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**Attempting Developmental
Regionalism Through AFTA:
The Domestic Politics – Domestic Capital Nexus**

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ABSTRACT

The relationship of regionalism to globalisation is modelled in the literature either as open regionalism aimed at integration with the global market or as a project of resistance to global market forces. Neither of these ideal-type models adequately accounts for an empirical puzzle associated with the ASEAN Free Trade Area (AFTA). Although AFTA is acknowledged as a project of open regionalism aimed at attracting FDI to the Southeast Asian region, its members surprisingly chose to accord foreign investors full market access and national treatment privileges at least ten years later than to ASEAN national investors in AFTA's investment liberalisation component programme. How do we explain this seeming contradiction? By making a conceptual distinction between foreign-owned and domestic-owned capital, a distinction that is particularly salient in the Southeast Asian context where domestic-owned, often 'emerging' capital performs vital social/political roles and whose survival is crucial in sustaining elite rule, this paper advances a third model of the globalisation-regionalism relationship. Developmental regionalism, which draws on strategic trade theory from the International Economics discipline, describes an approach to regionalism in which an initial period of partial and temporary resistance to global competition is employed to build up domestic firms able to eventually engage in global competition. In particular, it was to preserve domestic businesses that were closely allied with members of the political/ruling elite that led certain member governments in ASEAN to advocate a developmental role for AFTA through its investment liberalisation programme, while still using the regional tariff liberalisation component programme as the 'carrot' to attract FDI.

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ATTEMPTING DEVELOPMENTAL REGIONALISM THROUGH AFTA: THE DOMESTIC POLITICS – DOMESTIC CAPITAL NEXUS¹

Introduction

The growth of economic regionalism since the mid-1980s against the backdrop of globalisation has generated considerable scholarly interest in the relationship between globalisation and regionalism.² The IPE literature offers us the notion of ‘open’ regionalism to understand this seeming paradox. Open regionalism conceptualises regionalism as a way station to globalisation, a means through which policymakers enhance the participation of their respective national economies in globalisation processes. A contrasting model interprets regionalism as an attempt by state actors to collectively resist the negative effects of globalisation. Although providing considerable insight into developments in the contemporary world economy, neither of these two ideal-type models is able to account for a key empirical puzzle associated with the ASEAN Free Trade Area (AFTA),³ a project of economic regionalism adopted by governments in Southeast Asia during the 1990s.

AFTA has conventionally been explained as a project of open regionalism, adopted by the ASEAN member governments as an instrument to attract foreign direct investment (FDI) to the ASEAN region through the ‘carrot’ of the single regional market. Yet, when the same governments formally incorporated an investment liberalisation component programme within the AFTA project in 1998, they opted to accord full national treatment and market access privileges to foreign (non-ASEAN) investors at least ten years later than to domestic or ASEAN national investors. Although member governments removed this particular discriminatory clause in September 2001, the fact that a distinction between

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¹ A revised version of this paper will be published in *Third World Quarterly*, 24 (2) in 2003.

² Gamble and Payne (1996). Regionalism is defined here as a states-led project to coordinate economic policies and arrangements in a given region.

³ ASEAN is the ten-member Association of Southeast Asian Nations. AFTA was formally adopted as a regional project in 1992 by Indonesia, Malaysia, Singapore, Thailand, the Philippines and Brunei, AFTA’s core or founding members. ASEAN’s new members – Vietnam, Laos, Cambodia and Myanmar acceded to AFTA when they joined ASEAN.

foreign and domestic investors was adopted and maintained for a three-year period is puzzling given AFTA's acknowledged role as a magnet for foreign investment.

This article explains this as a move by ASEAN member governments spearheaded by Malaysia to use the investment liberalisation programme of AFTA as a developmental tool to build up domestic firms, in addition to using AFTA's tariff liberalisation programme to attract FDI to the single regional market. Specifically, the idea was to nurture domestic capital by using both the expanded regional market and the offer of temporary investment privileges to domestic-owned capital ahead of foreign investors. These temporary investment privileges took the form of earlier market access and national treatment for ASEAN national investors in the ASEAN regional market, particularly in non-manufacturing sectors, and represents an attempt at what I term 'developmental' regionalism. AFTA, in short, displayed the features of *both* open and developmental regionalism due to the political significance of foreign *and* domestic-owned capital in ASEAN. While both forms of regionalism were driven by the imperative of growth, distributive concerns were weaved into the concern with growth in developmental regionalism as governments sought to direct economic benefits to those segments of domestic capital that were important in sustaining elite rule. The analysis suggests that although AFTA was triggered in the first instance by the external pressures associated with globalisation, it was the tussle at the domestic level between the imperatives of growth and domestic distribution (directed towards politically important domestic-owned businesses) that shaped the distinctive way economic cooperation unfolded. In short, the nature of domestic coalitions was a crucial mediating variable between globalisation and regional outcomes.

Following this brief introduction, the next section develops the notion of developmental regionalism by drawing on strategic trade theory from International Economics. This section also elaborates on how developmental regionalism relates to globalisation, including a comparison with existing ideal-type models of regionalism, namely open regionalism and the resistance version, and suggests why such a developmental project might have proved attractive to governments in ASEAN. This concept is then applied to AFTA in the following two sections, which explain developmental regionalism as a project through which a number of ASEAN governments

sought to nurture domestic-owned capital amidst global market competition.⁴ The final section of the paper addresses the question of why member governments were promoted to halt their attempt at developmental regionalism in September 2001.

The Analytical Framework: Developmental Regionalism and the Domestic Political Economy

Contemporary regionalism is generally conceived of as a response to the pressures and incentives associated with economic globalisation (Gamble and Payne, 1998; Hveem, 2000; Mittelman, 2000: 111). One source of these pressures and incentives is the growing economic inter-linkages between countries that generate common interests in cooperation (Hurrell, 1995: 56). But, globalisation is much more than the interactions and interdependencies between countries. Globalisation is best regarded as a multi-faceted structural phenomenon generating multiple pressures and incentives arising from the complex interplay of its material, institutional and cognitive dimensions (Higgott, 2000: 70).

