THE IMPACT OF REGIONAL INTEGRATION: ASSESSING OPPORTUNITIES AND CHALLENGES FOR ASEAN'S TRANSITIONAL ECONOMIES

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ABSTRACT

The growing economic and political interdependencies of markets around the world characterize the complexity of globalization in the 21st century. For most developing countries, globalization of markets presents a greater opportunity to attract foreign investments that would help stimulate national economic growth. Among the factors that influence a company's decision to invest in a foreign location, accessibility to markets and stability of the host countries' political environment are important determinants because internal political stability is interdependent with internal economic stability. We propose that the determinants of investments in the transitional economies of ASEAN are not confined to its national political stability alone but rather to regional political stability and the opportunity of greater market share acquiesced by regional economic integration. This paper therefore aims to stimulate discussions regarding the influence of regional integration on national development, as well as to contribute to the greater body of knowledge of regional integration studies.

Keywords: regional economic integration, foreign direct investment, ASEAN, Southeast Asia

INTRODUCTION

The growing economic and political interdependencies of markets around the world characterize the complexity of globalization in the 21st century. In relation to globalization and the growing interdependencies of markets, this trend has also influenced the resurgence towards greater economic integration initiatives among different markets. For most developing countries, globalization of markets presents a greater opportunity to attract foreign investments that would help stimulate national economic growth. Hence, this paper was written with the intent to analyze the opportunities, as well as challenges, that regional integration can offer for transitional economies such as Lao PDR.

It is a common assumption that the opening of markets can provide various benefits for growing economies wanting to capitalize on global trade, as we will discuss in this paper. Nevertheless, it can also be argued that all forms of business transactions, particularly in today's interdependent global market environment, involve some degree of risks. For example, studies have shown that factors related to a country's political stability play a significant role in a firm's decisions to invest abroad (Robock and Simmonds, 1989; Meldrum, 2000; Tchankova, 2002). A country's political stability is dependent on various factors that can emanate from within as well as from outside its physical borders. Both economic and non-economic factors can influence a country's political stability. For example, rising prices of consumer goods coupled with rising unemployment can lead to society's resentment towards government, which in turn can lead to demonstrations and even violent revolts. From this general example, it can be seen that the study of socio-political or non-economic forces can be equally important in foreign market analysis as these factors can adversely affect the stability of a country's business environment, affecting the welfare of its peoples and businesses. Therefore, we shall look into how both national and regional integration factors can encourage economic growth through foreign investments.

With increased market interdependence through international trade supported by constant technological advancements, the uncertainty of today's environment is also increased as more and more players are involved. Scholars such as Miller (1992) and Dunning (2002), among others, have highlighted the interdependent nature of the political, economic and social environments within and among countries and how this creates uncertainties and risks in the market. The complexity of today's global marketplace is made greater with the increasing popularity of bilateral and multilateral agreements among nations which allows for the integration of diverse markets in various economic, social, and/or political agreements. Although complex, globalization and regionalization have contributed greatly to the creation of new markets and greater access into new markets with untapped resources around the world. Competition among these new markets are also high as attracting investments would greatly help national development for the less developed countries of today's globalized world.

The Changing Landscape for Foreign Investments: The Influence of Globalization

The concept of globalization can be defined as "the intensification of the process of interaction involving trade, migration and dissemination of knowledge" that leads to the growing interdependencies of countries worldwide (Piasecki and Wolnicki, 2004, p.308). As such, globalization has deepened interdependence between both government and non-government players, on all levels and industry sectors, through an array of international cooperation.

Consequently, many scholars believe that globalization has also influenced the resurgence towards regional integration initiatives. The concept of "new regionalism" supported enhanced economic activity among players within proximity of a geographical region that wanted to increase and strengthen its involvement in the global economy (Stubbs and Reed, 2006). Another characteristic of the 'new regionalism', according to past literature, was the ability of sovereign countries to attach themselves to one or several forms of regional institutions or trade groups in their efforts to participate, as well as benefit from, the globalization of markets (Bowles, 1997; Urata, 2002; Stubbs and Reed, 2006). This made overlapping membership a common feature of any one country's regional integration activities. This resulted in the emergence of many forms of regional integration initiatives especially after the end of the Cold War, as seen by the creation of various multilateral agreements such as trade blocs, security pacts, and even 'growth triangles'.

