

# Regional Integration and Benefits from Foreign Direct Investment in ASEAN Economies: The Case of Viet Nam

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In recent years Viet Nam has been pursuing the twin goals of promoting inward foreign direct investment (FDI) and regional development in the context of the Association of Southeast Asian Nations (ASEAN). The paper surveys transnational corporations (TNCs) with operations in ASEAN, and finds that Viet Nam has now largely achieved its initial objective of being a major FDI recipient. The regional aspect is especially manifest in consumer electronics, although most subsidiaries in Viet Nam still perform assembly-type operations oriented toward the local market. This has to change if Viet Nam is to maintain its development momentum. Under the threat of international competition and in order to maximize the dynamic gains from FDI, Viet Nam has to reorient its policies and emphasize a shift toward targeting efficiency-seeking investments and developing more advanced links with TNC regional and global value chains. This new approach would benefit from a full-scale development of the ASEAN Free Trade Area (providing access to a regional market) and the ASEAN Investment Area (securing capabilities in Viet Nam and other ASEAN countries), as well as other regional trade and investment initiatives.

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## I. INTRODUCTION

Perhaps the most compelling reason for the Association of Southeast Asian Nations (ASEAN)<sup>1</sup> to cooperate in promoting inward foreign direct investment (FDI) is the need to enhance individual country and regional competitiveness through cooperation, thereby promoting ASEAN as an investment region—

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<sup>1</sup>ASEAN consists of ten member countries. The earlier member countries are Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand. Cambodia, Lao People's Democratic Republic (Lao PDR), Myanmar, and Viet Nam (the "new" members) joined from the mid-1990s.

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a regional model of attracting foreign direct investment. A linked reason is that, because of the region's integration process, it is natural to include investment given that trade arrangements and other aspects of economic cooperation are already part of the region's integration agenda. Clearly investment cooperation is a subset of a larger set of regional integration arrangements, but one that can help strengthen the overall integration process. The value of these arrangements, however, depends on the degree to which FDI and transnational corporations' (TNCs) regional operation strategies are centered on (or are evolving toward) using combined regional locational advantages (differential levels of resources, human capital, cheap labor, and markets in an area of 450 million people) to create value chains across the region (and beyond).<sup>2</sup>

This paper addresses two issues. First, it assesses the extent to which Viet Nam, as a new member of ASEAN,<sup>3</sup> has been drawn into the trade and investment nexus in Southeast Asia and, in particular, the regional and global value chains established by TNCs (Section III). Second, it assesses whether Viet Nam should deepen and widen this process, in order to potentially secure greater net gains from inward FDI; and, if so, how should it proceed (Section IV). These two issues are analyzed using both secondary data and some of the results of a recent research project called the Bradford study, conducted by the authors and other colleagues (Mirza et al. 2003), one aim of which was specifically to look at the lessons for the newer ASEAN member countries based on experiences of the older member countries. The Bradford study's methodology is introduced in the next section, prior to the analyses for Viet Nam in Sections III and IV. The final section concludes with implications and policy recommendations.

## II. PROJECT METHODOLOGY

Foreign direct investment impacts on the growth and development of host countries in a variety of ways (UNCTAD 1999, Giroud 2003), ranging from "direct effects" on employment and training; through classical "multiplier effects" (e.g., workers use their wages to buy goods, which stimulates other industries) to

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<sup>2</sup>The "AFTA effect" has also eased the trend toward greater investment cooperation. The ASEAN Free Trade Area allows a member country with a restrictive investment regime to still be serviced through trade routes by a TNC producing in another country and exporting to the former. Under such conditions, the economic argument for protecting or restricting investment flows to a certain industry or country becomes weak. If an industry or a country's market can be serviced through trade routes then there is little point in restricting FDI flow. This realization has made ASEAN countries more receptive toward investment cooperation.

<sup>3</sup>In this respect, this analysis on Viet Nam could also be extended to other new ASEAN member countries (albeit there are significant differences between Cambodia, Lao PDR, Myanmar, and Viet Nam); and, possibly, countries joining other established regional groupings.

“spillover” effects whereby indigenous firms acquire knowledge and technology from foreign firms through a variety of transmission mechanisms (for further discussion of these effects, see Section IV.C). In this context, the ASEAN region is a prime target for investigating FDI impact because it has been a major and successful recipient of investment by TNCs for three decades, albeit the scale of inward FDI flows has declined in recent years. This was the fundamental justification for the Bradford study. One of the prospects afforded by looking at FDI in ASEAN as a whole was the opportunity to examine how the regional aspect impacted on newer member countries such as Viet Nam, both in terms of direct economic consequences (such as incorporation into the regional value chains of TNCs) and indirect benefits, principally, as the project was designed, with regard to the lessons that could be learned from the experience of older member countries.

The Bradford study was divided into two parts. The macro part was an econometric assessment of the *degree* to which FDI has resulted in growth and poverty reduction in ASEAN countries. This part of the study will be alluded to in Section IV,<sup>4</sup> but the main focus of the present paper will be on the micro part of the Bradford study, which examined the *detail* of FDI impact by interviewing top executives at TNC subsidiaries in a number of ASEAN countries. The principal issues discussed in the interviews included the overall scale and configuration of subsidiary activity, international and regional integration, the subsidiaries’ role in the local economy, human resource development, and future intentions in ASEAN. Both objective and subjective data were collected. Operational data were collected, some from secondary sources.

The Bradford study used a semistructured questionnaire to interview managers in five ASEAN countries, namely Cambodia, Malaysia, Singapore, Thailand, and Viet Nam. The questionnaire was structured in the sense that it was very detailed and had about 60 principal questions, with a number of subquestions and options. However, the interviewees were given the opportunity to mention, discuss, and elaborate on issues beyond the strict rubric of the formal questions (hence “semistructured”). A number of variants of the questionnaire were used, especially for Singapore where most firms interviewed were regional headquarter companies (RHQs). The firms selected for interview were chosen using the following criteria:

- (i) *Industry*: Firms engaged in electronics/electrical and garments/textiles products (a few firms in other industries were selected as a control group and by way of comparison).
- (ii) *Origins*: Non-ASEAN TNCs, ASEAN TNCs, and indigenous firms (the indigenous companies represented both a control group and a

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<sup>4</sup>See Mirza et al. (2003, section 3) for a full discussion of the findings of the micro study.

way of comparing competitors—and thereby competitive effects—in selected products).

- (iii) *Size:* Appropriate levels of small to large measured by number of employees and capital.
- (iv) *Locations:* Penang, Kuala Lumpur, and Selangor (Malaysia); Central Region, including Bangkok (Thailand); Hanoi and Ho Chi Minh City (Viet Nam); Phnom Penh (Cambodia); and Singapore. These choices reflect the location of significant numbers of firms, sites of partner institutions, and practical issues.

A mix of stratified and purposive sampling was used. The proportions of firms selected by industry, source etc. thus reflect the size and rankings of TNC activity in most respects in each host country. The number of firms interviewed in each host country was based on (i) the relative size of FDI in each country; (ii) the time available for fieldwork and other resources; and (iii) other considerations, e.g., the fact that Singapore was in the frame mainly because it was host to most RHQs in ASEAN. The interviews took place during a number of field trips made by the researchers over about a year from late 2001 to the start of 2003. The interviews were, normally, two to two-and-a-half hours in length, though a small number were shorter and some much longer. The number of interviewees varied, but in most cases the chief executive officer, managing director, or equivalent top executive with a sufficient oversight of the subsidiaries' overall activities participated in the interview.

A total of 113 companies were interviewed. A number of these companies were “pure” RHQ firms, i.e., they had no manufacturing activities whatsoever (although others were also engaged in manufacturing). In addition 10 companies interviewed were indigenous firms (normally direct competitors with one or more TNC subsidiaries in the sample), and for comparison, some firms came from other industries (e.g., two automakers in Thailand). Table 1 indicates the main characteristics and most of the quantitative information of 88 manufacturing companies in the five host countries and four industries surveyed. The subsidiary companies interviewed are dispersed by source, although most are from Europe; Japan; Taipei, China; and United States (US), in line with the overall shares of inward FDI by source in ASEAN. Most companies were established before 1996, which means that the companies interviewed have been some time in ASEAN and about a half of the parent TNCs have more than one subsidiary in the host country in which the interview took place. In other words there is a reasonable history, experience, and scale to the investments.