Material changes in production, trade and finance, especially since the 1980s have heightened both the pressures on governments as well as competition among them as they seek to generate wealth for their societies by attracting transnational corporations (TNCs) to locate within their territories (Stopford and Strange, 1991: 1). Increasingly, the assets required for wealth creation in the 'new' world economy centre on information, technological innovation as well as management and organisational competence, what are termed 'created assets' that reside within these global firms (Dunning, 1993: 6). While previously salient 'natural assets' such as labour, land and natural resources remain important in many sectors, governments wishing to involve their economies in higher valued-added economic activities have become increasingly reliant on the wealth-creating resources controlled by TNCs (Stopford and Strange, 1991: 1). In addition, neoliberal economic rules instituted at the multilateral level, especially through the WTO, increasingly prescribe free markets and proscribe government intervention in and control of economic activity, which effectively adds a second set of pressures on governments unable to employ traditional policy instruments to meet domestic social and political

⁴ The analysis focuses on the original ASEAN members – Indonesia, Malaysia, the Philippines, Singapore and Thailand, as these were responsible for initiating major policy decisions in AFTA.

objectives (George, 2002). Moreover, these multilateral rules are creating an environment in which TNCs face fewer and fewer restrictions worldwide on their activities. This has contributed to a shared consciousness among governments of heightened global market competition vis-à-vis the global corporate giants and a sense of the growing dominance of these TNCs in markets everywhere. Governments, therefore, not only react to actual external pressures associated with globalisation they often respond in anticipatory fashion to perceived challenges to the competitiveness of the home economy and of home country firms (Palan and Abbott, 1996: 32). Regionalism can emerge as one such response to these multiple pressures.

The literature identifies two ideal-type models of the globalisation-regionalism relationship, with open regionalism the dominant theoretical model as well as in practice (Mittelman, 2000: 126). Open regionalism⁵ is aimed primarily at advancing the competitive position of business in global competition (the liberal economic interpretation) or to attract wealth-creating FDI to the region amidst competition with other sites for it (the economic realist interpretation).⁶ The main driving force behind open regionalism is the concern with economic efficiency, or more broadly with ensuring economic growth through participation in global wealth creating activities. An alternative ideal-type model of the globalisation-regionalism relationship in the literature is the ‘resistance to globalisation’ model of regionalism (Hveem, 2000: 75-78). Resistance projects are driven largely by concern with non-economic or social values like distribution and social justice, seeking to preserve through regionalism particular forms of domestic social/economic arrangements that are arguably difficult to sustain individually amidst globalisation (Mittelman, 2000: 116-30). While proponents of regionalism in this model seek to resist globalisation, the advocates of both variants of open regionalism accept full engagement with globalisation.

While providing useful insights into the relationship between globalisation and regionalism, these two models are limited in their treatment of the state-market

⁵ The term ‘open regionalism’ originally meant a form of regionalism that was based on the principles of unilateral liberalisation as well as non-discrimination in tariff preferences between members and outsiders (Drysdale and Garnaut, 1993: 187-88). The term is now used in a more general sense to characterise regionalist schemes that are fundamentally about engaging with the global market (Gamble and Payne, 1996: 251).

⁶ The conceptual distinctions between the two variants of open regionalism are discussed in Nesadurai (2001: 60-70).

relationship, particularly that between governments and fractions of capital distinguished by their ownership – domestic or foreign-owned capital.⁷ Neither variant of open regionalism makes an adequate distinction between foreign and domestic capital, although the former is privileged in the FDI variant. Although it may be increasingly difficult to distinguish business in terms of its nationality – the ‘who is us?’ question posed by Robert Reich (1991: 304) – such a distinction, nevertheless, remains relevant in particular political contexts where policymakers and politicians do consciously make this distinction for various political reasons. In these settings, and this is especially true for developing countries where domestic capital is usually not as well developed as foreign capital but often plays a crucial social/political role, governments may well respond to globalisation in ways that attempt to preserve and nurture domestic capital.

By making an analytical distinction between foreign and domestic capital, a third model of regionalism is possible – developmental regionalism (Nesadurai, 2001: 74-79). See Table. Deriving from the notion of the developmental state, developmental regionalism encapsulates the developmental state idea of state intervention in markets to promote national development agendas, in this case by adopting an approach to regionalism through which to nurture emerging domestic firms to eventually become internationally competitive. This is achieved through two instruments: one, the expanded regional market generated through inter-state cooperation and two, temporary protection or privileges for domestic capital in this expanded market. According to strategic trade theory from the international economics discipline, both measures can help to secure benefits for domestic firms over their foreign competitors.⁸

⁷ The conventional treatment has been of segments of capital distinguished by their market orientation, either towards the domestic market or the international market. See, for instance, Gourevitch (1977).

⁸ This insight comes from Paul Krugman’s ‘import protection as export promotion’ variant of strategic trade theory, which reveals that when a domestic firm is given a privileged position in the home market, it enjoys an advantage in scale over foreign rivals that enables the firm to realise ‘learning by doing’ benefits. A larger protected home market offers greater dynamic scale and learning effects to the privileged firm. See Krugman (1984).

Ideal-type Models of the Globalisation-Regionalism Relationship

Theoretical Models (Ideal-Types)	Relationship to Globalisation	Key Driving Force	Key Features	Relationship to Foreign and Domestic Capital
Neoliberal Regionalism [Variant of open regionalism]	Engages with globalisation	Concern with efficiency	No new barriers to non-members imposed; Full deregulatory agenda contemplated; Also associated with agenda to reduce government's role in all aspects of economic activity; Hence the neoliberal credentials.	Does not distinguish between foreign-owned and domestic-owned capital
FDI Model [Variant of open regionalism]	Engages with globalisation	Concern with attracting FDI, a crucial source of growth; Efficiency may be either a primary or secondary concern.	No new barriers to non-members imposed; Deregulation agenda could be extensive or limited; Ambivalent with regard to government's role in the economy; More likely to be an instance of embedded neoliberal regionalism	Foreign capital (FDI) privileged
Resistance Model	Resists globalisation	Concern with political legitimacy	Seeks insulation from global market forces; Dominant agenda is social/distributive.	Other social groups, apart from capital privileged, notably labour
Developmental Regionalism	Essentially engages with globalisation, although it also involves limited and temporary resistance to it	Concern with distribution initially, with growth a long-run concern	Employs temporary protection of, or temporary privileges for, domestic-owned capital; Distribution is thus directed towards domestic capital.	Domestic-owned capital privileged

Source: Nesadurai (2001: 88)

Proponents of developmental regionalism, it is argued, are not necessarily resisting globalisation through regionalism. They do not fully accept the anticipated dominance of foreign/global firms that is associated with globalisation, however, and attempt to support

the development of domestic capital through regionalism. We may regard the concern with domestic capital as a preoccupation with distribution, or with the selective allocation of economic benefits including rents to domestic businesses, in contrast with the generalised growth/efficiency imperative that underpins open regionalism. Nevertheless, concern with growth/efficiency is not absent either in developmental regionalism. Rather, the growth imperative is infused with distributive concerns. Developmental regionalism is, therefore, not about resisting globalisation completely, but neither is it about complete acquiescence to global market forces. Instead, it encompasses a period of temporary and limited resistance to aspects of globalisation through which attempts are made to build capabilities to enable domestic businesses to eventually participate in global market activities. This model of regionalism, therefore, allows us to consider departures from open regionalism as representing a distinct approach to regionalism rather than merely as inconsistencies in open regionalism or as instances of protectionism.

