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The RCEP and the Changing Landscape of World Trade-- Assessing Asia-Pacific Investment Regionalism Next Stage

Julien Chaisse

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The RCEP and the Changing Landscape of World Trade

Assessing Asia-Pacific Investment Regionalism Next Stage

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Abstract: This article provides a detailed economic and legal analysis of the Regional Comprehensive Economic Partnership (RCEP) with regard to foreign investment with the objective to give an assessment of the impact of this new treaty on investment policies and flows in the Asia-Pacific region. Part One analyzes recent foreign direct investment flows in the ASEAN+6 countries, focusing on sectors of rapid growth and participation in global value chains and offers an overview of the RCEP rules on investment from an economic and legal perspective. Part Two analyzes the impacts of deep integration agreements on investment, as in the ASEAN Comprehensive Investment Agreement and RCEP’s rules on investment, with particular emphasis on the actual and potential role of small and medium-sized enterprises. The final section looks forward, with best case and plausible-scenario analysis of future impacts on FDI within RCEP, if deep integration progresses among the 16 countries.

Keywords: FDI, investment, FTA, ASEAN, GVC

1 Introduction

The Regional Comprehensive Economic Partnership (RCEP) was launched in November 2012 and negotiations began in May 2013. The objective of launching the RCEP negotiations was “to achieve a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement among the ASEAN Member States and ASEAN’s FTA Partners” that will “cover trade in goods, trade in services, investment, economic and technical cooperation, intellectual

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property, competition, dispute settlement and other issues.” The first round of negotiations was held in May 2013, and by November 2017 19 rounds had taken place, as well as several RCEP ministerial meetings. Details of the negotiations are confidential, although official reports provide progress reports, e.g., two of the eighteen chapters (on small and medium-sized enterprises and on economic and technical cooperation) had been concluded by the end of 2016. Negotiations have become more complex, with around 700 officials gathering for negotiations in 2017, compared to 60 delegates at the meetings in 2013. This report is being written as RCEP is negotiated. It makes no attempt to second-guess detailed provisions of the final agreement, but accepts the objective stated above. An early expectation was that RCEP would provide a basis for more open trade and investment in the region by addressing concerns about a “noodle bowl” of overlapping bilateral agreements. 

Another key economic rationale for RCEP resides in the scale of economy. The consolidated market size for RCEP (48% of the world population and 28% of the world GDP in 2016) is large enough to create a positive trade creation effect and boost more inclusive economic growth in this region. The higher ratio of intra-regional trade among RCEP member economies of over 40% is another promising factor in expecting a large trade creation effect. Over the last half century, and especially since the late 1980s falling international trade costs have encouraged finer division of labor crossing international borders, commonly referred to as global value chains (GVCs).

With reduced fixed costs of trading, the process of finding specialized niches or tasks in GVCs favors small and medium-sized enterprises (SMEs) which can be nimble and specialized. This process may require foreign investment if a

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1 The founding documents, approved 20 November 2012, are the “Joint Declaration by Leaders on the Launch of the Regional Comprehensive Economic Partnership” and the “Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership”. Quotations are from the preamble to the “Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership”.