For most states, the commitment to these integration activities stems from some form of commonality or common interest. These interests may range from purely economic factors or a combination of factors. For some regional groupings, this may be a common culture, religion, and/or language (e.g. Stevens, 1997; Simone, 2001). Reasons for cooperation could also stem from purely geographical factors and the need to capitalize on shared natural resources in the region (e.g. Ohmae, 1993; Jaya suria, 2003; Suhand Khan, 2003). Regional integration that focused more on economic cooperation among nationsgenerally involves integration of market-driven and policy-driven initiatives that leads to deeper trade and financial interdependence and harmonization of policies among the region's economies (Hettne, 1996; Dent, 2005).

Globalization, together with the growth of regional cooperation among nations, has created greater interdependence among markets around the world.The complexity of today's global marketplace is made greater with the integration of diverse markets in various economic, social, and/or political agreements. Therefore, although globalization allows for greater opportunities for businesses to expand, it is also able to create complex relationships that can increase market uncertainty. Moreover, with increased inter dependence; nations quickly realized that their neighbors, who often had a similar geopolitical history and economies to their own, faced many of the same economic and/ or socio-political development problems.

The Age of New Regionalism: Opportunities and Threats

The economic and political environment of the 21st century supports the growth of regional economic integration because it allows countries of all sizes harness their resources collectively to gain access and leverage in world trade. Many different theories have been presented in past literature explaining the motivations and the functions of regional integration; therefore, the perceived benefits, as well as drawbacks, of regional integration is also dependent of the objective and type of regionalism that countries enter into. There is a consensus amongst researchers that regional integration focused on economic regionalism, such as free trade areas and 'growth triangles' can increase inter-regional and intra-regional trade (Zahrnt, 2005; Urata, 2002; Dent, 1998; Ohmae, 1999).

Researchers have highlighted that the appeal of belonging to a regional grouping, particularly for emerging economies, is that it allows these countries to increase their economic space thus allowing for more trade and investment opportunities with larger markets. The assimilation of nations under one regional organization or bloc also creates a larger market that facilitates economies of scale allowing for a potential inflow of more foreign capital for countries in the region (Suhand Khan, 2003; Wint and Williams, 2002). The opportunities for increased trade within a regional grouping can also be supported by national and regional transport infrastructure development because it would allow for a greater degree of connectivity between different geographical markets (Anderson, Engvall, and Kokko, 2007).

The integration of markets based on economic and trade initiatives is not only attractive to countries but also to future investors. Based on past studies, some of the main drivers for foreign direct investments (FDI) entering into today's emerging economies include the ability to gain greater access to markets, access to resources and lower operating or production costs (Dunning, 2002; Wint and Williams, 2002; Suhand Khan, 2003). For example, Anderson, Engvall, and Kokko (2007) highlighted in their research that market integration is particularly important in developing countries because it provides opportunities for local businesses to participate in the market economy through trade with open economies in the region. Hence, from a business perspective, it would seem that countries belonging to a trade bloc or those privy to free trade agreements do offer strong incentives for international firms wanting to capitalize from investment incentives as well as the growth and investment opportunities offered by the host countries' affiliated trade partners.

Nevertheless, a conducive economic environment is not only dependent on purely economic factors. As the world market has become more complex and countries more inter-connected, the nature of risk itself is also changing. International business exposes firms to varying degrees of risk as each country is governed by its particular ideology, legal system and cultural-national identity. Diversity of social values and political conditions in emerging markets may also give rise to enhanced risks which may include ethnic-religious clashes and any other socio-political forces that can obstruct business operations.

