

Research Focus

Multinational corporations and Pacific regionalism

Philippa Dee*

Both trade and investment are crucial to economic development. Foreign direct investment (FDI) adds to the stock of resources for development. Trade provides the discipline of competition, ensuring the most efficient use of the resources available.

It is now recognised that FDI and trade respond jointly to the complex forces of economic geography. Both phenomena reflect a tug of war between forces that tend to promote geographical concentration and those that tend to oppose it—between 'centripetal' and 'centrifugal' forces. And the key players making the balancing decisions are multinational corporations.

The result is a complex pattern of production and trade across the Asian region. Victor Fung, a Hong Kong clothing and textile executive, has described how his company may divide the production process for a particular clothing order into six or more steps with suppliers in different countries throughout the East Asian region. His company will routinely re-optimize the supply chain for each new order. Moreover, firms such as his may invest in some countries, and deal at arms length in others. This behaviour is better described in network terms, rather than as simple horizontal or vertical FDI.

Key research questions are whether this network model of trade and FDI is unique to the East Asian region, and whether the investment provisions of preferential trade agreements (PTAs) have had any influence on these investment decisions of multinational corporations.

Recent empirical research by the author suggests that there could be a pattern of FDI unique to the Asian region. This is not because FDI into the region falls neatly into any single archetype pattern. Rather, as a result of the high degree of economic integration in East Asia, FDI in the region responds relatively clearly to the forces of economic geography, unimpeded by other considerations.

One key driver is comparative advantage. Productive activity may be dispersed to take advantage of relative factor endowments. The labour-intensive parts of the production process go where labour is relatively abundant, while other parts of the production process go elsewhere to take advantage of capital, or the speed or quality of logistical and other services critical in the production chain.

But comparative advantage is mitigated by considerations of scale economies and transport costs. Where economies of scale are strong, it may be cheaper for production to be concentrated in one spot. If transport costs are high, it may be better for production to occur close to markets, rather than where resources are cheap.

FDI in the Asian region follows complex patterns. But it appears to respond quite clearly to these economic fundamentals.

Globally, FDI also appears to be influenced by the investment provisions of PTAs. But there are important differences across regions.

The clear winners from the investment provisions of PTAs appear to be the 'big eight'

Pacific Economic Cooperation Council XVII general meeting

As part of Australia's year of hosting APEC, the Pacific Economic Cooperation Council (PECC) will hold its next General Meeting (PECC XVII) in Sydney on 1-2 May 2007. This is the first time since 1980 that the General Meeting has been held in Australia. Up to 200 delegates from PECC's twenty-four member economies are expected to attend.

PECC XVII will be hosted by the Australian Pacific Economic Cooperation Committee (AUSPECC) with the theme *Managing the Challenges of Growth*. Sub-themes will cover what's new in the state of the region; building relevant institutions to serve the region; the consequences of demographic change; the challenges posed by constraints in regional resources markets; and the impact of environmental concerns on sustaining growth.

Keynote speakers and participants will include: the Hon John Howard, Prime Minister of Australia (invited); Mark Johnson, Deputy Chairman, Macquarie Bank & Chair of APEC Business Advisory Council; David Spencer, Australian Ambassador for APEC; Alan Beattie, World Trade Editor, Financial Times; HE Mr Cheng Siwei, Vice Chairman, National People's Congress of the People's Republic of China; Dr Mari Pangestu, Indonesian Minister for Trade (invited) and Prof Warwick McKibbin, Australian National University & member of the Reserve Bank Board.

Water security

Dry Water, a policy brief by Quentin Grafton, Jeff Bennet and Karen Hussey was launched on 4 April. The brief evaluates the recently announced national plan for water

contd. on next page

countries that are also the main sources of accumulated FDI—Canada, France, Germany, Japan, the Netherlands, Switzerland, the United Kingdom and the United States. Interestingly, individual countries in the 'big eight' group do not appear to suffer from investment diversion when other source countries sign investment provisions into PTAs with third parties.

Smaller developed countries appear able to attract FDI by signing investment provisions into PTAs. However, this effect can be offset by provisions in the same agreements that boost forms of service delivery (cross-border trade, movement of people) that substitute for FDI. More importantly, the small rich countries appear to suffer investment diversion when their source countries sign investment provisions into PTAs with third parties.

The African and South Asian groupings of developing countries were not major players in signing PTAs over the estimation period (1988–97). But they were largely insulated from

any investment diversion when source countries signed PTAs with third parties.

Although many countries in the Latin American group have signed NAFTA-style PTAs with strong investment provisions, this appears not to have attracted FDI into the region.

Finally, the phenomenal growth of FDI into the Asian region appears not to have been driven by the investment provisions of PTAs signed with their bilateral source countries. But the network nature of regional investment within Asia means that individual members have been insulated from any investment diversion when their source countries have signed PTAs with third parties. This is because the investment that the sources make in third countries can be a general equilibrium complement to bilateral investment within the overall Asian network.

The findings suggest that in Asia—where FDI and trade are sufficiently driven by fundamentals, in a way that takes advantage of

fine divisions of comparative advantage, but subject to considerations of economies of scale and transport costs—the resulting network patterns of investment do not need to be boosted by investment provisions of PTAs. Further, the network patterns can be sufficiently strong to insulate a country from investment diversion when the FDI source countries play the PTA game elsewhere.

This is in strong contrast with the findings for Latin America. When FDI and trade are not sufficiently driven by fundamentals, the investment provisions of PTAs signed with source countries have little real effect.

Thus the investment provisions of PTAs pose neither a threat nor a promise to FDI in the Asian region.

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contd. from previous page

security, provides a review of how to assess the trade-offs between water use and environmental flows and examines the social dimension of water policy.

5 April–21 June, GDLN Global Issues Seminar series

10 April, PNG Executive Update, Port Moresby

11 April, PNG Community Update, Port Moresby

13 April, Kokopo Community Update, Kokopo

17 April, Alotau Community Update, Milne Bay

Crawford Seminars*

3 April, David Vanzetti, Crawford School *Chicken Supreme: How the Indonesian Poultry Sector can survive Avian Influenza*

24 April, Philippa Dee, Crawford School *Multinational corporations and Pacific regionalism*

1 May, Trevor Breusch, Crawford School *Replication in applied economics: The case for data and code archives*

***Seminars are held at 12.30pm in Seminar Room 4, Crawford Building**

Publications

Asia Pacific Press

Arndt's Story: the life of an Australian economist, Peter Coleman, Peter Drake and Selwyn Cornish, with Bettina Arndt (eds), Asia Pacific Press and the Institute of Southeast Asian Studies, Singapore

A biography of Professor Heinz (H.W.) Arndt, the pioneering development economist. For a full description, visit www.asiapacificpress.com

RRP \$45

SPECIAL OFFER: Readers of the *APEC Economies Newsletter* are invited to purchase *Arndt's Story* at the special introductory price of A\$30 before 31 May 2007. Please contact Email: books@asiapacificpress.com

Pacific Economic Papers

360 *China and East Asian energy: prospects and issues, Volume 1*

Peter Drysdale, Kejun Jiang and Dominic Meagher (eds)

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