4 On the concept of trade costs as the difference between the costs of international and domestic trade, and problems of measuring trade costs see Patricia Sourdin and Richard WT Pomfret, Trade facilitation: defining, measuring, explaining and reducing the cost of international trade (Edward Elgar Publishing, 2012), p. 1. In this article, “trade costs” are defined as this difference and trade facilitation refers to measures to reduce trade costs.
potentially efficient niche producer is constrained by shortage of domestic capital. It is also likely to require specialized services, at least for coordinating production and logistics along the supply chain, and movement of skilled labor, e.g. if technical staff from an adjacent link in the supply chain are needed to trouble-shoot a problem. In sum, an environment in which SMEs can effectively occupy niches in GVCs should not only minimize the costs of trading goods as inputs and outputs but also allow substantially free movement of capital, skilled labor, and business service providers. The GATT/WTO trade law hardly went beyond setting rules for trade in goods. Regional trading arrangements before the 1980s also focused on tariffs. Only in the early 1980s with the European Union’s Single Market program and Australia–New Zealand Closer Economic Relations did RTAs address what came to be known as “deep integration” issues. From the mid-1990s deep integration spread to North–South RTAs such as NAFTA or the EU’s Euro-Med Association Agreements, and after 2000 Japan’s Economic Partnership Agreements. In such agreements, preferential tariffs are unimportant. For Baldwin “the critical difference between 20th and twenty-first century trade is the trade-investment-services nexus” which in the last two decades of the twentieth century was addressed in bilateral investment treaties, but in the twenty-first century is increasingly addressed in deep RTAs. RCEP clearly aspires to deep integration. This article provides a detailed economic and legal analysis of the RCEP with regard to foreign investment with the objective to give an assessment of the impact of this new treaty on investment policies and flows in the Asia-Pacific region. Part One analyzes recent foreign direct investment flows in the ASEAN + 6 countries, focusing on sectors of rapid growth and participation in GVCs and offers an overview of the RCEP rules on investment from an economic and legal perspective. Part Two analyzes the impacts of deep integration agreements on investment, as in the ASEAN Comprehensive Investment Agreement (ACIA) and RCEP’s rules on investment, with particular emphasis on the actual and potential role of SMEs. The final section looks forward, with best case and plausible-scenario analysis of future impacts on FDI within RCEP, if deep integration progresses among the 16 countries.

2 RCEP in Context Economic and Intuitional Features

Termination of US interest in TPP provides scope for RCEP to fill the vacuum and establish standard-setting rules in areas such as foreign investment. A significant feature of the transition from TPP to CPTPP is the weakening of claims to be leading the world in addressing the Singapore Issues that were supposed to be tackled in the WTO’s Doha Development Round but have so far made little progress in that forum. The WTO Trade Facilitation Agreement has now come into force, and RCEP can bolster its impact by clarifying how the general principles of the Trade Facilitation Agreement are to be put into practice. The November 2017 outline of the RCEP Agreement included chapters on investment and competition as well as covering other regulatory issues.