Viet Nam is used as a suitable case study in this paper because the sample size is reasonable. Twenty-five percent of the subsidiaries interviewed are in Viet Nam. Meanwhile, because a similar number of firms were interviewed in Malaysia and Thailand (31 and 28 percent respectively), some useful comparisons

and assessment of lessons from the ASEAN experience can be made for Viet Nam. Malaysia and Thailand also represent the closest models in ASEAN for new member countries such as Viet Nam to follow and can be regarded as “exemplars.” Both countries resemble Viet Nam in many respects, especially Thailand, in terms of development and economic characteristics (e.g., a substantial initial pool of trained and untrained labor). Both are not “too” far ahead in terms of GDP

Table 1. **Characteristics of Interviewed Manufacturing Companies (N=88) by Country of Ownership, Destination, Period of Establishment, and Degree of Parent Company Involvement**

Characteristic		Respondents (percent)	Comments
Country of Origin (number of firms and percent)	US	12 (14%)	Concentrated in Malaysia (7 out of 12)
	Japan	27 (31%)	Fairly equally dispersed between Malaysia (10), Thailand (9), and Viet Nam (7)
	Europe	11 (12%)	Biggest number in Malaysia (5)
	Taipei, China	11 (12%)	Fairly equally dispersed between Malaysia (2), Thailand (4), Viet Nam (3), and Cambodia (2)
	Hong Kong, China	8 (9%)	Fairly equally dispersed between Thailand (3), Viet Nam (2), and Cambodia (2)
	Singapore	4 (4%)	Entirely in Cambodia (3) and Viet Nam (1)
	Korea, Rep. of	6 (7%)	Biggest number in Viet Nam (3)
	Other	2 (2%)	Both in Viet Nam
		7 (8%)	Biggest number in Thailand (4)
Host Country	Malaysia	27 (31%)	Mostly in EE (18) and CE (7)
	Thailand	25 (28%)	Mostly in EE (16) and CE (5)
	Viet Nam	22 (25%)	Mostly in CE (8) and G (8)
	Cambodia	11 (12%)	Entirely in G (11)
	Singapore	3 (3%)	Entirely in EE (3)
Date Firms Started Operations (number/percent)	Before 1980	14 (16%)	67% of firms in Singapore commenced operations before 1980; 33% in Malaysia
	1980-1985	8 (9%)	16% of firms in Thailand commenced operations
	1986-1990	20 (23%)	Big growth years in Malaysia (37% established in this period) and Thailand (36%)
	1991-1995	19 (22%)	Growth years in Thailand (16%), Viet Nam (45%), and Cambodia (27%)
	1996-2000	19 (22%)	Growth years in Thailand (16%), Viet Nam (27%), and Cambodia (54%)
	2001 or 2002	8 (9%)	Continuing expansion in Viet Nam (23%) and Cambodia (18%)

*continued.*

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Table 1. *continued.*

Characteristic	Respondents (percent)	Comments
Mean Ownership Share (percent)	86%	Most companies (57) are wholly owned by the foreign company; only 9% are minority owned. The mean ownership by source country in reverse order is: Europe (99%), US (94%), Japan (84%), NIEs (82%); ASEAN (77%); Other (77%)
Number of Companies Owned by Foreign Parent in Host Country	1  Over 1	47  41
		Nearly a half of parent companies have additional companies in the host country in which they are invested. This is the case for more than a half of Japanese parents (17 out of 27). Multiple companies are more common in Malaysia (17 out of 27) and Thailand (16 out of 25), reflecting longer periods of establishment.

Note: CE = Consumer Electronics; EE = Electrical and Electronics; G = Garments; T = Textiles; NIEs = Newly Industrialized Economies (Hong Kong, China; Republic of Korea; Taipei, China).  
Source: Mirza et al. (2003).

per capita or other unique characteristics (unlike Brunei and Singapore). Malaysia and Thailand also possess substantial FDI in a range of industries, a path that Viet Nam is emulating, as Section III shows (unlike Cambodia, Lao PDR, and Myanmar, the other new ASEAN member countries). Finally, both Malaysia and Thailand are relatively successful in attracting, retaining, and benefiting from FDI (unlike, certainly recently, Indonesia and the Philippines).<sup>5</sup>

### III. INTEGRATION OF TNCs' REGIONAL AND GLOBAL PRODUCTION NETWORKS IN ASEAN

The influence of TNCs on ASEAN's development is undeniable, not only because of the activities they conduct within each individual country, but also through their regional and international network of internalized and externalized relationships. In this section, we look at the connections between the organizational and geographical dimensions of activities of TNCs located in the five countries under study, taking regional and global dimensions into consideration. When considering TNCs' geographic configuration in ASEAN, one needs to understand different locational advantages that a country may offer, which might explain the dispersion of TNCs' functional activities, as well as the complex inter-

<sup>5</sup>See Mirza et al. (2003) for further a comparison of Viet Nam with the other ASEAN economies.

relationships established between various entities of the same company. External relationships are also substantial across the region, even though the boundaries between activities internal and external to the firm have become blurred (Dicken and Malmberg 2001). Transnational companies have created a web of relationships with suppliers and customers throughout the region, thus further contributing to the development of regional firms and strengthening the activities of foreign firms established in ASEAN.

Because countries in ASEAN show varying levels of development and locational advantages, their experiences with TNCs activities differ. For instance, Viet Nam started welcoming FDI later than some of its neighboring countries. While early investment in ASEAN tended to be production-related to take advantage of the low-cost labor in the region, by the 1990s, many subsidiaries in the region have strengthened their capabilities and became centers of excellence, moving toward more technology-intensive activities in some sectors. Recently, TNCs have started to integrate their operations worldwide and concentrate activities in well-selected locations. The process of integration among these key locations within the overall global value chain is key to TNCs' competitiveness. In ASEAN, integrated plants are now replacing screwdriver plants, which previously received semifinished parts from parent companies for assembly. Integrated plants either produce parts and components in-house, or purchase them from sister companies or local producers in the region, thereby creating a complex network of internal and external relationships.

These recent trends can be summarized, first, by the fact that TNCs selectively locate specific subsidiaries across ASEAN depending on the locational advantages of host economies (e.g., factors appropriate to particular functional areas); and second, by the intricate internal and external relationships created on a national and regional basis, as well as corporate global links. These regional links have been formed over time, with a hierarchical nature of inward investment starting with Singapore, followed by Malaysia, Thailand, and Indonesia; and finally countries newly opened to FDI, such as Viet Nam. Market penetration reflects this pattern, with companies gradually enhancing subsidiaries' activities in more developed countries of the region. For this reason, numerous TNCs have located their RHQs in Singapore (Airriess 2001). In the electronics sector, some subsidiaries have opened research and development (R&D) centers in Malaysia and Thailand.<sup>6</sup> Companies in the survey discussed a gradual development from being purely manufacturing subsidiaries until small production-related R&D centers could be developed in-house. The type of activities conducted in subsidiaries in Viet Nam, and even more so in Cambodia, however, remain basic assembly-type operations. In parallel to the specificities of activities in individual countries, busi-

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<sup>6</sup>This partly makes up for the fact that foreign firms appear to undertake less R&D than local firms, as in the case of Thailand (ADB 2004, 228).

ness networks by TNCs have developed over time across the region. For instance, many RHQs located in Singapore maintain strong relationships with other subsidiaries of the same company in the region, because they often oversee activities such as supply and marketing. This regional orientation of firms and subsequent creation of networks is well documented in the literature, particularly in the electronics industry (UNCTAD 1993, Dobson and Chia 1997, Borrus et al. 2000, Legewie and Meyer-Ohle 2000, Sturgeon 2002, Giroud 2004). TNCs upgrade their technologies in certain subsidiaries, which might be beneficial to other subsidiaries in the region, as is the case for Japanese electronics firms in East Asia (Song 2002), and companies in the automobile industry (Japan Research Institute Limited 2001). The subsequent investment pattern is beneficial for host countries' development (Ito and Krueger 2000). While the development of regional production networks has been observed and studied in the case of the electronics sector in Asia (see for instance Wong 1997, Richter 1999, Borrus et al. 2000), the configuration of the production chain in the textiles and garment sectors differs. The garments industry remains more fragmented organizationally and is less sophisticated technologically than the textiles industry (Dicken 2003, 318); and neither industry portrays a regionalization of operations within Southeast Asia akin to that witnessed in the electronics industry. The textiles and garments industries are dominated by international subcontracting arrangements; additionally, the production chain is fragmented according to materials, processes, and end uses, each of which is often located in various parts of the world, depending on the level of development of countries. In Southeast Asia, manufacturing in the sector is highly labor-intensive, particularly so in newly developing economies such as Viet Nam. In choosing locations, companies pay attention not only to low labor costs, but also to orientation of specific markets and international trading agreements. Some regional production networks within Southeast Asia do occur, largely thanks to the investments made in Cambodia and Viet Nam by companies originating from Indonesia, Malaysia, Singapore, and Thailand.