The question that remains, however, is why political actors would seek to nurture *domestic* capital. Why would they prefer to maximise the wealth of a segment of society instead of maximising the wealth and efficiency in society as a whole? The following section addresses this question with regard to the specific case of ASEAN by focusing on the nature of domestic coalitions amidst elite politics.

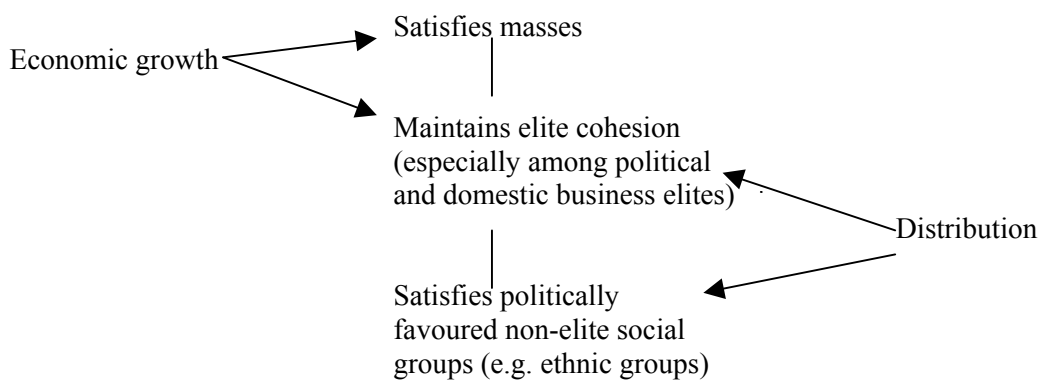
Domestic coalitions and elite politics in ASEAN

Although political systems in ASEAN during much of the 1990s ranged from democracies, to semi-democracies and authoritarian regimes, all the ASEAN countries shared the basic characteristics of elite governance political systems where political power was largely in the hands of elites despite the presence of mechanisms for citizen participation (McCargo, 1998: 127). The political elite was, however, not completely insulated from domestic society, and needed to respond to concerns arising from this level in order to maintain elite rule and its legitimacy, which remained fragile throughout the 1990s. In such settings, political elites depend on two factors to maintain themselves in power as well as to ensure the stability and security of the prevailing domestic regime or political system.

On the one hand, political elites need the support of citizens to maintain their right to rule and to ensure political order, and this is largely achieved through creating material

wealth for citizens – the notion of performance legitimacy, which remains relevant to date (Alagappa, 1995: 330; Stubbs, 2001). This explains the preoccupation of political leaders with securing and maintaining key sources of growth in the economy, of which FDI is pre-eminent in ASEAN. On the other hand, elite rule is also sustained by unity and accommodation between members of the elite/governing coalition (Haggard and Kaufman, 1997). Political elites selectively distribute economic benefits to their elite partners as a primary means to achieve elite unity. See Figure.

The Role of Growth and Distribution in Elite Governance Political Systems



Core Elite Goals

Maintenance of elite rule (especially incumbents);
 Stability of the domestic
 political regime (sustains the political status quo);

Source: Nesadurai (2001: 85)

By the 1990s, it was the accommodation between the political elite and an emerging domestic business class that was crucial in much of ASEAN. The material and other forms of political support provided by domestic businesses helped incumbent political elites maintain their power base, while the former in turn received economic privileges through preferential policies instituted by the latter. In addition, domestic businesses were privileged because they helped political actors fulfil broader political aims. This was especially clear in the Malaysian and Indonesian cases, where political legitimacy also rests on the capacity of the state to develop respectively an ethnic Malay and indigenous Indonesian domestic capital class, particularly to offset the dominance of

ethnic Chinese capital.⁹ Thus, although political actors were powerful and had some degree of autonomy in decision-making, they were, nevertheless, constrained by the need to respond to domestic society at these two levels – citizens in general and to domestic business interests allied with political and state elites.

Tensions can emerge when particular policies generate significant trade-offs between the growth and distributive imperatives,¹⁰ or between maximising wealth and efficiency in society as a whole and maximising the wealth of a segment of society. In much of ASEAN, foreign capital remains a key source of growth and exports, particularly in the high value-added and advanced sectors of the economy that virtually all governments are increasingly targeting, although domestic-owned firms are not entirely absent from this picture. On the other hand, the distributive imperative in ASEAN, where it exists, is usually aimed at privileging domestic-owned capital or segments of it that are also close allies of the political elite. A simplifying, though not unreasonable assumption made in the paper is that the foreign capital governments are targeting is internationally oriented and thus in favour of liberal market policies that maximise growth. While domestic capital may be either internationally oriented or emerging/inward focused, it is when the political elite is closely allied to the latter that the tension between growth and distribution becomes pronounced. Since this segment of domestic capital is not as well developed as foreign capital, policymakers may well adopt measures to protect, preserve and/or nurture emerging domestic capital vis-à-vis foreign capital if the former is to survive direct competition with the latter.

When such distributive policies involve restricting the domestic operations of foreign (or internationally oriented) firms, growth prospects may be weakened if the latter are significant agents of growth. Growth need not, however, be disrupted if the extent of distribution is limited, either to particular sectors or in terms of time. On the other hand, governments may find it necessary to limit their distributive agenda during times of economic distress, or expected economic hardship, which will affect citizens in general through unemployment, for instance as well as threaten elite unity (Haggard and Kaufman,

⁹ See Crouch (1996) for Malaysia and Habir (1999) for Indonesia.

¹⁰ Growth is defined here as the expansion of economic wealth of a country, irrespective of its distribution among different groups, firms or individuals. Distribution, on the other hand, involves the conscious allocation by governments of income, rents and other economic benefits to particular individuals, groups or firms who would otherwise not have received these gains through the workings of the free market.