Although emerging markets presents many opportunities for businesses, yet the risks are high due to the uncertainty of its environment. According to Meschi (2005) "a significant proportion of these [country] risks is related to the political and economic uncertainty of these countries: i.e. government instability, political turmoil, debt default or rescheduling, fluctuating currency rates, discriminatory tax systems, and corruption (p.143)". Other researchers identify political risk in emerging markets to include many non-economic factors that are sometimes exclusive only to that specific country or region (e.g. Meldrum, 2000; Stevens, 1997; Miller, 1992; Desta, 1985).

Generally, non-economic risks emanating from the socio-political aspect of a country's environment can include factors such as ethno-religious clashes, violence of separatist groups, and even civil or external war (Robock and Simmonds, 1989; Bouchet, et al, 2003). The likelihood of the occurrence of these factors is higher in developing countries such as those in the Southeast Asian region because geopolitical history also has a big influence on political risk. For example, Stevens (1997) highlights that in assessing political risk in most LDCs and developing countries, the factors of ethnic and religious composition have commanding influence over a nation's stability. This is particularly true for the countries of Southeast Asia, as the literature has shown that its complex and turbulent history is a huge contributing factor in shaping the condition of the region's political and economic relationships (Indorf, 1984; Severino, 2001; Church, 2003).

Many scholars also agree that events that happen in one country can have an impact on another, and usually in unexpected ways, both in terms of economic and political effects. Political stability provides governing institutions an environment to create and implement policies that can promote development. Based on this, we support the idea that national stability also promotes regional stability because it allows for countries to focus on larger objectives and be more receptive with the idea of regional cooperation through joint-policy initiatives Hence common concerns of businesses entering and investing in foreign countries, especially in newly developing markets, were based on the issue of uncertainty in the countries' political and economic environment as well as that of their surrounding neighbors.

ASEAN Regionalism and Foreign Direct Investment

Out of the various forms of regional economic integration that exist in today's global market, the Association of Southeast Asian Nations (ASEAN) and the ASEAN Free Trade Agreement (AFTA) has been a notably active group. AFTA was formed in January 1993 with the aim of creating a Free Trade Area in the region that can take advantage of its large market and its competitive geographical position. According to Bowles (1997), one of ASEAN's main reasons for the formation of AFTA was the desire to remain attractive to foreign investment, which gave ASEAN the ability "not only to offer multinational corporations a larger regional market for production and consumption but also increased credibility about their commitment to trade openness by providing joint guarantees of this".

Prior to the creation of ASEAN, the conditions within the region of Southeast Asia were described by many as the "Balkans of the Orient" because it was conflict-ridden

(Caballero-Anthony, 2005). Earlier attempts to establish any form of regional cooperation or integration initiatives were unsuccessful due mainly to recurring territorial disputes, ethnic clashes and other such disturbing political developments; which also had contagion effects upon the region's overall business environment. It was established that most of these recurring problems have their roots in hovering animosities and distrust among the ASEAN members due to unsettled problems (Indorf, 1984; Ganesan; 1999).

In 1995, ASEAN increased its membership through the inclusion of Vietnam. By 1999, ASEAN's membership also included Cambodia, Myanmar, and Laos. After the fall of communist Soviet Union, the bipolar world order ended thus generating the creation and opening of new markets around the world. These transitional economies and/or emerging economies around the world were generally viewed as having high risk environments for investors because of the uncertainty of their political and legal institutions which are viewed essential for protection of foreign businesses interests. Higher level of political risks were also attributed to controlled economies or non-market-driven economies because the uncertainty of the reliability of government policies and perceived higher rate of corruption existent in these countries (Bouchet, Clark, and Groslamber, 2003; Clark and Tunaru, 2001).

Many scholars believed that the addition of the new members – which were mostly going through economic transitions – would affect the economic and political stability of the region. This uncertain and unstable bilateral and multilateral relationship can be perceived as risks, especially for those who depend on the stability of ASEAN-based policies. This is particularly important in ASEAN because the institution that binds their cooperation is not by a rule-based supranational entity but rather is voluntary in concept and determines its actions through dialogue and consensus by all its members.