2.1 Analysis of Data on Foreign Direct Investment Flows by Sector in ASEAN + 6 Countries

The overall patterns of FDI in the ASEAN + 6 countries are apparent from UNCTAD’s World Investment Report database (Table 1). Richer countries tend to be origin countries and poorer countries destination countries for FDI. The ASEAN 10 are all net FDI recipients and, except for Malaysia in recent years, their inward stock exceeds their outward stock of foreign capital. Magnitudes vary greatly, with Singapore’s inward and outward stocks exceeding those of the other nine ASEAN countries combined. However, over the decade 2005–15, the other four original ASEAN members (Indonesia, Malaysia, Philippines, and Thailand) have experienced a rapid increase in outward FDI from low bases. Among the + 6 countries China and Japan have the largest FDI flows, with the difference that Japan is primarily a net exporter of FDI while for China inflows and outflows have been roughly balanced in recent years. The Chinese picture may be distorted by capital flowing through Hong Kong or Macao; Hong Kong has the biggest stock of both inward and outward FDI in Asia. Korea has become a large net exporter of FDI, while India, Australia and New Zealand remain net recipients. More detailed FDI data are in the annual ASEAN Investment Reports, which provide details of source and destination countries and sectoral breakdowns of FDI in ASEAN, as well as details of individual companies’ involvement. The biggest sources of FDI into ASEAN are intra-ASEAN, EU, Japan and USA. Intra-ASEAN FDI Inflows increased from $15 billion in 2011 to $22 billion in 2015 (18.5% of the total). RCEP partners contributed about a third of FDI inflows into
### Table 1: FDI inflows, outflows, and stocks in million US dollars, 2005 and 2015.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Brunei Darussalam</td>
<td>289.5</td>
<td>173.2</td>
<td>16.6</td>
<td>507.9</td>
<td>2,124.6</td>
<td>6,060.9</td>
<td>553.3</td>
<td>2,645.2</td>
</tr>
<tr>
<td>Cambodia</td>
<td>381.2</td>
<td>1,701.0</td>
<td>6.3</td>
<td>47.5</td>
<td>2,471.0</td>
<td>14,738.6</td>
<td>267.0</td>
<td>531.0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>8,336.3</td>
<td>15,508.2</td>
<td>3,065.0</td>
<td>6,249.6</td>
<td>41,187.0</td>
<td>224,843.4</td>
<td>−1,762.0</td>
<td>30,171.5</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>27.7</td>
<td>1,219.8</td>
<td>−6.0</td>
<td>1.1</td>
<td>680.8</td>
<td>4,850.2</td>
<td>14.9</td>
<td>15.9</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4,065.3</td>
<td>11,121.5</td>
<td>3,075.5</td>
<td>9,899.4</td>
<td>44,459.5</td>
<td>117,643.8</td>
<td>22,034.9</td>
<td>136,892.0</td>
</tr>
<tr>
<td>Myanmar</td>
<td>110.4</td>
<td>2,824.0</td>
<td></td>
<td></td>
<td>6,480.4</td>
<td>20,475.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>1,854.0</td>
<td>5,234.0</td>
<td>189.0</td>
<td>5,601.9</td>
<td>14,978.0</td>
<td>59,302.6</td>
<td>2,028.0</td>
<td>41,100.0</td>
</tr>
<tr>
<td>Singapore</td>
<td>18,090.3</td>
<td>65,262.4</td>
<td>12,552.5</td>
<td>35,485.0</td>
<td>237,009.4</td>
<td>978,410.8</td>
<td>191,211.2</td>
<td>625,259.1</td>
</tr>
<tr>
<td>Thailand</td>
<td>8,003.7</td>
<td>10,844.6</td>
<td>807.0</td>
<td>7,776.2</td>
<td>61,413.3</td>
<td>175,441.6</td>
<td>5,167.7</td>
<td>68,057.9</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>1,954.0</td>
<td>11,800.0</td>
<td>65.0</td>
<td>1,100.0</td>
<td>22,444.3</td>
<td>102,791.3</td>
<td>65.0</td>
<td>8,590.0</td>
</tr>
<tr>
<td>China</td>
<td>72,406.0</td>
<td>135,610.0</td>
<td>12,261.2</td>
<td>127,560.0</td>
<td>272,094.0</td>
<td>1,220,903.0</td>
<td>57,205.6</td>
<td>1,010,202.4</td>
</tr>
<tr>
<td>Hong Kong, Macao, China</td>
<td>34,058.0</td>
<td>174,892.1</td>
<td>27,003.2</td>
<td>55,143.3</td>
<td>493,894.7</td>
<td>1,572,605.8</td>
<td>476,192.8</td>
<td>1,485,663.4</td>
</tr>
<tr>
<td>Japan</td>
<td>2,775.8</td>
<td>−2,250.0</td>
<td>45,781.2</td>
<td>128,653.8</td>
<td>100,901.1</td>
<td>104,369.7</td>
<td>386,585.0</td>
<td>1,226,553.6</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>13,643.2</td>
<td>5,042.0</td>
<td>8,330.0</td>
<td>27,639.8</td>
<td>104,879.1</td>
<td>174,573.2</td>
<td>38,683.1</td>
<td>278,395.0</td>
</tr>
<tr>
<td>India</td>
<td>7,621.8</td>
<td>44,208.0</td>
<td>2,985.5</td>
<td>7,501.4</td>
<td>43,201.6</td>
<td>282,273.0</td>
<td>9,741.3</td>
<td>138,967.4</td>
</tr>
<tr>
<td>Australia</td>
<td>−28,293.9</td>
<td>22,264.5</td>
<td>−35,783.2</td>
<td>−16,738.9</td>
<td>247,747.9</td>
<td>537,351.1</td>
<td>205,367.8</td>
<td>396,431.0</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1,204.7</td>
<td>−985.8</td>
<td>−1,339.2</td>
<td>214.3</td>
<td>44,094.0</td>
<td>66,055.6</td>
<td>11,778.0</td>
<td>17,261.5</td>
</tr>
</tbody>
</table>