1997). By threatening the political future of incumbent political elites, economic decline, or the prospect of it, often compels governments to restore the conditions favouring growth, particularly since growth will allow distribution to take place with fewer costs than under conditions of generalised economic decline. The rest of this paper employs the analytical framework developed above to account for developments in AFTA.

AFTA: Encompassing Both Open and Developmental Regionalism

AFTA has generally been explained as a project of open regionalism aimed at attracting FDI to member economies through the carrot of the single regional market.¹¹ Globalisation had by the early 1990s significantly altered patterns and flows of FDI and increased worldwide competition for it. By 1991-92, the surge of FDI into ASEAN particularly from its traditional sources in the OECD countries, Taiwan and Hong Kong had moderated, flowing instead to China (Hay, 1996). This raised considerable concern among ASEAN governments as FDI was a crucial source of growth, and had helped these countries emerge from the disastrous economic and political consequences of the mid-1980s recession. The ASEAN governments attempted through AFTA to offer foreign investors who were increasingly practising a regional division of labour an alternative regional space of investment/production vis-à-vis China. China by itself offered investors a potentially competing 'regional' investment site in the Asia-Pacific region (Baldwin, 1997: 3), and was regarded by all the core ASEAN countries as their primary competitor for FDI. Specifically, it was the tariff liberalisation component programme of AFTA (the CEPT, or Common Effective Preferential Tariff scheme) that members employed to define a distinctive space of production for global capital in the wider Asia-Pacific region. It was, thus, the growth imperative that drove the turn to open regionalism in AFTA.

Yet, when the ASEAN Investment Area (AIA) was formally adopted as a component programme within AFTA in October 1998, it stipulated that full market access and national treatment privileges in the manufacturing sector would be accorded to ASEAN investors by 2010 and to all foreign investors only in 2020. Later, its coverage was extended to include agriculture, forestry, fisheries, mining, as well as services incidental to all these sectors. Although the AIA programme was accelerated in 1999,

¹¹ See, among others Ravenhill (1995) and Bowles and MacLean (1996).

only ASEAN investors were to be accorded full market access and national treatment privileges at the earlier dates of 2003 in manufacturing and 2010 in the other sectors. Foreign (non-ASEAN) investors would receive these benefits only in 2020 as originally scheduled.

Some scholars advise against reading too much into the AIA distinction between ASEAN and non-ASEAN or foreign investors since they contend that it is irrelevant or redundant in the first place due to essentially liberal FDI regimes in ASEAN.¹² This argument can be challenged in two ways. First, if the distinction is indeed irrelevant, the question of why policymakers would choose to make it in the first place needs to be answered. It is insufficient to assume that policymakers were acting irrationally or were misinformed, since the implications of instituting such a distinction were actively debated during the three years of discussions leading up to the formal adoption of the AIA Agreement in 1998, and continued to be debated from its adoption until September 2001 when this particular clause was dropped. Clearly, there were some quarters for whom the distinction was salient. Moreover, when member governments revised the terms of the AIA Agreement in 1999, a year after its initial adoption, they continued to privilege ASEAN investors over foreign investors. Second, the argument that the foreign-ASEAN distinction is irrelevant or redundant is easily challenged on empirical grounds. Foreign investors continued to face investment restrictions in many of the original ASEAN countries during the 1990s in selected sectors and in particular policy areas despite liberalisation of FDI regimes, thus making the AIA distinction between domestic and foreign investors significant. This was especially true for the non-manufacturing sectors where fairly restrictive FDI conditions prevailed. These restrictions ranged from equity ownership conditions, market access to certain sectors, land ownership regulations, and access to domestic sources of funds.¹³

Another possible explanation, and one that can be accommodated within the open regionalist framework, is that the AIA Agreement constituted an additional tool to reinforce AFTA as a means to attract FDI to the region. The temporary discrimination of non-ASEAN/foreign investors was simply a way of offering domestic capital in the

¹² Menon (1998: 18) subscribes to this view.

¹³ Only in Indonesia were the restrictions on FDI minimal, which made the ASEAN/non-ASEAN investor distinction in this country somewhat irrelevant. See Nesadurai (2001: 164-72).

different ASEAN countries sufficient time to prepare for full investment liberalisation in 2020. This argument appears to have some merit if we consider the way the AIA Agreement was framed. The original Agreement, in fact, specified that full market access and national treatment privileges were to be accorded to *all* investors immediately where possible, but allowed governments to maintain temporary exemptions in a variety of sectors and policy areas as they saw fit (ASEAN, 1998).

Yet, this does not explain why *ASEAN* investors were allowed full market access and national treatment privileges ten years earlier than foreign investors. The exemptions, which were fairly extensive, were to be removed by 2003 and 2010 for ASEAN investors and only in 2020 for all other foreign investors (ASEAN Secretariat, 1999). Such a move would not have protected domestic investors from all external investors, since other ASEAN investors were to be treated as domestic investors from 2003/2010. This suggests that there were other dynamics apart from the FDI dynamic that shaped the development of AFTA. As the following discussion reveals, domestic political priorities centred on the need to preserve emerging domestic-owned capital that was politically salient in the face of a different set of globalisation pressures also influenced the design of AFTA.

Anticipated changes in multilateral investment rules

Attempts by advanced country governments and their TNCs during the 1990s to develop global rules to lower and remove ‘beyond the border’ barriers to free trade (Smythe, 2000: 72) constituted a second set of globalisation pressures and incentives that confronted the ASEAN governments. In particular, it was the move through forums like APEC, the WTO and the OECD to develop a multilateral regime for investment that would maximise freedom of operation for foreign investors in as many countries as possible that was especially salient. Even though these attempts through the OECD and APEC were unsuccessful, many developing country governments including in ASEAN expected guarantees to foreign investors to be written into the WTO framework eventually (Khor, 2001: 86).

Although a group of developing countries including Malaysia and Indonesia successfully kept investment off the negotiating agenda for the First WTO Ministerial Meeting in 1996, many governments regarded this reprieve to be only temporary. These expectations were not misplaced. A working group on investment was established at the

1996 Ministerial to study the feasibility of incorporating investment into the WTO in the future. In 1998, the WTO General Council decided that the working group should continue its work until the Seattle ministerial meeting in 1999 when members would decide on whether to incorporate investment within the WTO (WTO, 1998). The European Commission was particularly interested in ensuring that the national treatment principle formed a key part of any future WTO regime on investment (Khor, 2001: 87). Expectations of an impending global investment regime reinforced perceptions in ASEAN of further intensification of market competition for domestic firms and of the potential dominance of foreign corporations. They led at least two of the five original ASEAN national governments to contemplate providing preferential investment treatment for ASEAN firms in the AFTA regional market as a means to build up domestic firms.