In addressing the issue of FDI and risk, it is undeniable that the political stability of the host country is often viewed as a major determinant of political risks assessment. Governments determine policies and a government's internal and external relations can also influence a country's direction and policies related to its business environment. Scholars assert the importance of understanding the socio-political environment of a country and the types of political risks it poses is because host government actions can affect the viability of a firm's operations on any level due to the interdependent nature of business and politics (Dunn, 1983; Griffin and Pustay, 2002).

It is highly unlikely that one is able to fully assess the political risks of any foreign market because political risk in itself is a very subjective concept. This is because the actors of international business involve both government and non-government actors with varying and sometimes even conflicting interest. As mentioned by Meldrum (2000) in reviewing country risk and FDI, "governments do not always follow the 'Rational Actor Model'. Even in dictatorships, foreign policy is the result of interplay and bargaining amongst the participants (p.27)". Hence, we review how national political stability and regional solidarity among ASEAN and AFTA members can help increase the marketability of the transitional economies of ASEAN.

Competing for Investments: Regional Integration and Political Risks of Lao PDR

Prior to ASEAN membership, the less developed economies of Myanmar and Loa PDR were relatively closed to outside investors. Both Laos and Myanmar joinedASEAN on 23 July 1997, and at that time, both countries were also relative behind in terms of economic development compared to its neighbors. Nevertheless, over the years, many developing countries – including Laos and Myanmar - have embraced policy changes and have engaged in activities aimed at attracting increased flows of FDI. For example, the Lao government introduced an open-door policy in the late 1980s and has taken a number of measures to reform its administrative structure and policy that would promote a more market-based economic environment. This was reinforced by the adoption of a "code for FDI" by the Lao Government in 1988 - under the New Economic Mechanism policy - with the hope to have revenue generated and job opportunities created in the country (Anderson, Engvall, and Kokko, 2007). These reforms, together with AFTA (ASEAN Free Trade Area) and WTO membership, have created a more conducive environment for national and regional trade activities (*ibid.*).

The role that FDI plays in the development of a country is especially for developing economies, as the inflow of investments can help reduce economic disparity and development gaps among the ASEAN members. For example, Lao PDR (Laos) is a country governed by a one-party political system with a traditionally rural economy, where agriculture accounts for over 60% of Laos' economy. Besides agriculture, FDI have also helped boost the economy of Laos, where it can be seen that there has been an increase of FDI, particularly in the hydro-power energy sectoras well as banking andinsurance, telecommunications and transport, and mining (Suhand Khan, 2003). For example, according to the World Bank data, in the year 1988, FDI was at US$2 million. Over the years it increased to US$159.8 million in 1996 before decreasing to a low point at US$4 million in the year 2002. Following that, FDI in the year 2003 to 2005 increased slowly, well below US$30 million. In the year 2006, the flow of FDI increased significantly at this time to US$187.4 million dipping in the year 2008 (US$227.7 million) before settling at US$318.6 million in the year 2009. It can therefore be assumed that the economic reforms employed by the Lao government since the late 1980s have strengthened the economy significantly over the years.

What is evident from the above example is that investors are looking towards countries in the Asian region as being important investment centers in the world. It is understandable that the transitional economies of ASEAN offer attractive markets because they offer advantages such as abundant natural resources. Nevertheless, the allure of resources alone may not be suffice to attract and maintain investments in the country, particularly at a time where more and more markets are opening their doors and offering competitive investment incentives to attract multinational companies. Due to the implied positive economic impact of FDI for the emerging markets of Southeast Asia, there exist a possibility that it can also led to increased competition among the regional neighbors themselves to secure FDIs intheir countries.

The emergence of new markets with similar characteristics around the world creates a competitive environment for attracting FDI inflows, particularly for "economically-young" countries which are new to the workings of global trade. Because of greater openness created through globalization of markets, countries cannot solely rely on cheap and/or abundance of natural resources as investment incentives for foreign investors. This is particularly true for the "obscure" economies of countries such as Myanmar and Laos, which have not had much exposure to foreign investment as compared to its immediate neighbors.