In line with the emergence of regional production networks by TNCs, recent trends in FDI and trade indicate how closely integrated economies in Southeast Asia have become, particularly so in Viet Nam. Intra-ASEAN investment flows represent a mere 10 percent of overall flows in the region (see Table 2). Thus, the share of intraregional investment within total inflows in ASEAN countries remains limited, but increased to 17 percent in 2002 (UNCTAD 2003, 46), reflecting the continuing improvement in the private sector's recovery from the Asian crisis and deepening regional integration. Flows of FDI to ASEAN have increased particularly after the signing of AFTA. The experience of individual economies within this regional integration differs widely. Viet Nam, for instance, distinguishes itself inasmuch as over one fifth of investment inflows are intraregional flows. Viet Nam is attractive because of its large population, political stability, and diversified industrial base. The majority of intraregional inflows

originate from indigenous firms and foreign firms based in Singapore, Malaysia, and Thailand. Overall, over two thirds of all investment inflows in Viet Nam comes from East Asia (ASEAN; People's Republic of China [PRC]; Japan; Republic of Korea [Korea]; Hong Kong, China; and Taipei, China), and over 90 percent of manufacturing FDI comes from companies based in East Asian economies. Viet Nam's clear regional integration with neighboring countries and other Asian countries reflects the nature of the global and regional economy into which the country emerged in the 1990s (Krumm and Kharas 2003), attracting both East Asian TNCs and non-Asian TNCs located in countries in the region and integrating Viet Nam within their regional operations.

Table 2. Foreign Direct Investment Flows in ASEAN  
(BOP Basis, US\$ million, and percentages)

	As Host Countries				As Home Countries			
	Total Inflows (1995)	Intra-Regional Flows (share of total)	Total Inflows, 2001	Intra-Regional Flows (%)	Total Inflows, 1995-2001	Intra-Regional Flows (%)	Total Outflows to other ASEAN, 1995-01	Share in Intra-ASEAN Inflows
Brunei	582.76	53.42	526.44	2.01	4,334	30.1	244.12	1.60
Cambodia	150.70	-	112.90	-	1,101	-	5.79	0.04
Indonesia	4,346.00	14.01	(3,278.53)	(7.32)	4,288	3.2	1,179.13	7.73
Laos	88.40	7.39	23.90	12.80	458	54.5	10.03	0.07
Malaysia	5,815.00	28.83	553.95	14.44	12,264	19.7	2,190.48	14.36
Myanmar	317.60	30.45	192.01	35.08	3,164	31.1	19.21	0.13
Philippines	1,577.00	15.32	1,049.00	21.19	10,115	10.1	236.32	1.55
Singapore	9,686.20	8.21	8,583.10	(2.02)	66,142	4.2	9,936.68	65.13
Thailand	2,004.04	8.01	3,780.45	42.49	28,545	13.6	1,419.83	9.31
Viet Nam	1,780.40	21.75	1,300.27	18.57	11,944	20.0	15.12	0.10
Total ASEAN	23,540.09	14.94	10,352.17	9.01	142,358	10.7	15,256.71	100.00

Note: Figures for Malaysia include reinvestment earnings; figures for 1995-2001 include total cumulative figure, and excludes data on FDI in Cambodia.

Source: ASEAN Secretariat.

The country-specific advantages presented by Viet Nam has allowed it to distinguish itself from other countries in the region, and it has succeeded in attracting substantial investment, following a path similar to that experienced by Malaysia and Thailand in the early 1990s. Viet Nam established itself as a major host by attracting more investment than other emerging economies in the region in the late 1990s, overtaking Indonesia and the Philippines. By 2002, Viet Nam was the third largest recipient of FDI flows in ASEAN, behind Singapore and Malaysia, strengthening its position as a significant investment base (UNCTAD 2003). Viet Nam has therefore achieved a key position both in terms of prime investment host within the region, and as a recipient of intraregional inflows. The case of Viet Nam also stands out because its economy is interlinked with that of neighbor-

ing economies through intraregional trade (Sakakibara and Yamakawa 2003b). Asia as a whole represents 42 percent of Viet Nam's total merchandise exports and 78 percent of the country's merchandise imports (ADB 2003).

Singapore is a key partner to Viet Nam, second to Japan in terms of export and first in terms of imports. Viet Nam's export success is due, to a large part, to its textiles and garment industry (Hill 2000), and has mostly occurred after the *Doi Moi* reform process (Cooper 2002, Gates 2000). Regional integration through trade has taken place throughout ASEAN. Intraregional exports doubled during the last decade, up from over US\$43 billion in 1993 to over US\$70 billion in 1995 and US\$84 billion in 2001. Similarly, intraregional imports have nearly doubled, from US\$37 billion in 1993 to US\$53 billion in 1995 and US\$38 billion in 2001. (There has been a recent reversal, however, which probably will not be permanent; see Section IV.B.)

At a firm level, the Bradford database (Mirza et al. 2003) allows analysis of the integration of TNCs' activities internationally and regionally. In terms of scale of activities, subsidiaries had on average more factories in Malaysia and Thailand (2.19 and 2.36 factories, respectively). The smallest number of factories was found in Singapore where companies did not necessarily have a factory, but where operations were sometimes purely administrative. Similarly, the largest factories (in terms of number of employees) were found in Malaysia and Thailand. Subsidiaries in the electrical and electronics industry and in the textiles industry are larger than those in the garments industry. Although more than a third of companies in the sample subdivide activities worldwide on a regional basis, only 14 subsidiaries mentioned that their parent company considered ASEAN as a distinct region. Of these, 12 had their RHQs located in Singapore.<sup>7</sup> Many companies include ASEAN within a wider regional context, and include other Asian and Pacific countries in their subdivision of operations. Out of 55 firms with operations in more than one ASEAN country, 31 indicated a moderate to very close integration of activities across regional operations. Regional integration is highest in the case of companies with their headquarters in ASEAN (average integration in this case is 4.5 on a scale of 5), and is the lowest for companies with their headquarters in other East Asian economies or Japan. When it comes to roles of subsidiaries and their capacity to interact with sister companies, firms in the electrical and electronics sector often have a key strategic role, whereas this is less the case in the garments and textiles industries. Slightly more than half of the TNCs in the Mirza et al. (2003) study are manufacturing platforms and perform no other strategic function. These subsidiaries are closely dependent on their parent firm and/or the RHQs for strategic decisions. Over two thirds of subsidiaries in the textile and garment industry have no strategic role and merely manufacture the goods, against only two fifths in

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<sup>7</sup>Singapore is attractive to higher value-added type of activities and hosts many of the RHQs in the region.

the electrical and electronics industry. In line with the investment and development path, only 40 percent of subsidiaries in Malaysia and Thailand solely perform manufacturing activities. One fifth of subsidiaries in these two ASEAN countries have in-house R&D facilities, and in Malaysia another fifth are completely autonomous subsidiaries. The picture is very different in Cambodia and Viet Nam, where over three quarters of subsidiaries only perform a pure manufacturing base function. Looking into the range of activities and integration on a regional basis highlights the different levels of development and investment experience. Singapore has undoubtedly established itself as a developed economy and attracts high value-added activities. Many subsidiaries in Malaysia and Thailand have succeeded in establishing themselves as centers of excellence within their company's global activities. Subsidiaries in Viet Nam and Cambodia remain manufacturing platforms. Yet, as mentioned above, Viet Nam is following Malaysia and Thailand closely and is fast becoming a major investment recipient in the region, because of its country-specific advantages, recent international trading agreements, and regional integration.

Regional integration further occurs through trade, and Table 3 illustrates trade patterns by subsidiaries on a global and regional basis. Figures indicate where subsidiaries' outputs are sold and where their inputs originate. The geographical destination and origin are presented as a share of total exports or imports and local trade is taken into consideration, showing the depth of relationships established by subsidiaries within host economies. Overall, 28 percent of outputs from subsidiaries in ASEAN is sold in the local market, and just over a quarter of all inputs are purchased locally.<sup>8</sup> By combining shares of the local market and ASEAN, it appears that only 35 percent of output manufactured by foreign subsidiaries remains in the region, and even then part of this is aimed at companies that will integrate the input to export the final products to markets outside of ASEAN. The major markets for products are the developed markets of Europe, Japan, and North America. Slightly more regional integration takes place in terms of input, as overall 39 percent originate from either the local market or regional markets. In this case, nonregional imports originate primarily from neighboring East Asia and Japan. This reflects the position of subsidiaries in ASEAN within the global chain of activities of their firm, with strong dependence on Asia for the upstream activities and final markets primarily in the West.

