustainability of their economies. To overcome this, the ASEAN countries strategize to diversify their economic activities and reduce the dependency on the manufacturing by moving towards the services sectors as the next engine of growth. In order to enhance the efficiency and contribution of services sector, the presence of foreign services providers is crucial to stimulate competition and increase productivity of the domestic firms. Thus, the first issue here is how to attract more services-based FDI into ASEAN countries.

At present, numerous literatures exist on the determinants of FDI. However, most of these studies focused on aggregated FDI industries or the manufacturing sector. For instance, a literature survey on the determinants of FDI over the last three decades by Agarwal (1980) and Chakrabarti (2001) generally have either ignored the role of services FDI or considered services as part of manufacturing FDI. Recently few studies have attempted to examine the determinants of services FDI in aggregate and sector specific such as Kolstad and Villanger, 2008, Terpstra and Yu (1988), Moshirian

(1997), Cullen-Mandikos and MacPherson (2002) and Buch and Lipponer (2004). Thus, in spite of the rapid growth of services FDI, there exists very limited empirical literature on the determinants of FDI in services, especially on developing countries. To the best of our knowledge, there is no study found on ASEAN countries as well. It is important to find out the determinants of services FDI is this could eventually assist host countries with policy formulation to attract more services-based FDI. Therefore, the study intends to address the following questions

i. What are the determinants of FDI in services?
ii. What are the appropriate policies and strategies that should be adopted by ASEAN to attract FDI in services?

Besides identifying the determinants of FDI in services, it is important as well to examine the impact of FDI in services. The impact that the present study intends to explore is on the services trade. Theoretically, there are twofold link between FDI and trade flows. The first link argued that FDI is complement to trade implying a positive relationship between them, while the second relation assumed that FDI inflows could affect trade negatively or serve as a substitute to trade. Usually multinational firms determine the sequence and international transaction through their cross-border activities. However, it is difficult to apply cross-border activities to many services. This is because services require interaction between producers and consumers due to non-storability characteristic that allow them to be produced where they are consumed. Therefore, delivery of services abroad requires a movement of either producer or consumer, or through subsidiary firm. Thus, the services can easily be traded abroad through firms that move directly to foreign production.

In this context, FDI and trade are linked through subsidiary firms, which engage themselves with production in the host country. For instance, FDI impacts host country's trade through exports of goods or services produced by these firms. In a host country, FDI engages in production of traded good and services due to little or inefficient production by local firms. The FDI and tradable services (e.g. insurance, consultancy and legal services) are positively related which is often a different case for most of non-tradable services (UNCTAD, 1996). Thus, the study seeks to find empirical evidence on the the relationship between services FDI and services trade by addressing the following questions.

i. Is there any relationship exists between services FDI and services trade?
ii. Is services FDI is a complement or substitute to services trade?

1.3 Research Objectives

Specifically the study intends to empirically

i. Investigate the determinants of services FDI for ASEAN countries
ii. Examine the impacts of services FDI on services trade for the ASEAN countries

1.4 Significance of the Study

FDI has been an important area within international economics and international business literature. Since the classical work by Dunning (1973, 1981) on the determinants of FDI inflow, many studies have been conducted to explore further the determinants of FDI inflow across various economies. Various aspects of FDI were investigated not limiting to the determinants of FDI but also to its spillover effects. However, most of the previous studies generally focused on FDI in manufacturing sector or FDI in its aggregated form. Empirical literature on the determinants of services FDI and its impact on services trade in host countries are clearly lacking.

Relying on this argument, the contribution of this paper is to complement the existing few studies in the literature. This thesis makes two main contributions, namely to the existing literature and policy implications. As been mentioned throughout the discussion in this chapter, there is obvious gap in the literature on FDI in terms of the determinants of services FDI and its impact on host countries' economy. Since there are very few studies on this issue, the present study serves as a complement to the existing literature on services FDI. Moreover, the present study will serve as a basis for future research in services FDI due to growing internationalization of services sector and outsourcing of business services by both developed and developing countries. As for the policy implications, the findings from the present study will provide useful insights for the ASEAN and developing countries' policy makers on the important determinants that will influence the FDI inflows. Identifying the important factors and ensure a conducive environment are in place for the FDI attraction is very crucial, especially for developing countries.

1.5 Organization of the Chapters

The organization of this thesis is as follows; Chapter one describes the background of the study, problem statement, research objectives and the significance of the study. Chapter two presents the review of the theoretical and empirical evidences on the determinants of foreign direct investment and the impact of foreign direct investment on trade. Chapter three describes the theoretical framework, model specification, estimation procedures, variables description and also data sources. Chapter four presents and discusses the findings. Chapter five provides the summary of the study and suggests some policy measures to enhance the inflow of FDI in services into ASEAN region as a whole and to increase its contribution to trade in services.

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