4th March 2012

Institutional Capacity and Regional Integration: Constraints on Investment and Trade.

A submission to the Inquiry: Australia in the Asian Century

by

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Our submission has as its focus regimes for the regulation of Foreign Direct Investment (FDI) in Asia, and specifically in the ASEAN region. These regulatory regimes are critical to debates regarding the opening of economies to FDI, the development of services trade and regional integration. For Australia there is a need to develop our understanding of these regimes in both their strengths and limitations. Higher level negotiations and agreements have been a characteristic of Australia’s engagement in the region at the official level. Attention to the factors affecting integration in trade and investment at more basic, functional levels such as the formation of regulation and capacity to administer laws and regulations attracts less attention and resources. However the implementation of higher level agreements and therefore the likelihood of their success depend upon timely and efficient implementation.

Australia has only limited knowledge of the processes by which regulatory regimes for FDI are developed within Asia and little empirical knowledge regarding the institutional capacity of countries in this area. Such capacity related to inward FDI includes the workings and capabilities of government agencies in terms of legitimacy and flexibility as well as the human capital and skills of the civil servants.

We suggest that Australia needs to develop an enhanced understanding of regulatory regimes as both restrictors and enablers of FDI. Contemporary governance theory as well as the approaches of applied economics and international business can be used to attain a more nuanced understanding. The capacities of national civil services have an important role in supporting regulatory regimes that assist or impede integration within Asia.

Research is called for into institutional practice; research that explores capacities within ASEAN, (and later Asia more broadly) that might enable greater regional integration. Such capacities underpin the regulation of FDI and the opening of economies to investment and
trade. More open trade and investment requires much more that a focus solely on nations signing up to regional agreements; divergent practices in FDI regulation need to be enumerated and their efficacy assessed. In particular, there is a pressing need to explore the capacities within states that enable effective regulation of FDI.

Effectiveness of states in regulating FDI flows and proposals can be viewed from several perspectives including the efficient screening of proposals. Each of the ASEAN countries, to a greater or lesser, extent undertakes screening of foreign direct investment proposals. An emphasis on efficient and successful FDI screening processes foregrounds the capacities of governments to influence and shape investment flows. Such practices affect the quantum and the sectoral composition of investment flows into individual countries and across the region.

A fundamental challenge is the limited information on the capacities within each ASEAN state (indeed within Asia) to support and foster effective regulatory regimes on FDI. Here we call for projects supported by the Australian government that focus on bureaucratic capacity, particularly in the ASEAN region. At this stage we do not even have summary data on the strength and weakness in many areas of development. In particular we lack objective data on capacities within government, civil society and the private sector to effectively engage with and enable inward FDI. Preliminary analysis (Sadleir, Mahony & Rafi 2011) suggests that the countries of ASEAN possess only fragmented and underdeveloped capacities to screen inward FDI effectively. Aside from the adverse implications for individual member states this constrains any mooted regional approaches to FDI. Whilst international agencies such as the Asia Development Bank (ADB) support institutional strengthening objective metrics are not generally available. (The Australian government might work with the ADB to develop indicators of bureaucratic capacities related to the screening of inward FDI and regional policy development). Efficient FDI regulatory frameworks appear to be a necessary if not sufficient condition for regionalism.

Knowledge of institutional capacities also underpins understanding of the practices and regulatory regimes associated with the development of services trade and investment such as the export of education and consultancy. However we do not possess a strong generalized understanding of the capacity or capabilities within the markets which we wish to target. FDI is in fact an exemplar of a range of issues that confront Australia in the region. The development of fine grained understanding of capacities and capabilities of regulatory regimes in the region can complement higher level umbrella agreements at a multinational level to promote greater openness in investment and trade.

At a more fundamental level research might be directed towards understanding how regulatory regimes are formed and explaining why they differ between nation states. Our current work explores how social norms shape differences in institutional practices and such norms also limit the implementation of higher level agreements e.g. commitments to open trade and investment are mediated in each national environment in face of social and political factors such as nationalism and attention to indigenous rights. We have demonstrated that even in the case of two very similar countries such as New Zealand and Australia important
differences are evident in our regimes for the screening of FDI by the Overseas Investment Office and the Foreign Investment Review Board respectively (Saleir and Mahony 2009; Mahony and Sadleir 2011). Extending this approach for ASEAN suggests the strong likelihood of similar interaction between institutions and societal values.

The question arises as to how to develop data with which to analyze these issues of capacity and the role of social norms in shaping regulatory regimes. In regard to capacity two possible ways forward are suggested for research: either use more generally available data sets on measuring political risk associated with particular countries; or seek more in-depth analysis on a country by country basis. The former approach is likely to be a less accurate means of assessment and the later likely to be time and resources intensive. A third possibility is to encourage both states in ASEAN and other regional actors to be more supportive and proactive in making such information publically available. Given that the activities of regulating FDI through government can be reasonably well defined, it is likely that a cross country project to facilitate greater viability of bureaucratic data could be achieved with the necessary commitment of resources from within ASEAN. In turn such data would provide the basis for enabling more focused development of national regulatory capacities within ASEAN, and in turn offering the emergence over time of a more certain regulatory FDI regime for foreign investors seeking to enter this region.

In order to collect data relevant to an understanding of the social norms that affect and shape regulatory regimes in the several countries of the Asia inductive approaches are most appropriate. Here Australia is well placed with a range of Asia research centres which could cooperate in interdisciplinary studies.

Conclusion

Our submission has focused on one, key vehicle for enhancing Australia’s role in the Asian Century— that of FDI and its regulation. This has important implications for the transformative contribution of international business. Regulatory regimes provide both the doorway for FDI and at times reflect limits to a feasible rate of integration. Differences between countries suggest variations in regulatory frameworks. Their operations present significant contingencies that may confront the expansion of international business and flows of FDI. Understanding differences in institutional capacities requires a considerable commitment to data collection. Such commitment is not currently evident.

Policy in the short term should be aimed at research; research involving conceptualisation, quantification and development of metrics of institutional and bureaucratic capacity. ASEAN and the ADB might be enlisted in such tasks.

In the longer term such research and will underpin approaches to develop and support institutional capacity of countries of the region to strengthen and foster skills and capabilities.
in government agencies, as well as educational bodies and businesses. Such institutional capacity will enable more effective regulation of inward FDI at the country and regional level facilitating the expansion of investment flows in the region.

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References


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