Taking the specific case of Viet Nam allows analyzing trends in more detail. Viet Nam differs from Malaysia and Thailand in the configuration of subsidiaries' activities. First, as much as 40 percent of foreign subsidiaries' output is sold locally in Viet Nam, while the shares are lower for the other two countries. Second, foreign subsidiaries in Viet Nam rely less on local supplies than their

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<sup>8</sup>Although part of these purchases in the local economy often take place among foreign subsidiaries, as opposed to purchase from locally owned firms.

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counterparts in Malaysia and Thailand, but import more from neighboring ASEAN countries. These trends reflect the low level of component production in Viet Nam, the market orientation of some foreign firms in the country, and the nature of the textile and garment industry (as half of the firms in the sample are in this industry). The regional dependence of foreign subsidiaries in Viet Nam for their upstream activities shows that the major sources of imports are East Asia (30 percent of inputs), Japan (14 percent), and ASEAN (23 percent). East Asia is a significant source of inputs for Cambodia and Thailand; while local/ASEAN inputs are more important for Singapore and Malaysia. Viet Nam is balanced in terms of the proportion of ASEAN and East Asian inputs, probably because it is a major site for cheap but skilled labor for export-oriented industries of TNCs based in both ASEAN and the rest of East Asia. The size of its population and its location between ASEAN and southern PRC are probably also factors. The activities of TNCs in Viet Nam are therefore closely related to firms in Asia and ASEAN in particular, and trends indicate that the country is strengthening its position as an investment recipient. The close upstream integration of activities indicate that Viet Nam does benefit from early development of countries in the region, where foreign subsidiaries are already in operation and where local economies are comparatively more developed.

**Table 3. Direction of Outputs/Exports and Direction of Inputs/Imports of Interviewed Firms (percentage share)**

Survey Country	Direction of Interviewed Firms						
	Local	ASEAN	Japan	East Asia	Europe	North America	Rest of the World
Total Outputs/Exports (100%)	28	7	13	8	20	22	4
Singapore	40	10	0	20	10	20	0
Malaysia	29	7	10	8	20	23	3
Thailand	26	13	14	8	14	23	2
Viet Nam	40	2	21	8	10	13	10
Cambodia	0	0	1	5	57	36	0
Total Inputs/Imports (100%)	26	13	15	29	7	7	3
Singapore	2	40	5	2	10	0	40
Malaysia	35	8	22	11	13	11	0
Thailand	35	1	18	25	3	16	2
Viet Nam	20	23	14	30	7	0	6
Cambodia	0	18	0	82	0	0	0

Notes: Export requirements are imposed by governments on 57 percent of companies, but this tends to reflect their intended output orientation in any case. Local content requirements are imposed by governments on 8 percent of companies.

Source: Mirza et al. (2003).

As a conclusion to this section, while global factors need to be taken into consideration, one should not underestimate the central role of geography in the

determination of overall scale of FDI and dispersal of industries.<sup>9</sup> Investment location and strategies differ depending on the industry concerned, and as results from Mirza et al. (2003) have shown, subsidiaries have located in specific countries and regions, establishing themselves within a series of global and regional value chains. Viet Nam has substantially benefited from its position within ASEAN and Asia as a whole.

#### **IV. DEEPENING VIET NAM'S INTEGRATION INTO TNC REGIONAL AND GLOBAL PRODUCTION NETWORKS**

As the previous section shows, Asia and ASEAN account for a preponderant share of Viet Nam's international trade and inward investment, with over a third of recent FDI coming from East Asian economies (especially Hong Kong, China; Japan; Korea; and Taipei, China) and up to a quarter from ASEAN neighbors (chiefly Malaysia and Singapore). A considerable number of the operations established by companies based in ASEAN countries are "grandchildren" subsidiaries of TNCs whose ultimate headquarters are located elsewhere in the world. Thus, subsidiaries in Viet Nam are integrated into the global and regional value chains of firms, although, to date, most foreign subsidiaries continue to perform simple assembly-type manufacturing activities. That said, the above analysis of TNCs' global and regional activities suggests that further, potentially beneficial interrelationships across borders are eminently achievable. If Viet Nam is to further pursue this course of action, however, it needs to address a number of key issues: first, to what extent is Viet Nam able to continue to attract investment; second, how should such a strategy interface with that of its neighbors, especially in a regional context; and, finally, *should* it pursue this course (in other words how would increased FDI be beneficial to Viet Nam's economy)? These three questions are examined in Sections IV.A to IV.C below.

##### **A. Viet Nam's Competitive Position in Attracting FDI**

It might seem strange to query Viet Nam's attractiveness to TNCs, especially given the rapid rise and scale of inward FDI (Section III). However, bearing in mind that 40 percent of output by companies in Viet Nam is sold locally (Table 3), it is worth investigating the motivation of companies investing in the country and the consequent implications for competitive positioning. Table 4 suggests that, if we leave aside the broadly neutral reasons (e.g., political stability), then only 14 percent of the remaining reasons for investing in Viet Nam can be regarded as broadly "efficiency seeking" (i.e., using cheap local factors to service

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<sup>9</sup>Jovanovic (2003) makes this point in his discussion of the significance of location, international/regional division of labor, and comparative advantage.

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regional and global markets), whereas a full 45 percent of the reasons are “market seeking.” The other motives are “mixed” and can be either efficiency or market seeking, depending on contingencies. By contrast, 30 percent of the non-neutral reasons for investing in Malaysia are efficiency seeking and 21 percent for Thailand (in fact 55 percent of the reasons for investing in Thailand are market seeking, but the country differs from Viet Nam in being relatively advanced, with a diversity of industries).

Table 4. Reasons for Investing in Selected ASEAN Host Countries

		Viet Nam		Malaysia		Thailand	
Type of Reason / Reason		Number	Percent	Number	Percent	Number	Percent
Broadly Efficiency Seeking	International trading systems	1	1.6	2	3.0	1	1.5
	Low production costs	1	1.6	3	4.5	0	0.0
	Good infrastructure	0	0.0	5	7.5	0	0.0
	Regional dynamics/prospects	1	1.6	1	1.5	2	3.0
	Regional penetration (including intraregional relocation)	0	0.0	1	1.5	0	0.0
	Rationalization/reorganization policy	1	1.6	1	1.5	4	6.0
Mixed	Labor-related issues (cost, quality, capability development)	15	24.2	8	11.9	15	22.4
	Language ability	1	1.6	4	6.0	0	0.0
	Follow competitors	1	1.6	2	3.0	1	1.5
Broadly Market Seeking	Growth rates	0	0.0	0	0.0	0	0.0
	Size of the local market	9	14.5	6	9.0	3	4.5
	Sociocultural issues	0	0.0	0	0.0	3	4.5
	Gain local market share	1	1.6	1	1.5	1	1.5
	Follow customers	0	0.0	5	7.5	4	6.0
	Customer recommendation/decision	1	1.6	1	1.5	1	1.5
	Brand building	0	0.0	1	1.5	0	0.0
	Prior business contacts (OEM or other)	8	12.9	4	6.0	6	9.0
Broadly Neutral	Government incentives/policies	10	16.1	9	13.4	12	17.9
	Political stability	2	3.2	4	6.0	4	6.0
	Economic stability	2	3.2	5	7.5	4	6.0
	Other	6	9.7	3	4.5	4	6.0
	Total	62	100.0	67	100.0	67	100.0

Note: Multiple responses apply: each firm was asked to give up to three reasons for investing in the host country.  
Source: Mirza et al. (2003).

The reason why the distinction between efficiency and market seeking investments, albeit imperfect, is important is because there is ample evidence that efficiency seeking FDI is more likely to have a positive long-term impact on the host economy. For example, in a very large-scale recent study by the McKinsey Global Institute that surveyed four major developing countries (Brazil, PRC, India, and Mexico) and five important sectors (automotives, consumer electronics,

food retail, retail banking, and information technology/business process offshoring), it was found that efficiency-seeking investment “overwhelmingly” had a positive impact on the host country (McKinsey Global Institute 2003). The impact of market seeking investments is more mixed. The econometric, macro part of the Bradford study found a strong link between FDI and growth in the older ASEAN member countries, as well as a strong, unambiguous, direct link between FDI and poverty reduction (Mirza et al. 2003, section 3). One of the reasons for this is the preponderance of efficiency-seeking investments in ASEAN countries such as Malaysia, Singapore, and Thailand.