Laos - an ASEAN member since 1997 - was regarded as high-risk areas because of the perceived stifled bureaucracy and high levels of corruption associated with its rigid authoritarian government. Interms of political risks, ratings given by the World Bank from 1998 to 2008 (refer to Table 1) do not show any distinct pattern of neither increasing nor decreasing levels of risks. This can be interpreted that affiliation to a regional grouping alone does not automatically reduces the political risk ratings of a country. This is understandable because a country's socio-political environment, particularly pertaining to governance of internal conflicts and implementation of policies, is still an internal matter of the state. Nonetheless, political risk ratings for the years between 2006 and 2008 are within the mid-percentile rank signifying some degree of stability.

Table 1 Political Risks Ratings by World Bank

	1998		***2000***		***2002***	***2003***	***2004***	***2005***	***2006***	***2007***	***2008***
Lao PDR	31.7		22.6		36.1	17.8	27.4	37	46.2	40.4	43.5

Source: World Governance Indicators (World Bank) for selected years.
Ratings: 0 – 100 percentile with lower ratings signifying higher risks due to violence and/ or government instability.

Despite the perceived high levels of political risks, the country's economic growth had remained relatively buoyant throughout most of the 2000s. For example, according to reports in the Asia Monitor for 2006, Laos was expected to maintain stable economic growth (between 7% - 8%) with continued FDI inflows and broader market access from its immediate ASEAN partners and China. Reports from the Global Edge (globalEDGE.com) concurs by stating that GDP growth in 2009 and 2010 remain strong, particularly due to the development of the hydroelectricity and mining sectors in the country.

Undoubtedly, the country's natural resources have attracted investors from neighboring countries. In the period of 2000 to 2008, the total project approved in Lao PDR (refer to Table 2) was 1,045 with a value of US$6.461 billion. The electricity generation (hydropower) is the most attractive investment sector, followed by agriculture and mining. Investments also flow into industry and handicraft (weaving of silk), services, trading and others.

Table 2 Approved Foreign Investment in Lao PDR by Sector 2000-March 2008

No	Sectors	Projects	Value of Investment (US$)
1	Electricity Generation	41	3,301,791,585
2	Agriculture	175	838,085,036
3	Mining	145	647,818,829
4	Industry and Handicraft	195	467,546,066
5	Services	175	323,125,718
6	Trading	100	275,841,554
7	Construction	29	180,586,874
8	Hotel and Restaurant	61	162,561,245
9	Wood Industry	40	99,810,379
10	Banking	11	55,096,000
11	Telecom	4	72,390,980
12	Garment	37	28,344,920
13	Consultant	32	8,613,252
	Grand Total	**1,045**	**6,461,612,438**

Source: FDI Policy of Lao PDR in presentation by Phouvong Sihomvong, Lao Embassy Bangkok in Thailand (2011).

Laos a competitive advantage to investors also lies in its geographic importance. Although landlocked, the country can play up its ability to provide transportation links among the ASEAN members and Asia's biggest economy, China. In the competitive world of attracting FDI, Lao PDR greatest assets include its geographic location, abundance of natural resources, and most importantly, its affiliation to ASEAN. Although political and legal institutions contribute to risks worries for most investors, the lack of opposition to its single-party system and continued collaborative development initiatives with its ASEAN members have enabled the economy to grow at a steady, albeit slow, pace.

ASEAN membership has had an influence on increasing the attractiveness of the emerging economies in the region. In terms of existing FDI inflows, major investors in Laos come from ASEAN members which have assisted greatly in developing its economic growth. Gunawardana and Sisombat (2008) highlighted that ASEAN countries-Thailand, Singapore and Malaysia have invested a total of US$200 million in June 1993. Thailand especially was the dominant investor since 1998. It was noted that between 1988 and 1994, Thai investment in Laos was US$554 million. The rapid increase of ASEAN investment in Laos from 1997 to 2004 indicated that Laos is becoming a favorable investment location for ASEAN investors with cultural links with Laos (Gunawardana and Sisombat, 2008).