ASEAN countries in 2015: Japan $17.4 billion, China $8.2 billion, Korea $5.7 billion, Australia $5.2 billion, New Zealand $2.2 billion, India $1.3 billion and intra-ASEAN $22.1 billion (Table 2). The largest sector in 2015 was finance and insurance, even though FDI inflows fell from $46 billion in 2014 to $39 billion in 2015. The second-largest inflow was in manufacturing, where FDI from Japan is the largest. Australia stands out in wholesale and retail trade, although the 2015 FDI may have been a spike (the 2014 figure was $325 million). The EU is also a large source of FDI in wholesale and retail trade, as well as having large FDI in “other services”. Chinese, Japanese and Korean companies’ involvement in infrastructure development in the region is understated, because some of the values of infrastructure contracts are not captured in the FDI data system.7

The annual ASEAN Investment Reports highlight the speed of change. In the early 2000s, Korean FDI in southeast Asia was overwhelmingly in natural resources, but by 2015 it was mostly in manufacturing and services. The role of regional value chains (RVCs) is also dynamic. In 2016, HP was expanding its production into Myanmar, Cambodia and Lao PDR, using Thailand as the company’s digital hub in the region; Denso was pursuing a similar strategy with respect to auto components.8 Unsurprisingly given global patterns of GVC formation these developments in RVCs are most pronounced in electronics and automobiles, but in southeast Asia there are similar patterns in clothing and other sectors. There is also evidence of local ASEAN companies starting as contract suppliers to foreign multinationals, but quickly becoming foreign investors themselves; this is especially evident for firms from the original ASEAN members and Vietnam opening production affiliates in Cambodia, Lao PDR and Myanmar.9

Nevertheless, generalization can be difficult. Some GVC arrangements are stable; Intel has continued sourcing from Vietnam, to the extent that 80% of the world’s central processing units for personal computers are produced in Intel’s Vietnam factories.10 ExxonMobil, perhaps driven by scale economies and locational advantage, has its largest petrochemicals complex worldwide in Singapore. The regional FDI by cement giants like Siam Cement is in response

7 ASEAN, ASEAN Investment Report 2015: Infrastructure Investment and Connectivity (Jakarta: Association of Southeast Asian Nations, 2015).
Table 2: FDI inflows into ASEAN, by sector and origin, million US dollars, 2015.

<table>
<thead>
<tr>
<th></th>
<th>ASEAN</th>
<th>Japan</th>
<th>ROK</th>
<th>China</th>
<th>India</th>
<th>Australia</th>
<th>NZ</th>
<th>USA</th>
<th>EU</th>
<th>Canada</th>
<th>HK</th>
<th>Taiwan</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>AFF</td>
<td>4,080</td>
<td>56</td>
<td>100</td>
<td>62</td>
<td>4</td>
<td>2</td>
<td>0</td>
<td>9</td>
<td>138</td>
<td>0</td>
<td>328</td>
<td>9</td>
<td>4,831</td>
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<tr>
<td>Mining</td>
<td>1,038</td>
<td>792</td>
<td>6</td>
<td>230</td>
<td>0</td>
<td>38</td>
<td>51</td>
<td>398</td>
<td>1,615</td>
<td>20</td>
<td>70</td>
<td>0</td>
<td>7,253</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>5,119</td>
<td>8,395</td>
<td>2,706</td>
<td>930</td>
<td>-223</td>
<td>-50</td>
<td>8</td>
<td>906</td>
<td>2,482</td>
<td>32</td>
<td>505</td>
<td>920</td>
<td>29,015</td>
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<tr>
<td>Electricity &amp; gas</td>
<td>346</td>
<td>188</td>
<td>486</td>
<td>550</td>
<td>9</td>
<td>13</td>
<td>1</td>
<td>18</td>
<td>-155</td>
<td>0</td>
<td>77</td>
<td>94</td>
<td>1,983</td>
</tr>
<tr>
<td>Trade &amp; repair</td>
<td>1,043</td>
<td>2,221</td>
<td>937</td>
<td>162</td>
<td>177</td>
<td>4,843</td>
<td>-3</td>
<td>274</td>
<td>4,551</td>
<td>23</td>
<td>698</td>
<td>267</td>
<td>11,188</td>
</tr>
<tr>
<td>Transport &amp; storage</td>
<td>304</td>
<td>391</td>
<td>-47</td>
<td>339</td>
<td>0</td>
<td>-45</td>
<td>0</td>
<td>52</td>
<td>234</td>
<td>16</td>
<td>151</td>
<td>31</td>
<td>3,281</td>
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<td>IC</td>
<td>1,113</td>
<td>161</td>
<td>17</td>
<td>3</td>
<td>1</td>
<td>-18</td>
<td>0</td>
<td>23</td>
<td>274</td>
<td>0</td>
<td>-269</td>
<td>1</td>
<td>1,825</td>
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<tr>
<td>Finance</td>
<td>3,584</td>
<td>2,544</td>
<td>605</td>
<td>3,586</td>
<td>1,034</td>
<td>3,330</td>
<td>2,152</td>
<td>8,595</td>
<td>706</td>
<td>739</td>
<td>1,242</td>
<td>1,005</td>
<td>39,322</td>
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<td>Real estate</td>
<td>2,752</td>
<td>131</td>
<td>416</td>
<td>1,822</td>
<td>272</td>
<td>56</td>
<td>9</td>
<td>425</td>
<td>511</td>
<td>17</td>
<td>588</td>
<td>116</td>
<td>9,207</td>
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<tr>
<td>other services</td>
<td>377</td>
<td>2,033</td>
<td>317</td>
<td>417</td>
<td>-99</td>
<td>-2,976</td>
<td>18</td>
<td>782</td>
<td>8,786</td>
<td>7</td>
<td>109</td>
<td>31</td>
<td>8,142</td>
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<tr>
<td>Unspecified</td>
<td>2,395</td>
<td>483</td>
<td>139</td>
<td>53</td>
<td>81</td>
<td>0</td>
<td>6</td>
<td>710</td>
<td>521</td>
<td>38</td>
<td>263</td>
<td>173</td>
<td>3,927</td>
</tr>
<tr>
<td>Total</td>
<td>22,149</td>
<td>17,395</td>
<td>5,680</td>
<td>8,155</td>
<td>1,254</td>
<td>5,193</td>
<td>2,241</td>
<td>12,192</td>
<td>19,667</td>
<td>893</td>
<td>3,621</td>
<td>2,646</td>
<td>119,975</td>
</tr>
</tbody>
</table>