The ASEAN response

The concerns about a global free investment regime were strongest in Indonesia and especially Malaysia and were centred on the future of domestic firms. Although the Malaysian government had instituted extensive neoliberal economic reforms from the mid-1980s, the government and the private sector both saw foreign interest in negotiating global investment rules as posing the biggest threat to domestic companies.¹⁴ The expectation was that global rules would eventually allow foreign corporations unrestricted access to the domestic market. Malaysian policymakers had, by the early 1990s, begun to voice their reservations about the country's overwhelming dependence on FDI and articulated the importance of nurturing Malaysian multinationals.¹⁵ In response to moves to include investment into the inaugural WTO agenda, Malaysian trade minister Rafidah Aziz argued against the idea of full market access and national treatment privileges for foreign investors. She pointed out that such a move would prevent national governments from implementing "national level investment policies ... to enable [domestic firms] to grow and be able to compete with large established foreign firms".¹⁶ Indonesia expressed similar concerns, and formally objected to the inclusion of investment in the WTO agenda together with Malaysia and six other developing countries.¹⁷ Singapore, the most open of

¹⁴ Interview with Ong Hong Cheong, former coordinator of Malaysian participation in OECD workshops, May 2001.

¹⁵ See Ali (1992) and Abdullah Tahir, quoted in Felker (1998: 247).

¹⁶ *Business Times*, 'Malaysia against restrictive investment rules: Rafidah', 10 July 1996.

¹⁷ *Business Times*, 'Malaysia, seven others jointly oppose new WTO rules', 5 November 1996.

the ASEAN economies to FDI, did not reject the idea of a global investment regime, while the Thai government was rather ambivalent on this point.

Using the AIA as a developmental tool to nurture domestic capital

In response to concerns about the future of emerging domestic capital, the Malaysian side advocated a developmental role for the AIA that would help to nurture *domestic* capital through the privileging of *ASEAN* investors in the AFTA market. The single regional market under AFTA would provide the necessary scale and learning economies for domestic firms. Preferential market access and national treatment privileges for ASEAN investors was aimed at providing domestic (ASEAN) firms space to grow and become internationally competitive before TNCs were allowed full investment privileges in the regional market.¹⁸ A crucial part of this project was also to encourage the development of *ASEAN* conglomerates through joint ventures or other forms of alliances between ASEAN investors as a means of competing with the global corporate giants. A senior official from the ASEAN Secretariat explained, “the ASEAN countries saw the need to develop ASEAN multinationals using the grace period before foreign (non-ASEAN) investors would be accorded the same privileges”.¹⁹ Whether the idea of using the AIA as a developmental tool was workable is a separate issue that cannot be addressed in this paper. Why such a project was adopted is the more interesting question, to be addressed in the next section.

The Indonesian government explicitly supported the Malaysian position on the AIA when then Coordinating Minister for the Economy, Ginandjar Kartasasmita, publicly endorsed in October 1998 the Malaysian suggestion of using the AIA to develop ASEAN multinationals and conglomerates that would be globally competitive.²⁰ Although technocrats from the Commerce Ministry in Thailand found the privileging of ASEAN investors in the AIA to be contradictory to AFTA’s role as an instrument to attract FDI to ASEAN,²¹ the Thai government did not reject the Malaysian suggestion.²² Neither did Singapore, although it had always advocated openness to foreign capital.

¹⁸ Interview with Karun Kittisatoporn, a senior official on ASEAN from the Thai Commerce Ministry, August 2000.

¹⁹ Interview with Dr Wee Kee Hwee, July 2000.

²⁰ *Bisnis Indonesia* (Indonesian Business), 10 October 1998.

²¹ Interview with Karun Kittisatoporn.

²² Interview with an official of the Singapore Trade Development Board, conducted via e-mail in June 2001.

In fact, the respective investment agencies in the core ASEAN countries accepted the need to initially accord investment privileges to ASEAN investors in the AIA and only later to extend these to non-ASEAN investors.²³ This point had, in fact, been extensively debated during the three years of consultations that led up to the formal signing of the AIA Agreement in October 1998. It had been noted at these consultations that privileging ASEAN investors would be difficult to justify on economic grounds, since foreign TNCs possessed the wealth-creating assets that the ASEAN countries required in order to participate in increasingly sophisticated global production.²⁴ Nevertheless, it was also acknowledged that preferential treatment of ASEAN investors could potentially stimulate intra-ASEAN investments and facilitate the emergence and growth of indigenous ASEAN multinationals, which were a necessary vehicle “to compete in a world economy increasingly characterised by globalisation and competition”(Chia, 1996: 21). ASEAN leaders and policymakers were broadly united on the importance of domestic firms becoming large and/or multinational as a means of meeting global market competition.

Where the investment officials differed was on how to define an ‘ASEAN’ investor in terms of its minimum ASEAN equity share (or maximum foreign equity share). This was a critical point in the negotiations, since many domestic investors in the ASEAN countries were also involved in joint ventures with foreign capital. In any case, FDI was an important player in ASEAN and the ASEAN governments were not advocating keeping out FDI; they were only interested in nurturing domestic capital through temporary privileges accorded to the latter, and particularly in non-manufacturing sectors. Thus, developmental regionalism was to be achieved through the AIA without necessarily jeopardising the role of the CEPT tariff liberalisation component of AFTA in attracting manufacturing sector FDI.

Thus, it was not surprising that a very open economy like Singapore advocated a liberal definition of an ASEAN investor that stipulated only a minimum 30 per cent ASEAN equity share. This meant that any venture up to a maximum foreign equity share of 70 per cent could qualify for national treatment and market access privileges.²⁵ The Thai Board of Investment, in contrast, advocated a minimum ASEAN equity share of at

²³ See *Bangkok Post*, ‘Hopes vary for investment area’ 11 September 1996.

²⁴ See the argument put forward by economists at these meetings (Chia, 1996: 20).