The negative implications of market seeking investments in Viet Nam, especially because of its early stage of development, can also be underscored by examining the TNC subsidiaries interviewed in Viet Nam during the micro part of the study. Of the 22 firms in the sample; eight were in garments (an export-oriented industry, but prone to severe competition from many other developing countries); and eight in consumer electronics. All of the latter were oriented toward the limited<sup>10</sup> local market; all firms imported inputs that were further assembled or processed for domestic sale (the scale of the market was deemed too small to justify the production of local inputs); and most were worried about the quantity and quality of trained labor, especially management. On the positive side, a number were joint ventures with local companies, which encourages a degree of local learning. The Multilateral Investment Guarantee Agency came to similar conclusions about Viet Nam’s consumer electronics industry, stressing that the supplier industry is underdeveloped, locally secured parts are of poor quality, and higher level managers and technicians are in short supply (MIGA 2003, 40-1). In other words, a million unit strong market for products such as TVs (unaffordable for most individual households) does not encourage significant investment; diversification of the industry; or other positive impacts on sector productivity, output, and employment. In fact, consumer electronics and similar fledgling industries in Viet Nam are threatened on a number of fronts: for example by both the scale economies of PRC-based industries and the increasingly innovation-led growth models being adopted by ASEAN neighbors such as Malaysia (MIGA 2003, Boston Consulting Group 2004).

Of course, the situation for Viet Nam is not unremittingly negative. Sample firms stressed the relatively high education levels and quality of Vietnamese workers and recognized how far they and the country had come in a short time (a little over a decade). One interviewee, who has 20 years experience in Asia, including in Cambodia, PRC, Philippines, and Viet Nam remarked that the quality and productivity awareness of Vietnamese workers is higher than any other developing Asian country, including People’s Republic of China. Other firms

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<sup>10</sup>That is, local incomes are very low.

interviewed in Viet Nam shared this view. Moreover, a country's competitive position is the result of a variety of factors, and with Viet Nam they are in its favor. Using an intensive range of measures, Kearney (2004) rated Viet Nam as 20<sup>th</sup> most attractive in its offshore location index, not a bad result, although key potential competitors for FDI fared better: India and the PRC at 1<sup>st</sup> and 2<sup>nd</sup>, respectively, in the survey; while ASEAN neighbors such as Malaysia, Philippines, Singapore, and Thailand are positioned, in order, 3<sup>rd</sup>, 5<sup>th</sup>, 6<sup>th</sup>, and 13<sup>th</sup>. Most importantly, the survey helps to identify key areas for improvement if Viet Nam is to enhance its competitive positioning vis-à-vis other countries. In the survey, although the country came 2<sup>nd</sup> in terms of "financial infrastructure" (compensation costs, infrastructure costs, tax, and regulatory environment), it scored 25<sup>th</sup> and 24<sup>th</sup> respectively in "people skills and availability" and "business environment." Essentially, Viet Nam has to put a lot of effort into improving capabilities and attributes such as developing a sizeable, quality labor force; business process experience and skills; government support for key industries; and security of intellectual property, especially if it intends to concentrate future efforts on encouraging inward efficiency-seeking foreign direct investment. Moreover, fortune may be smiling on Viet Nam. Given a likely upturn in FDI flows over the next few years (according to a recent survey, UNCTAD 2004), this could well be an opportune moment for Vietnam to pursue this new stage in its development. Certainly, as increasing numbers of low-income countries enter the world economy, economic development posited on cheap, low-skilled labor is no longer a viable option for Viet Nam.

## **B. Viet Nam and Regional Developments**

Interestingly, while Viet Nam's small market size implies that the country should primarily focus on attracting efficiency-seeking FDI, the market toward which goods (industrial and consumer) are oriented *is* an issue. In the past, efficiency-seeking investments were frequently focused toward sales in industrialized international markets such as Europe, Japan, or North America, (indeed about 60 percent of output from firms in the Bradford sample go to these markets, as indicated in Table 3). However this is changing, partly because of the development of local or regional value chains (e.g., the hard disk industry in ASEAN; see McKendrick et al. 2000, Gourevitch and Bohn 2000), but more importantly because of TNC entry or expansion into other competitive *and* populous developing countries such as Brazil, PRC, India, and Mexico (McKinsey 2003). The Boston Consulting Group (2004, 16) reminds us, "...although the cost advantage remains the key driver of globalisation, in recent years it has been reinforced...by two other major factors. First [low-cost countries'] internal markets have matured into attractive, fast-growing markets, providing a powerful incentive for companies to invest locally. Second, capabilities in [low-cost countries] have greatly improved...."

Nowhere is this situation more evident than in the PRC (Boston Consulting Group 2003), a country on Viet Nam's doorstep, with which the country has to compete in terms of potential market and capabilities. In this respect, Viet Nam's position in ASEAN can be a major help, both in terms of market (the ASEAN Free Trade Area [AFTA]) and capabilities (the ASEAN Investment Area and consequent links into regional capabilities through TNC value chains).

In 2003 McKinsey conducted a major study of the competitiveness of Southeast Asian economies on behalf of ASEAN, a synopsis of which has appeared in the *McKinsey Quarterly* (Schwarz and Villinger 2004). McKinsey concluded, along with many other commentators, that Southeast Asia had a lot of factors going for it, including a population of 560 million people, vast natural resources, highly skilled workers, and export-oriented industries in medium- to high-technology sectors. However, the region continues to rely on the cost advantage it once enjoyed (but no longer does with respect to countries such as the PRC and India) without securing either or both of a *market access advantage* (i.e., TNCs keen to serve local markets; indeed intraregional trade as a share of total trade has fallen by 19 percent over the last decade; see Schwarz and Villinger 2004); or a recognized regionwide *capabilities advantage* to any degree (despite highly skilled workforces in Malaysia, Singapore, Thailand, and in pockets elsewhere in the region). The reasons for the former include subscale markets despite AFTA; unnecessary costs (especially different product standards across countries); and volatile rule implementation (the AFTA tariff rates are now very low, mostly between 0 and 5 percent, but these are not complied with by officials, because of ignorance, lack of training, or willfulness). ASEAN remains fragmented as a market.

In response to the study, in October 2003 ASEAN countries—including Viet Nam—endorsed an accord to create a single market (the ASEAN Economic Community [AEC]) by 2020, starting with a push in priority areas. The initial benefits of a fully implemented AFTA or AEC for Viet Nam are likely to be modest because of Viet Nam's small share of trade with ASEAN (Sakakibara and Yamakawa 2003a, 55), but these are likely to grow over time. In addition, Viet Nam is pursuing a number of other strategies to improve its market asset advantage, both in partnership with ASEAN and unilaterally. A number of free trade agreements (FTAs) are in the process of being negotiated by ASEAN with key neighbors, including PRC, India, and Japan. The ones with the PRC and Japan are most advanced. The most important is probably the ASEAN-PRC FTA, which secures "market advantage" access to the PRC's market for Viet Nam and its regional partners, and illustrates that relations between developing countries and regions need not be competitive. It is estimated that the ASEAN-PRC FTA will increase ASEAN's gross national product by 1 percent, and the PRC's by 0.3 percent, in the short term. In addition, Viet Nam is pursuing a number of bilateral deals, from the recently agreed FTA with Japan to more modest agreements with

other countries, including the PRC and Korea (for further discussion on ASEAN and Viet Nam's regional agreements see Wee and Mirza 2004). Viet Nam is advantageously located geographically between the ASEAN bloc of countries (to the west) and other East Asian countries (to the east and north), most especially People's Republic of China. This may allow it to benefit as an intermediary, which it could exploit as the various FTAs come into force.

The ASEAN Investment Agreement (AIA), inaugurated in 1998, is an extension of AFTA and includes the specific intention of realizing regional integration by ASEAN and non-ASEAN TNCs through the utilization of the regional division of labor (Wee and Mirza 2004). ASEAN is one of the most diverse regions in the world in terms of resources and capabilities and a full implementation of the AIA, through the removal of intra-ASEAN barriers to investment, harmonization of investment policies, and national treatment of TNC subsidiaries, would go a long way toward Viet Nam increasing interconnection with various sources of advantage across Southeast Asia. However, as with trade, the region remains schizophrenic about investment cooperation, although a number of actions are under way or planned. These include consolidation and shortening of end dates (varying between 2003 and 2015) for various elements of the AIA; reconsideration of scheduled industries (those not subject to the AIA in various countries); identification and elimination of impediments to intra-ASEAN FDI; inclusion of services into the AIA; and recognition and support for nonequity forms of investment.<sup>11</sup> Past experience has shown that companies will deepen their regional integration based on fundamental economic factors (as evinced by the spillover of TNC operations from Singapore to Indonesia, Malaysia, Thailand, and more recently to the Philippines and Viet Nam, as discussed in Section III), whether governments pursue regional agreements or not. Indeed Viet Nam remains a likely place for companies based in ASEAN to invest: a third of all companies interviewed in the Bradford study said they were intending an investment or further investment in Viet Nam during the short term. However, a fuller realization of the AIA would certainly boost TNCs' ASEAN regional value chain activities and integrate countries further into a regional market and production base. Overall, it is in Viet Nam's interest to pursue ASEAN integration, both at the AFTA and AIA level, and thereby secure access to a wider regional market and regional division of labor/capabilities. In tandem with its ASEAN partners, this regional integration would allow Viet Nam to offset the actual or potential challenge posed by large developing countries such as Brazil, PRC, and India (Boston Consulting Group 2004), which simultaneously offer TNCs low labor costs; a large unified market; and a range of "capabilities" such as diverse labor skills, managerial capacity, pro-

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<sup>11</sup>This is a partial list based on an internal ASEAN document, partly drafted by one of the co-authors.

ductivity, and a degree of innovative abilities (all of these exist in ASEAN as a whole).