Source: ASEAN (2016, Table 1.2).

Notes: AFF, agriculture, forestry and fisheries; IC, information and communications; “unspecified” includes data unclassified for confidentiality reasons.
to booming infrastructure construction, combined with cement’s economies of scale in production and high transport costs.

Athukorala makes an explicit link between the RCEP and the strength of international supply chains among the RCEP countries.\textsuperscript{11} He concludes that the link implies a push for multilateral negotiations, because the value chains are global and GVC-participating countries need the market-access guarantees offered by WTO membership. However, much of the production part of value chains is regional, and it is usually only at the final demand stage that the chains become global. The deep integration, in areas such as investment encouragement and protection, necessary to facilitate cheap, fast and certain delivery of components across national borders may be better negotiated bilaterally or regionally.

### 2.2 RCEP Rules on Investment in Context: BITs, FTAs, and TPP

Asian States have also concluded a prolific number of IIAs, including mega regional trade agreements with investment chapters like the Trans-Pacific Economic Partnership Agreement (TPPA), the ACIA and the continued negotiation of the Regional Cooperation Economic Partnership (RCEP) involving ASEAN Member States and parties to the ASEAN+ 6 regional trade agreements.\textsuperscript{12} Indeed, more than a third of IIAs currently in existence involve Asian signatories.\textsuperscript{13}

The current section looks at the investment agreements concluded by the RCEP countries. In total, RCEP states have concluded 712 BITs and 294 PTAs which contain an investment chapter. Since approximately 3,000 BITs have been concluded worldwide over the same period of time, it means that RCEP states have taken part in no less than 30% of international investment rule-making.