²⁵ *Bangkok Post*, ‘Investment area plan proceeding’ 9 January 1998.

least 51 per cent in keeping with prevailing Thai investment policy, at least during the initial negotiations on this matter. On the other hand, the Thai Commerce Ministry that has overall charge of AFTA policy and negotiations was more concerned about emphasising the AIA as a tool to attract FDI rather than its developmental role. It was able to pressure the Board to lower the minimum ASEAN equity figure to 30 per cent.²⁶ The other countries, all with varying degrees of restrictions on foreign participation, preferred a more conservative definition, however. In the end, the ASEAN governments agreed to define an ASEAN investor as a domestic investor according to each prospective host country's local investment laws and policies.²⁷ Flexibility prevailed for two reasons. First, it allowed individual governments the independence to adopt mixes of domestic/ASEAN and foreign investment that met national needs. Second, it continued to facilitate joint ventures between foreign and domestic/ASEAN firms as a way of building up the domestic partner through technology transfer and learning from the foreign partner.²⁸

The Role of Domestic-Owned Capital in ASEAN

The different positions of the ASEAN governments on the AIA reflect the political salience of domestic-owned capital in these societies and the coalitions formed by the latter with the political/ruling elite. Although Thailand and Singapore did not actively champion a developmental clause in the AIA, the absence of a challenge from these governments on the issue needs to be explained. As the following discussion shows, the Malaysian move to privilege domestic/ASEAN investors through the AIA was actually helpful to domestic-owned capital in Singapore and Thailand undertaking expansion in the regional market.

Singapore

Although FDI had been the principle source of growth for Singapore during the 1970s, the mid-1980s recession led the government to adopt a new growth strategy that emphasised the expansion of domestic capital, particularly non-manufacturing capital through regionalisation, although FDI remained important (Yeung, 1999: 8). By the early

²⁶ *Bangkok Post*, 'BOI backs 30% as level for national treatment', 17 January 1998.

²⁷ *Bangkok Post*, 'Proposal aims to classify ASEAN investors as locals', 21 March 1998.

²⁸ Discussion with then ASEAN Deputy Secretary General, Dr Suthad Setboonsang, July 2000.

1990s, the government had also planned to use regional market expansion to groom a new generation of Singaporean TNCs capable of competing with global TNCs (Wong and Ng, 1997: 136). The shift in emphasis to domestic capital was seen as necessary to reduce Singapore's overwhelming reliance on FDI. It also brought political benefits to the ruling government by co-opting domestic private capital that had for various reasons been sidelined in the past in favour of FDI (Parsonage, 1994: 10). Domestic private capital was heavily concentrated in service-related sectors, some of which was already going regional in ASEAN. As a result of this shift in economic strategy, domestic private capital became part of the ruling elite in the 1990s, albeit as the junior partner in the ruling coalition of political/state elites and state capital. The privileging of ASEAN investors in the AIA did not contradict Singapore government strategy to support economic restructuring based on the regional expansion of domestic capital.

Thailand

Domestic capital has played a key role in the Thai economy from the 1950s. Although Thailand experienced an FDI boom since 1985, foreign capital did not overwhelm domestic capital, which also expanded considerably after 1985, often in joint ventures with FDI (Phongpaichit and Baker, 1996: 156). Most importantly, domestic capital, particularly urban (Bangkok-based) big business had also begun to expand overseas. Unlike Singapore, Thailand did not have a formal policy to develop domestic capital or a formal regionalisation policy to support the overseas expansion of Thai private capital. Nevertheless, the government's commitment to AFTA served the interests of the Bangkok-based business elite, which was in close alliance during the 1990s with both elected politicians and liberal technocrats in the bureaucracy who advocated open economic policies for Thailand, including regional trade liberalisation (Krongkaew, 1997). Overseas expansion in the 1990s by outward-focussed elements of Thai domestic capital was especially evident outside manufacturing industry, where large family-based Thai conglomerates dominated (Phongpaichit and Baker, 1998: 28). The Shinawatra group, the Samart group, the Charoen Pokphand group and the Ucom group, for instance, ventured overseas to Southeast Asian markets in a variety of activities related to their core domestic business in telecommunications and information technology. As in the case of Singapore, the decision to privilege ASEAN investors in the AIA did not necessarily contradict the interests of the political and state elites nor that of its business allies since it clearly benefited internationally oriented Thai domestic businesses seeking to venture abroad.

That was, however, the state-of-play in 1998 when the AIA was initially adopted and the effects of the 1997-98 financial crisis were still unfolding in the country. Since then, the collapse of significant elements of Thai big businesses lent new emphasis to the role of FDI in spearheading growth in Thailand as the Democrat Party under then Prime Minister Chuan Leekpai sought to restructure the Thai economy towards greater market openness and competitiveness. Hence, there was some move to de-emphasise the foreign-ASEAN distinction in the AIA through attempts to bring forward the deadline for full foreign equity ownership in investment.²⁹ The Deputy Secretary General of the Thai Board of Investment, Chakramon Phasukvanich, in fact, suggested the crisis might force ASEAN to play down its intra-ASEAN investment area in favour of attracting FDI from outside ASEAN.³⁰ In the end, however, ASEAN member governments adopted a temporary and separate programme in March 1999 through which full foreign equity rights were offered to all foreign investors for a two-year period in a limited number of specially selected sectors, while the foreign-ASEAN distinction in the AIA was maintained.³¹

Indonesia

In the case of Indonesia, the support given by Ginandjar Kartasasmita, Indonesian Coordinating Minister for the Economy in the Habibie government for the Malaysian proposal vis-à-vis the AIA reflects economic nationalist thinking that envisages a key role for the state in directing markets to achieve national economic and political goals (Brown, 1998: 188). The liberal technocrats who dominated Indonesian policymaking since the mid-1980s had rejected these ideas. Instead, they instituted market liberalisation and deregulation as the path to growth. The Indonesian public, however, believed that these policies had disproportionately benefited ethnic Chinese businesses, particularly the conglomerates, and those belonging to the President's family (Borsuk, 1999). Although deeply resented, ethnic Chinese big businesses were a crucial link in Indonesian patronage politics (Habir, 1999). They gained their dominant economic position through connections with politically influential persons, including military elites and especially President Suharto, who also lent them protection from an essentially hostile indigenous Indonesian society. In turn, ethnic Chinese big businesses provided funds to the President,

²⁹ *Business Times*, 'ASEAN cuts deeper into trade, investment barriers' 8 March 1999.