### C. Lessons from ASEAN

Finally, *should* Viet Nam pursue a course of deepening and extending its integration into TNC regional and global networks? In other words, how might increased FDI and TNC presence in the economy be beneficial to Viet Nam's development? It is possible to start to answer these questions by looking at the experience of other ASEAN countries, most particularly the exemplars Malaysia and Thailand (Section II), as gleaned from our survey of TNC investors in these countries. The Appendix Table summarizes the main findings in terms of direct, consumption multiplier, value chain multiplier, and spillover effects; and the issues and implications are discussed below. These results are based on firm knowledge and experience (as well as factual information, such as the scale of employment or input and output data) on how their activities affect the local economy (and not an inference from the statistical analysis of broad economic data). However, the number of firms in the sample is small (27, 25, and 22 subsidiaries in Malaysia, Thailand, and Viet Nam, respectively), so the findings should be treated as a guide, rather than being definitive.<sup>12</sup>

Turning to *direct effects* first, in any host country, FDI manifests itself in the form of a TNC establishing local operations, usually through one or more subsidiaries. These subsidiaries must set up shop by building a factory and related facilities, buy necessary equipment and supplies and, most importantly, hire workers who will frequently need to be trained. These interfaces between the subsidiary company and the economy are typical of the main direct effects that FDI has on the host country. The extent of these direct effects depends on:

- (i) scale of the initial FDI;
- (ii) technology employed;
- (iii) numbers of people employed and the training and wages offered;
- (iv) degree to which the firm can procure essential goods and services (e.g., machinery, construction engineers) locally; and
- (v) proportion of profits reinvested periodically in the subsidiary (or other local expansion).

The Appendix Table shows that these effects have been high (employment, training, development of local capital) or middling (reinvestment). The nature of current subsidiaries in Viet Nam (few, small, market seeking, low-technology)

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<sup>12</sup>Having said this, the surveyed firms include some of the largest subsidiaries in these countries, with extensive local involvement.

means that the country is not able to potentially benefit from FDI to anywhere near the same degree as countries such as Malaysia or Thailand. This underscores the need to move toward efficiency-seeking FDI in the context of regional and global integration. Such a reorientation will also assist in upgrading human capital because the TNCS will be focused on the quality needs of more advanced markets, be these in ASEAN or further afield (and in both industrial and consumer goods). In addition Viet Nam can try and maximize net gains to FDI by using policies and measures refined by governments in ASEAN countries (e.g., the skill development fund in Malaysia; see Appendix Table).

Second, since the subsidiary company is a constituent element of the TNC, it is a part of a value chain, both within the country and internationally. These links are both backward (with suppliers) and forward (with distributors and sales organizations). Inasmuch as these linkages stimulate activity, employment, etc. in supplier and distributor firms and organizations in the host country, then the initial FDI has a multiplier, i.e., amplified, effect beyond the initial direct effect on the local economy. This multiplier can be referred to as the “*value chain multiplier effect*” since it operates along the value chain (i.e., by increasing the output of suppliers and sales organizations), and its extent depends on similar factors to the direct effect. In particular, the multiplier will be affected by the degree to which the value chain linkages are within the host country or without: the greater the proportion of linkages with firms outside the host economy, i.e., in the regional or international domain, the lower will be the multiplier effect in the host.<sup>13</sup> In the case of both Malaysia and Thailand, the value chain multiplier is relatively low, for different reasons depending on the nature of the linkages. In terms of backward linkages, where the value chain multiplier effect is “low”, the issues are (i) that inputs are imported from overseas because of a lack of local suppliers; and (ii) where local suppliers are used, these are themselves often the subsidiaries of foreign transnational corporations. With regard to forward linkages, other ASEAN countries tend to have a low value-chain multiplier because the output is exported; however, this is partly the consequence of efficiency-oriented investments (at least until a local market has developed to a sufficient level) and Viet Nam should not worry much about this, especially if it is trying to secure “market advantage” (Section IV.B) by deepening its linkages with ASEAN. Viet Nam has to develop a set of policies with respect to a local supply base, drawing on the experience, including failures, of its ASEAN neighbors. However, intensification of the AIA, matched by further TNC regional restructuring and integration of operations, implies a greater level of intra-industry trade. Not all inputs to subsidiaries in

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<sup>13</sup> Additionally, it is possible that some local linkages will be with the subsidiaries of other TNCs, diluting the multiplier effect because many such companies will also have some of their linkages abroad.

Viet Nam will be sourced in the country; and, by the same token, local-based firms will supply inputs to firms based in other ASEAN countries.

Third, in addition to the value chain multiplier, there is also the “standard” *consumption multiplier effect*: e.g., the subsidiary and its linked firms all pay taxes and their workers purchase goods and services (and pay taxes), all of which result in a boost to other sectors of the economy. In this respect, the FDI impact of the Malaysian and Thai economies has been high. The same could apply for Viet Nam, provided the country can attract efficiency-seeking subsidiaries in middle- and higher-technology industries (and thus higher remuneration, profits, and ultimately taxes). In order to do this, Viet Nam has to put a big emphasis on developing skills and capabilities (often in alliance with firms) in the domestic economy, as well as linking with regional capabilities through the regional division of labor. It can draw on policies pursued by both Malaysia and Thailand (because of their greater success), as well as other countries.

Fourth and finally, the subsidiary plays a role in transferring, encouraging, or obliging the transfer/take-up of knowledge, technology and skills—in a myriad of forms—to other organizations (especially indigenous firms) in the host country, principally through training, demonstration, and competitive effects. Collectively this is known as the *spillover effect* and can be the result of both deliberate (e.g., training of workers, quality control enforcement at suppliers, or student scholarships) and nondeliberate actions (e.g., competitive pressures on local firms or because the subsidiary can be seen as a “benchmark”, model, or source of “best practices”) (UNCTAD 2001 and 2003). In the longer run, this is the most important gain that an economy can receive from FDI because it means that indigenous concerns learn from foreign companies and are therefore in a position to redouble the development effort. From the evidence (Appendix Table), neither Malaysia nor Thailand has been very successful at reaping spillover gains. The greatest gain has come through the imparting of “world class” technology, knowledge, and expertise to some local suppliers, essentially because it is important to maintain quality and efficiency in a global supply chain. This underscores the necessity for Viet Nam to promote efficiency-seeking investment. One of the main reasons why few spillovers occur is either because of a dearth of local companies (certainly competitive ones in the manufacturing sector) or because they lack the capabilities to absorb foreign knowledge. In fact, Viet Nam has an established company base and some of these have set up joint ventures with TNCs (including in consumer electronics), which is a good start. However, as a whole, these companies have a long way to go before they are in a position to readily acquire and utilize technology from TNCs and other foreign sources. Viet Nam can again look to other ASEAN countries on best-practice lessons in order to do this. One policy it should certainly pursue (a relative failing in its exemplars, especially Thailand) is to encourage TNCs to train workers in scientific, engineering, and design skills, as well

as production skills. Local companies can then acquire these workers through the labor market, and utilize them in order to absorb and exploit foreign technology.

Overall the findings of the Bradford study imply that Viet Nam can learn a lot of lessons from Malaysia, Thailand, and other ASEAN economies (summarized in the Appendix Table) in order to encourage further FDI and maximize the net gains. These lessons arise from both the exemplars' successes and failures and can assist in devising pretty specific policies for FDI (and linked industrial policies), which could relate to issues such as which industries to support, orientation of subsidiaries, capability development policies (at various levels), infrastructural development, and regionalization strategies, such as the pursuit of free trade agreements. In addition, Viet Nam can look to advice in framing appropriate policies to a large research base and international institutions (including the Asian Development Bank, ASEAN Secretariat, and United Nations Council for Trade and Development).