In terms of substance, investment treaty practice shows that virtually all treaties regulating foreign investment matters cover the following nine topics: (1) definitions and scope of application; (2) investment promotion and conditions for the entry of foreign investments and investors; (3) general standards for the treatment of foreign investors and investments; (4) issues of monetary transfers; (5) expropriation (direct or indirect); (6) operational and other conditions; (7) losses from armed conflict or internal disorder; (8) treaty exceptions, modifications, and terminations; and (9) dispute settlement. These diverse provisions are important to reassure foreign investors that they will be able to reap the benefits of their investment; furthermore, no trend in the recent treaty practices of states denies such an approach, although evidence on the extent to which investment decisions are influenced by investment treaties is mixed. (The extent to which BITs actually attract increased flows of foreign direct investment is disputed. According to Salacuse & Sullivan, entering a BIT with the United States would nearly double a country’s FDI inflows; however, entering BITs with other OECD countries had no significant effect on FDI. Another important study concludes that there is “little evidence that BITs have stimulated additional investment.” As shown by the RCEP investment chapter, the RCEP negotiations have developed against this background (Table 3).

The RCEP preserves core protections against nationality-based discrimination toward investors, uncompensated expropriations or takings of investments (art. 9.8), and treatment of investments and investors that runs afoul of the obligation to provide fair and equitable treatment and full protection and security (art. 9.6). Consistent with the U.S. Model BIT, the fair and equitable treatment obligation “prescribes the customary international law minimum standard of treatment of aliens.” In general, the provisions articulating these protections align with existing U.S. agreements and do not introduce new norms. These diverse provisions are important to reassure foreign investors

Table 3: RCEP rule-making innovations at a glance.

<table>
<thead>
<tr>
<th>RCEP provision</th>
<th>Issue of interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definitions (with Annex)</td>
<td>NAFTA excludes sovereign debt from coverage of Chapter 11. The RCEP includes sovereign long-term debt as a “form that an investment may take.” Similar to 2012 USA Model BIT.</td>
</tr>
<tr>
<td>Art. Scope and coverage</td>
<td>RCEP makes clear that the substantive obligations of the BIT apply to a state enterprise or other person when it exercises any regulatory, administrative, or other governmental authority delegated to it by that Party. Similar to 2012 USA Model BIT Art. 2.2.</td>
</tr>
<tr>
<td>Art. Relation other chapters</td>
<td>Does not apply to measures adopted or maintained by a Party to the extent that party is covered by the chapter on financial services.</td>
</tr>
<tr>
<td>Art. National treatment</td>
<td>Comparator is “in like circumstances.” Similar to NAFTA.</td>
</tr>
<tr>
<td>Art. Most favored nation treatment</td>
<td>Comparator is “in like circumstances.” Similar to NAFTA; however, exception on investor state dispute settlement (ISDS).</td>
</tr>
<tr>
<td>Art. Minimum standard of treatment</td>
<td>Embodies NAFTA Interpretation regarding the international minimum standard. Similar to 2012 U.S. Model BITs and similar provisions of recent U.S. investment agreements.</td>
</tr>
<tr>
<td>Art. Treatment in case of Armed conflict or civil strife</td>
<td>Complemented by Annex 9-A.</td>
</tr>
<tr>
<td>Art. Performance requirements</td>
<td>Expanded coverage that includes conduct by a host State to preference local technology against “technology of the Party,” which is defined as including technology owned or held under exclusive license by an investor of the other Party. Similar to 2012 USA Model BIT (Art. 8).</td>
</tr>
<tr>
<td>Art. Investment and environment, Health and other Regulatory Objectives</td>
<td>Encompasses a duty to enforce local environmental laws. Addresses environmental and labor obligations in a manner quite different from NAFTA, which only contains exhortatory language similar to U.S. free trade agreements.</td>
</tr>
</tbody>
</table>
that they will be able to reap the benefits of their investment; furthermore, no trend denies such an approach, although evidence on the extent to which investment decisions are influenced by investment treaties is mixed. The provisions identified in Table 1 will form the basis of this paper’s analysis with a view to determine whether the RCEP departs from previous U.S. treaty practices.