³⁰ *Bangkok Post*, 'Region's ministers reaffirm plan' 6 March 1999.

³¹ Joint Press Statement, First Meeting of the ASEAN Investment Area Council, 5 March 1999.

which he disbursed to selected organisations and individuals in return for political support (Liddle, 1999a: 51).

This meant that the President and government became extremely sensitive to anti-Chinese sentiment, which indigenous business exploited through its demands for preferential business treatment. Suharto had, in the past, used economic favours like preferential credit and import licenses to indigenous businesses during much of his tenure as President as a way to gain their political support, which led to the creation of a second corporate elite group – indigenous big business (Liddle, 1999a: 68). With the appointment of the economic nationalists to influential positions in the 1994 cabinet reshuffle, the fortunes of indigenous big business looked set to rise further. The economic nationalists quickly adopted the position that deregulation and liberalisation could be strategically integrated with state-driven industrial policy to develop domestic, especially indigenous business capabilities (Robison, 1997: 53).

The political salience of indigenous (and state) capital did not end with the financial crisis and the fall of Suharto in May 1998. Many Indonesians regarded further neoliberal reforms sanctioned by the IMF as attempts by western interests to impose a form of capitalism on Indonesia that would, once again, “prevent indigenous Indonesians from taking their rightful place at the economic table” (Habir, 1999: 202). The redistributive imperative to achieve economic parity between the ethnic Chinese and foreign investors on the one hand and indigenous groups, particularly in business, on the other, remained strong. It was, in fact, strengthened in the aftermath of Suharto’s fall, given the strong resentment against ethnic Chinese and foreign investment in the country. Both Habibie,³² Indonesian president in 1998 when the AIA was adopted, and Ginandjar had long been in favour of reducing Indonesian dependence on foreign investors and in weakening the dominant position of the ethnic Chinese business elite by building up state and indigenous businesses (Djidin, 1997: 26). While Habibie championed state capital, Ginandjar championed indigenous business interests (Liddle, 1999b: 20-21). Ginandjar’s open support of Malaysia’s developmental approach to the AIA emerged out of such ideas and the ascendance of indigenous business interests. Nevertheless, the financial and political crisis in Indonesia meant that the growth imperative, particularly to attract FDI to

³² Habibie had presided over Indonesia’s state-driven high-technology programme under Suharto’s tenure. He took over as President in 1998 when Suharto was ousted from power.

the country, became vital while IMF reforms made it difficult to translate economic nationalist ideas to firm policies.³³

Malaysia

In the case of Malaysia, the political salience of domestic capital is tied up with the country's long-standing ethnic politics, as well as with the broader economic nationalism of Prime Minister Mahathir that emerged in the late 1980s. Between 1970 and 1990, a state-directed development programme – the New Economic Policy (NEP) – drove the Malaysian political economy. The NEP was the outcome of ethnic riots following the May 1969 general elections caused by the majority Malay community's concerns at their economic marginalisation and fears that they would lose their political dominance to the relatively better off minority ethnic Chinese community as a result.

Among the objectives of the NEP was to create a Malay business (and middle) class and to achieve a target of 30 per cent Malay equity in the corporate sector. The NEP was vital to the legitimacy and security of the UMNO-dominated regime, since it enabled both a more equitable distribution of wealth for the Malays as well as Malay political dominance through control of economic resources. The United Malays National Organisation (UMNO) has long been the leading Malay party in Malaysia, regarded as the champion of Malay political rights in multiethnic Malaysia. Although the NEP was replaced by the National Development Policy in 1991 that scaled back ethnic preferences, the goal of creating a Malay business community continued to be emphasised in the 1990s (Tori, 1997: 236). Even the privatisation programme undertaken as part of the economic restructuring package adopted in response to the mid-1980s recession was actively used to create a Malay business class to fulfil the NEP goal (Crouch, 1996: 39). Privatisation largely benefited UMNO-linked Malay businesspersons, although a number of ethnic Chinese and Indian businesses gained as well. This group, in turn, became a valuable source of political and material support for various UMNO political leaders, including the Prime Minister (Gomez, 1996). By the late 1990s, therefore, this politically influential rentier domestic business community had become part of the governing elite (Khoo, 2000: 221).

³³ In any case, it is not clear that developmental regionalism through the AIA would have been feasible as a means to help develop indigenous Indonesian capital. It was more likely that the larger, more advanced ethnic Chinese businesses would have been the project's main beneficiaries.

The new Malaysian conglomerates that emerged out of privatisation and other preferential policies were also a key component of the wider economic nationalism of the Prime Minister. Especially after the mid-1980s recession, policy had moved beyond the NEP's narrow focus on building a *Malay* capitalist class to advocate the growth of large, *Malaysian* firms (which would include ethnic Chinese and Indian firms as well) as a means of meeting the competitive challenges of the global economy, although NEP goals remained salient (Khoo, 2000: 216). The policy shift reflected the strategic vision of the Prime Minister, who had never been content with Malaysia remaining a Third World producer of industrial commodities. Thus, he stressed the building up of Malaysian corporations and conglomerates able to compete with foreign TNCs in what was perceived to be an intensely competitive world economy.

Since foreign firms were dominant in the far more efficient, export-oriented manufacturing sector, it was in the non-manufacturing sectors that domestic capital, including ethnic Malay capital found its niche, using market restrictions as well as access to preferential treatment through political connections as a means to profits (Khoo, 2000: 218). As already noted in a previous section, the expectation among policymakers was that global rules would eventually allow foreign corporations unrestricted access to the domestic market. It was clear that Malaysian firms, including the politically privileged ones, would eventually have to compete with global firms, not only in international markets but in the domestic market as well. If politically important domestic firms were not ready for global market competition, their demise would have significant political repercussions for the NEP goal of advancing a Malay business class, for Mahathir's personal authority, and ultimately for the stability of Mahathir's ruling coalition as well as the security of the UMNO-dominated political system. The developmental role envisaged for the AIA by the Malaysian side was, therefore, intimately related to ensuring the survival of the domestic firms that were key players in the Malaysian political economy.

The Growth Imperative Overwhelms: Reviewing the AIA

In September 2001, the ASEAN governments agreed to remove the disparity in the AIA between foreign and domestic/ASEAN investors in the non-manufacturing sectors, thus offering foreign investors full market access and national treatment privileges by 2010 rather than in 2020.³⁴ How do we explain this policy shift?