## V. CONCLUDING REMARKS

Since the early 1990s, Viet Nam has been pursuing the twin, interlinked goals of promoting regional development (in the context of ASEAN) and inward foreign direct investment. Using the results of a survey of TNCs with operations in ASEAN, as well as secondary sources, this paper set out to determine the extent to which Viet Nam has been successful in achieving these goals. Furthermore, the inquiry was extended to ask whether the country should deepen and widen its consequent involvement in Southeast Asia's TNC regional value chains. Section III examined the first of these questions in considerable detail and answered in the affirmative, showing that Viet Nam is now a major recipient of inward FDI, mostly linked to the value chain of TNCs, especially in electronics and garments. The regional aspect is especially manifest in consumer electronics, although most subsidiaries in Viet Nam still perform assembly-type operations and are local-market-oriented.

Section IV looked at the second issue and concluded that it was essential for Viet Nam to pursue its involvement in regional integration. One reason for this is that regional integration (both within ASEAN and in the broader East Asian context) helps to offset the competitive pressures of large developing countries such as the PRC and India which, in addition to Viet Nam's low labor costs, also have two other advantages: large (potential) markets and other capabilities, including skilled labor, a pool of good quality managers, and a degree of innovatory capacity. ASEAN, especially reinforced by a full-fledged development of AFTA and the AIA, would help Viet Nam offset this competition by providing a relatively large market in Southeast Asia and secure access to the pool of capabilities inherent in ASEAN's regional division of labor. This links in with a related issue, that is, most of Viet Nam's FDI in middle or "higher" technology FDI, e.g., consumer

electronics, has tended to be in market-oriented operations. Unfortunately, investments oriented toward a small local market tend not to generate significant investment; diversification of the industry; or other positive impacts on sector productivity, output, and employment. This is in contrast to the high level of efficiency-seeking investments in other ASEAN countries, which has resulted in impressive gains from FDI, partly because TNCs aiming at global markets have to ensure that the quality and productivity of their operations (and their consequent links with local companies, including suppliers) have to be at an international level. This underscores the necessity for Viet Nam to pursue regional integration and further involvement in TNC value chains because, by doing so, it is helping to create the conditions under which TNCs are more likely to expand their investments in the country and pursue activities that will spill over as technology/knowledge transfer and other gains for the economy. As a corollary to this, Viet Nam has to, of course, expend considerable effort in improving domestic capabilities, including human resources and competence of suppliers, ideally in collaboration with TNCs and other organizations. Furthermore, in order to justify an emphasis on promoting additional inward FDI and determine appropriate policies, Viet Nam was compared with Malaysia and Thailand because the former is trying to pursue a similar path toward TNCs, growth, and development. Although not unqualified successes in terms of all the possible ways that FDI can impact on development, Malaysia and Thailand are good exemplars for Viet Nam (both because of failures and successes); and the analysis underlined the very careful and specific policies that Viet Nam can and should use to gain from the direct, value-chain multiplier, consumer multiplier, and spillover effects of foreign direct investment. This discussion also pointed toward the need for Viet Nam to increase its emphasis on efficiency-seeking FDI, e.g., because of the considerable transfer of knowledge along the supply chain from TNCs to suppliers in Malaysia and Thailand.

In conclusion, under the threat of international competition and in order to maximize the dynamic gains from FDI, the paper suggests that Viet Nam should reorient its policies regarding FDI, with increased emphasis toward targeting efficiency-seeking investments and development of more advanced links with TNC regional and global value chains. Moreover, the burgeoning imperative to provide “market advantage” and “capability advantage”, along with “cost advantage” means that Viet Nam has to work with its ASEAN member countries to promote AFTA (providing access to a regional market) and the AIA (securing capabilities in Viet Nam and other ASEAN countries). Of course, Viet Nam (and ASEAN’s) regional ambitions do not need to stop here and, in the context of forthcoming agreements with the PRC, India, Japan, and other neighbors, the possibilities are endless.

Appendix Table. **Lessons for Viet Nam based on a Summary of Malaysia and Thailand's Experience on FDI Effects on the Economy, Growth, and Poverty Reduction**

Type of FDI Effect		Degree of Impact	Evidence of FDI Effect	Comments on Malaysian and Thai Experience	Implications for Viet Nam
Direct Effects	Employment	High	The average number of employees per interviewed subsidiary in Malaysia and Thailand is 2,699 and 3,750 respectively. Women workers represent 48% of total in Malaysia and 71% in Thailand. Average annual output is US\$1,504 million in Malaysia and US\$327 million in Thailand. Two thirds of subsidiaries have sister companies in both countries.	A very high level of FDI in both countries means that manufacturing TNCs employ large numbers of people. Many subsidiaries are large, resulting in a big direct impact on the economy, growth, and poverty reduction. A very high proportion of workers are women and from poorer provinces.	<p>The average number of employees in companies interviewed in Viet Nam is only 86, which pales against the scale in Malaysia and Thailand (60% of subsidiaries are small, average output is US\$20 million). The difference arises from age of enterprise (most have been recently established); origin (ASEAN/East Asian investments can be small); and orientation (quite a few are aimed at the local market, which is small).</p> <p>Clearly there is a need to increase scale (although gigantism need not be the order of the day) by encouraging a wider range of industries and investors (by origin). Consideration needs to be given to issues related to location (i.e., how poorer provinces can benefit) and gender.</p> <p>Careful linking with ASEAN, East Asian, and global economies can maximize the net benefits of FDI.</p>

Type of FDI Effect	Degree of Impact	Evidence of FDI Effect	Comments on Malaysian and Thai Experience	Implications for Viet Nam
Training, Human Capital	High	About 90% of the workforce in Malaysian and Thai subsidiaries have secondary schooling or higher. In Malaysia 1.9% of the payroll is spent on human resource development; in Thailand the figure is 2.7 percent. Workers in both countries receive more than 6 days training each a year, often in certifiable courses. Firms rated the current level of employee skills at an average of 3.7 out of a scale of 1 to 5 (unweighted) in Malaysia and 3.4 in Thailand. The average rose to 4.0 and 3.8 respectively for pure production-related skills (i.e., excluding innovation, soft skills etc.).	Relatively advanced segments of value chains transferred to both countries; quality of local products has to be high in order to meet expectations of international markets; many subsidiaries assigned strategic roles (e.g., related to R&D) or autonomous. High expenditures on HRD and many days devoted for training.	Viet Nam has a relatively highly educated population, so 78% of the workforce in interviewed firms has been educated to at least a secondary school level. However, there is still some way to go in terms of funds spent on skills development (only 1.5% of the payroll). A policy such as the skill development fund in Malaysia (where companies are taxed 1% of payroll, but which can be recouped when workers are trained) might be useful. Vietnamese workers are currently receiving appreciably more days of training (9) than their Malaysian or Thai counterparts, but this probably reflects the recent establishment of the Vietnamese subsidiaries. Overall, firms rate Vietnamese employee skills at 3.1 (3.4 for pure production), appreciably lower than Malaysia and Thailand, but higher than might be expected given the countries' level of development. Viet Nam can build strongly on these foundations.

Type of FDI Effect	Degree of Impact	Evidence of FDI Effect	Comments on Malaysian and Thai Experience	Implications for Viet Nam	
(Reinvestment)	Middling	Very few companies gave precise figures. The general investment was the reinvestment was occurring, but not at a rapid pace because of economic conditions.	TNCs, the primary source of future FDI expansion in these economies, need to be convinced to reinvest more.	Many companies based in other parts of ASEAN indicated an interest in investing in Viet Nam. This should certainly be encouraged because it will bring more jobs, a wider range of industries, and link Viet Nam more into the regional and global value chain. It is worth mentioning that most large and many medium TNCs from all over the world are already in ASEAN—and making profits—which can be usefully invested in Viet Nam and the region.	
Consumption Multipliers	Consumption	High	Not directly measured, but implied by econometric study and the fact that average company size is large and wages quite high (because of past labor shortages).	A high rise in employment and wages has led to the growth of ancillary industries. Local conglomerates have grown on the back of this expansion.	Viet Nam should encourage local companies to take advantage of rising purchasing power, as in Malaysia and Thailand, ideally in manufacturing and not just retailing foreign-made goods.
	Taxes	High	As above. Income taxes are collected through companies, which means that the rate of collection is high. (Corporate taxes can be low, often because of privileges granted to exporters.)	Facilitated the improvement of social benefits, infrastructural development, education, training etc. (Note careful urban planning in Malaysia as opposed to Thailand.)	Careful infrastructural development and urban planning would be wise (avoiding white elephant schemes). Considerable attention has already been given to industrial zones. Care should be taken regarding export privileges extended to foreign TNCs. Opportunities exist for a variety of social, education, and other policies.