Being a part of ASEAN has also garnered the interest of other countries the greater Asia region, such as Japan and South Korea. According to Japanese officials during the 2nd ASEAN Coordinating Committee on Investment-Japan Consultation in Vientiane, although Laos is not as developed as its neighbors, the fact that Laos is a member of ASEAN makes it a very attractive area for Japanese investors because of its suitable location to access mainland ASEAN markets ("Japan mull investment…", 2005). It was also through ASEAN affiliation that Laos was able to garner the attention of Korean investors. Investment agreements signed between South Korea and ASEAN stimulated increased investment opportunities for the former in Laos. According to the Ministry of Planning and Investment (Laos), "from 2001 to March 2009 Korean companies have invested in 135 projects, with a total value of US$410 million in Laos" ("Koreans eye investments…", 2009). ASEAN's economic linkages with countries such as China and India have also allowed for greater market opportunities.

On the regional level, ASEAN has undertaken various initiatives to reduce transaction costs of business through trade liberalization and facilitation in its efforts towards making the region attractive to foreign investors; with the most notable initiative being the ASEAN Free Trade Agreement. Another significant economic attempt to boost investments in the region when ASEAN extended its membership to include the former Indochinese states of Southeast Asia came with the creation of the ASEAN Investment Area (AIA). The AIA was designed to enhance a process of FDI policy liberalization, promotion, and, to some extent, harmonization across ASEAN Member Countries (Severino, 2001).

Nevertheless, political stability and the absence of violence is also an important feature for investment decisions. For smaller countries such as Laos, the peace and stability of ASEAN's regional market is influenced by the conditions of the region's individual national markets. If the countries in the region were plagued by internal conflict, it could have adverse effects on neighboring countries. For example, ethnic based conflicts within a nation seldom stay within boarders, and thus, have the potential to involve others and lead into a bilateral conflict. In terms of risk, even though the countries were not governed under a supranational entity, governments worked together toward strengthening national political legitimacy, regional solidarity and overall regional market growth through ASEAN (Severino, 2001).

As such, ASEAN as an organization has provided a development path for its member states to gain a competitive advantage in attracting FDI, which is needed to boost national and regional economic growth. Should all the proposed ASEAN initiatives aimed towards boosting inter- and intra-regional trade succeed, we do see great potential for Laos' business environment to garner large investments. What is apparent is that the benefits of integration for smaller and less developed economies is not only confined to regional institutional building and policy coordination, but also as a gateway for attracting investments. Lao PDR's membership into ASEAN allowed it to extend economic and political relationships towards countries, and consequently towards foreign companies, that have larger capital and networks needed to develop the country further.

CONCLUSION

A structured and high quality business environment will lead to increased investment in an economy. Clear and growth-inducing regulations with well-functioning regulatory institutions will allow opportunities for businesses to start up and expand. Economic stability and institutional reliability is still a priority for major foreign investors coming into any new environments. Being a young player in the global marketplace, transitional economies such as Lao PDR should capitalize on integrated economic memberships - such as those provided through ASEAN – to attract FDI that can help develop national economic growth.

Following economic reforms in the year 1988, FDI inflow was at US$2 million in Lao PDR.Then in the year 2009; FDI was a remarkable US$318.6 million. In the period of 2000 to 2008, the total project approved in Lao PDR was 1,045 with a value of US$6.461 billion with the hydropower industry being the most attractive sector to foreign investors. A huge inflow of FDI to Lao PDR comes from ASEAN investors. Being a part of ASEAN, Lao PDR has also garnered the interest of other countries the greater Asia region, such as Japan and South Korea.

The affiliation of a country to an integrated regional economic group can help boost its attractiveness towards foreign investors despite high levels of political risks accorded to it. What can be seen in the case of some of ASEAN's higher political-risks countries would be foreign investors are still keen on investing in these economies.This paper has presented some of the reasons related to Lao PDR's market attractiveness that have been perceived by the authors to have stemmed from its membership within ASEAN. The lure of an economically integrated region offers investors greater opportunities that may offset the possible political risks incurred.

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