Although the AIA had been adopted in October 1998, right in the throes of the financial crisis, it was at that time not expected to adversely affect manufacturing sector FDI since its discriminatory effects were largely, though not solely, confined to the non-manufacturing sectors. It was the flow of FDI to the manufacturing sector that was considered to be crucial during this period, since it had been the main engine of growth and exports in ASEAN from the mid-1980s, and was believed by political leaders to be the main means of recovery from the crisis. Some member country officials as well as the ASEAN Secretary General believed that the AIA as it was then designed would jeopardise the inflow of FDI during such difficult times when the liberal reformist credentials of member governments were at stake.³⁵ Nevertheless, the latter continued to maintain the AIA in its 'original' form. Instead, member governments accelerated CEPT tariff liberalisation in 1998 as a means of reassuring foreign investors that they were committed to realising the single regional market, the main 'carrot' used to attract FDI flows to ASEAN. Member governments also temporarily relaxed investment restrictions for a one to two year period in selected manufacturing sectors in their respective countries as a way of maintaining investor interest in the region, as already noted.

Nevertheless, member governments agreed to a one year study on the AIA beginning in August 2000 in view of the report presented in July 2000 by the ASEAN Secretary General that revealed a fall in investment into ASEAN from US\$28 billion in 1997 to US\$13 billion in 1999.³⁶ Moreover, the report also showed that the ASEAN economies received only 17 per cent of FDI flows to Asian developing countries in 1999, compared to about 60 per cent in the early 1990s. China, on the other hand, received about 60 per cent in 1999, up from 18 per cent during the early years of the decade. The

³⁴ Joint Press Statement, *Thirty-third ASEAN Economic Ministers Meeting*, 15 September 2001.

³⁵ *Business Times*, 'ASEAN set to liberalise investment within region', 30 September 1999.

³⁶ *International Herald Tribune*, 'Investment in Southeast Asia plunges', 27 July 2000. Later information revealed a higher 1999 figure of US\$16 billion. See UNCTAD (2000).

negative correlation was not lost on ASEAN officials and leaders.³⁷ China's potential accession to the WTO and the anticipated diversion of FDI to China as a result added to the sense of urgency among the ASEAN leaders with regard to the FDI situation.

Concern about the future of FDI flows to ASEAN became especially pronounced by the middle of 2001, and it was this that finally prompted member governments including Malaysia to review the AIA in September 2001.³⁸ By this time, it seemed clear that growth in ASEAN was in serious jeopardy as all the main engines of growth in the global economy – the US, Western Europe and Japan – seemed headed into recession. In fact, it had become clear by early 2001 that a global economic slowdown was imminent, threatening the recovery that most member economies had experienced over 1999-2000 (MIER, 2001a&b). Falling demand in the US during 2001, still the region's main export market meant that the ASEAN region appeared to be facing a more severe downturn than the 1997-98 regional financial crisis. Not only were export markets threatened, but foreign investment too was expected to slow further as a result.³⁹

In short, growth and FDI had, by the middle of 2001, emerged as the overwhelming priority for the ASEAN governments, including Indonesia and Malaysia. In addition, foreign investors, notably American investors pressed the ASEAN governments to accelerate national treatment under the AIA by citing the need to counter the diversion of FDI to China.⁴⁰ It must be emphasised, however, that the relative decline of FDI inflows to ASEAN throughout the 1990s, and especially since the financial crisis, was not directly the result of the ASEAN-foreign distinction in the AIA. Nevertheless, there was concern in ASEAN that the clause could send the wrong signals to foreign investors at a time when ASEAN was facing a rather precarious foreign investment situation. The ASEAN decision of 16 September 2001 to allow market access and national treatment for *all* investors by 2010 in the non-manufacturing sectors was, therefore, directed at re-affirming ASEAN's openness to FDI.⁴¹ The attempt at developmental regionalism was halted, and open regionalism (at least, the FDI variant) has re-emerged as the main feature of ASEAN economic regionalism in the quest for growth.

³⁷ *Financial Times*, 'Foreign investors desert Southeast Asia for China, 13 October 2000.

³⁸ Interview with a senior Malaysian trade official, December 2000.

³⁹ See *Chairman's Statement, Seventh ASEAN Summit*, 11 November 2001.

⁴⁰ Press Release of the US-ASEAN Business Council, 13 September 2001.

⁴¹ See *Press Statement, Fourth AIA Council Meeting*, 14 September 2001.

Yet, it is also important to bear in mind that member governments have not agreed to implement complete regional investment liberalisation in non-manufacturing sectors anytime soon. This is targeted for 2010, suggesting that at the national level, full investment liberalisation will proceed cautiously. Domestic capital, in short, remains a key focus in the individual ASEAN economies, but support for it will likely be addressed through national instruments where possible and available rather than concerted regional ones. The regional instrument has been reserved once again to realise the FDI/growth imperative, but this is not to suggest that domestic distributive priorities have been marginalised across ASEAN. In fact, the AFTA experience confirms that the tussle between growth and domestic distribution is a key dynamic driving regional cooperation. Although not discussed in this paper, the delays in negotiating services liberalisation and Malaysia's temporary withdrawal of automobiles from AFTA disciplines further reveal that there are sectors where regional liberalisation will proceed cautiously, driven by domestic distributive priorities despite the overall concern with growth.⁴² Thus, while governments in Southeast Asia may turn to regionalism as a collective policy response to the pressures associated with globalisation, as in the case of AFTA, it remains the tussle between growth and domestic distributive imperatives that will ultimately shape regional cooperative outcomes and the precise form of regionalism.

Conclusion

Aside from its empirical insights into the dynamics of ASEAN economic regionalism in the 1990s, this paper is of wider analytical significance. Theoretically, it confirms the domestic level as a key level of analysis in explaining the relationship between globalisation and economic regionalism. Thus, regionalism may be one of three basic types, namely open regionalism, a resistance model, or a developmental version. Which project ultimately emerges is determined at the domestic level, where the domestic social and political setting mediates globalisation in significant ways. The analysis of AFTA has demonstrated that the particular domestic setting influences the way international events are interpreted by policymakers and other groups, their potential impact assessed and policy choices made. In short, while the systemic level –

⁴² This is discussed more fully in Nesadurai (2001).

globalisation – may well provide the initial trigger or impulse for regionalism, domestic political dynamics that shape the nature of domestic coalitions mediate the final outcome. It is precisely this form of interaction that gave rise to the distinct approaches to economic regionalism we have seen in ASEAN.

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