Type of FDI Effect	Degree of Impact	Evidence of FDI Effect	Comments on Malaysian and Thai Experience	Implications for Viet Nam	
Net Exports	High	Very high levels of exports—over 70% overseas. Although imports of inputs are also over 70%, the local value added (direct wages and salaries, local inputs) and large-scale production ensures that a high level of income stays in Malaysia and Thailand. Most foreign companies are export-oriented; few are oriented toward local markets.	Local companies have not always taken advantage of the opportunity to “seize” local markets before foreigners turn their attention inward, which is now happening. Export orientation as a mainstay for economic development is unsustainable in the long run; Malaysia and Thailand need to foster domestic-oriented development.	This is not yet an issue for Viet Nam and in the short run there is much to be gained from trade links with the rest of ASEAN and the PRC/East Asia.	
Value Chain Multipliers	Suppliers	Middling	In Malaysia, 73% of inputs are bought from nonaffiliated companies, but only 41% of these are bought in the domestic market from <i>both</i> indigenous and foreign-originated companies. A similar situation prevails in Thailand, with 68% of inputs coming from nonaffiliated suppliers, 48% of which are bought from locally based suppliers.	The import of inputs from abroad and the existence of many local foreign-owned suppliers means that there is a mid-level effect on local suppliers, and hence their contribution (through wages, salaries, taxes to the multiplier effect). However, foreign-owned suppliers contribute to the value-chain multiplier too, so the main concern, in terms of the value chain multiplier, is the high level of imports.	The purchase of local inputs is lower in Viet Nam than Malaysia and Thailand. Only 50% of inputs are bought from nonaffiliated suppliers and, of these, about 32% are from locally based companies (indigenous and foreign). Viet Nam thus has to pursue the establishment of capable local suppliers; however, the import of inputs is not yet an issue because (i) local suppliers do not exist and (ii) inputs from ASEAN allow entry into regional/global value chains. A regional division of labor also implies a greater intra-industry trade.

Type of FDI Effect	Degree of Impact	Evidence of FDI Effect	Comments on Malaysian and Thai Experience	Implications for Viet Nam
Distributors and Sales Organizations	Low to Mid	Most companies in the sample are export-oriented and thus do not establish forward linkages in the domestic economy. The few that do are keen on ensuring high quality distribution, sales, and service.	“Indirect exports” (i.e., sales of components/inputs to companies in Malaysia or Thailand that export their output) means that forward linkages may be even lower than they appear. (Note: This paper focuses on companies manufacturing in ASEAN and so there is a sample bias: local market importers are largely excluded.)	Viet Nam is currently producing quite a few consumer products in local-foreign joint ventures. Greater attempts should be made to learn sales and marketing skills, rather than simply benefit from a share in high profit rates. A large population with rising incomes gives Viet Nam some leverage in this respect.
International links	High	The companies interviewed export over 70% of output in both Malaysia and Thailand, while about two thirds of inputs are imported. While exports and imports from/to Japan and North America are high for subsidiaries in both countries (US firms and trade figure more highly in Malaysia, while for Thailand it is Japanese), European firms (hence trade) are far more important for Malaysia and East Asian imports for Thailand. ASEAN trade is small: firms in Malaysia import 8% of inputs from ASEAN, while firms in Thailand export 11% of outputs to ASEAN.	This results in sizeable exports by value, but high international linkages are a source of concern when too large a share is imported. One key issue is to improve the local supplier base. There are considerable opportunities for regional value chains, especially taken up by ASEAN TNCs and consumer electronics firms (among others).	Still low linkages in terms of overall scale, but in directionality Viet Nam is similar to Thailand, though US links are largely absent and there is a large level of input import from ASEAN (23% of imports by interviewed companies). This represents an incipient regional value chain (especially with Singapore, Malaysia and Thailand), which can be developed. East Asia’s share of input imports is 30%, which implies that the country could look to a wider East Asian regional grouping than ASEAN (perhaps ASEAN+3 makes more sense for Viet Nam and other ASEAN countries).

Type of FDI Effect		Degree of Impact	Evidence of FDI Effect	Comments on Malaysian and Thai Experience	Implications for Viet Nam
Spillover Effects (training, competitive effects, demonstration effects and human mobility)	Suppliers	Middling	<p>Of those firms that buy inputs from local suppliers, only 7% buy high-tech goods from these companies, otherwise purchases are low-tech (42%) or secondary inputs (51%). Nevertheless, local suppliers are provided knowledge and support in terms of the goods they produce. Among interviewed firms in Malaysia, the likelihood of product specification transfer is very high at 4.64 (on a scale of 1 to 5) and the figure is similar in Thailand at 4.41. Transfer of other types of knowledge or support is somewhat lower (mostly between 2-3 depending on type for Malaysia and around 2 for Thailand).</p> <p>Foreign firms are somewhat more supportive of suppliers in Malaysia (52% have a supplier partnership scheme) than Thailand (32%). Overall there has been considerable improvement in the direct production-related skills of local suppliers (cost, quality, delivery), the degree of improvement being rated at an average of 3.6 (on a scale of 1 to 4) for Malaysian suppliers and 3.1 for Thai suppliers. Improvements in other types of skills (innovation, design, commercial skills etc.) were deemed somewhat lower, though the overall level was higher for local suppliers in Malaysia.</p>	<p>There is little room for spillovers in high-technology areas, but international supply chains mean that “world standard” technology, knowledge and expertise is imparted or seeps to suppliers. At present this largely relates to skills necessary for direct production (cost, quality, delivery, inventory control, lead-time performance), but these are a basis for moving up the value chain. There is a considerable need to support local suppliers, especially to allow them to compete in higher technology or value inputs, often against foreign suppliers based locally. Although some R&amp;D is done locally, there is little opportunity for skills related to innovation, design etc. to seep to local suppliers and other firms. Policies to encourage this are necessary.</p>	<p>Vietnamese companies have to get to the first few rungs of (i) having sufficient foreign plants to supply and (ii) developing a wider supplier base.</p> <p>At present, to the extent it occurs, transfer of product specifications to local firms is only 3.1 (on a scale of 1 to 5) and between 1 and 2 in terms of other types of knowledge. There are no supplier partnership schemes (among the firms interviewed) but then there is the need for a critical mass of suppliers for such activities to occur. The firms interviewed rank the improvement in local suppliers at only 2.4 compared to 3.6 in Malaysia (but bear in mind that these are much younger relationships). Viet Nam clearly has to give priority to its supplier base, the quality of suppliers, and the relationships between suppliers and foreign subsidiaries.</p>

Type of FDI Effect	Degree of Impact	Evidence of FDI Effect	Comments on Malaysian and Thai Experience	Implications for Viet Nam
Distributors and Sales Organizations	Low	As mentioned above, there are few forward links with local distributors etc. because of the export orientation of foreign firms.	As earlier. Sales subsidiaries importing consumption goods might be significant in spillover effects (but these are not part of this paper).	As earlier.
Competitors	Low to Mid	Very few companies interviewed had significant direct competition from local companies, although there were some examples in garments, consumer electronics, and electronic components. These included air conditioners, white and brown goods, and semiconductors.	A long way to go, but this paper has identified a number of mechanisms and routes being taken by exemplar local firms attempting to become significant players in their own right in Malaysia and Thailand. These include locally owned conglomerates that have entered new industries because foreign firms have established a market (demonstration effect, e.g., airconditioners, and consumer electronics); created local engineering and managerial expertise (“spin-off” or “silicon valley effects”, e.g., semiconductor components manufacturers); or worked with foreign partners (joint ventures and similar, i.e., “learning by doing together”).	As with suppliers, Viet Nam has to encourage the development of local companies that can take advantage of mechanisms such as the demonstration effect, spin-offs, and learning by doing. In this study there was one Vietnamese company making progress in improving its core products, technology, and expertise through effective joint ventures with a number of foreign partners. Many more such companies are needed.

Type of FDI Effect	Degree of Impact	Evidence of FDI Effect	Comments on Malaysian and Thai Experience	Implications for Viet Nam
Human Capital	Low to Mid	Considerable human capital of a high calibre has been generated by foreign companies in Malaysia and Thailand (see under “direct effects”) above, but only a minimal level finds its way to locally owned suppliers, other manufacturers, spin-offs etc.	<p>Policies to improve the use of skilled labor by local companies are essential. This might require some reorientation away from export-oriented development, toward local markets and needs.</p> <p>Foreign companies should be encouraged to create and impart scientific, engineering, and design skills as well as production skills. There is also the issue of the “loss” of skilled women workers back to provinces and other occupations.</p>	As earlier under training.

Note: The summary data are drawn from 27 Malaysian, 25 Thai, and 22 Vietnamese subsidiary companies in the sample.  
Source: Mirza et al. (2003).

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