2.3 The Issue of Investor–State Arbitration

The significant increase in the number of international investment agreements (“IIAs”) over the past two decades has been accompanied by a meteoric rise in the number of investor–state disputes.18 In 2016 alone 70 investor–state arbitrations were initiated, the highest number of cases in a single year and significantly up from the 42 arbitrations initiated the previous year.19 Asia-Pacific itself has witnessed a startling number of investment disputes; about 21% of all investment disputes involve Asian states.20 The vast majority of claims are against India (17), making it the 12th highest sued country in the world, followed by Pakistan (9) and Indonesia (6).21 Several authors foretell a greater number of disputes involving Asian parties in the future, mainly because of the rising number of IIAs in parallel with increasing FDI flows in Asia, coupled with a greater awareness of investment rules shown by Asian actors.22

19 IIA Issues Note No. 2 [2016], IIA Issues Note No.1 [2015]. See also UNCTAD, World Investment Report 2016, available at: <http://unctad.org/en/PublicationsLibrary/wir2016_en.pdf>, <http://unctad.org/en/PublicationChapters/wir2015ch0_KeyMessage_en.pdf>. This is the number of publicly known cases. As a significant number of cases are conducted in a confidential framework, the actual number of disputes is likely to be higher.
20 See <http://investmentpolicyhub.unctad.org/ISDS/FilterByCountry>. See also J. Chaisse, Assessing the Exposure of Asian States to Investment Claims, Contemporary Asia Arbitration Journal (2013), 6, concluding that more than 90 investment disputes involving 24 Asia-Pacific states being filed since 1987; Chaisse’s study did not include cases involving Asian investors, or claims filed in 2014–2016.
2.4 Basics of Investor–State Arbitration

In practice, IIAs entail conflicts of interest between the investor and the host state over the nature of the control that could be exercised over the foreign investment. Essentially, the investor’s interest is to control its investment within a stable and predictable legal regime, while the host state seeks to exert its sovereign power to define its policies. This conflicting interest poses a big challenge to the policy-makers in Asian countries, because in developing their economies there is the greater need for the governments to adopt a milder approach of progressive liberalization. In other words, policy-makers in developing countries need to retain greater policy space than that in developed countries so that they can formulate policies in a flexible manner as the countries develop. Also the concern over the loss of sovereignty is relevant in this context – with respect to the pre-establishment phase, the starting point of general international law on foreign investment is that sovereign states have the right to decide whether to open their economies to foreign investors and to determine the modalities for its admission and establishment, which is a “prerogative deriving from national sovereignty”.23

With the rapid development of international investment law, increasing attention is paid to the need for the balance between the domestic and international legal frameworks seeking to promote foreign investment on the one hand, and the law and policies necessary to regulate the conduct of investors and investments to protect legitimate public interests, on the other.24 At the center of this issue, there are concerns over investor–state arbitration. While the investment regime has been construed largely through bilateral, rather than multilateral, negotiations, an increasing number of investment treaties have similar structures, purposes, and principles in part due to the fact that individual

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negotiations have proceeded on the basis of treaty models prepared by capital-exporting countries.

The most significant similarities include the provision of international arbitration as the ISDS mechanism. Investment arbitration is deemed to be a crucial feature of foreign investment protection because it provides access to a neutral forum for the settlement of disputes. Investor–state arbitration was welcomed not only as an alternative to the domestic courts of the host state, but also as a technique that “depoliticises” the disputes, by removing them from the intergovernmental political relationship between the home state and the host state. On the other hand, investor–state arbitration that operates outside the domestic legal framework of the host state can be considered to be an unwarranted interference with the sovereignty of the host state. This is especially so given that investor–state disputes have evolved from traditional expropriation cases to conflicts arising out of regulatory interference with various aspects of the investment, and therefore they are now considered to be “regulatory disputes within the public law sphere”.

2.5 ASIAN Trends

While international arbitration remains the preferred mechanism for resolving disputes between an investor and a state, several states disenchanted with or simply critical of investment arbitration are proposing viable alternatives. Several states are redefining the current investor–state arbitration framework and its relationship to democratic decision-making. In fact, the EU-Vietnam Free Trade Agreement contemplates the creation of an “investment court” that would

resolve disputes between investors and Member States.\footnote{See Press release of the European Commission, available at: <http://ec.europa.eu/trade/policy/countries-and-regions/countries/vietnam/>, accessed February 1, 2016, the text of the EU-Vietnam Free Trade Agreement was published, following the announcement of the conclusion of the negotiations. The legal review of the text has now begun and will be followed by translation into the EU’s official languages and Vietnamese. The Commission will then present a proposal to the Council of Ministers for approval of the agreement and ratification by the European Parliament. An investment court is also contemplated under the EU-Canada Comprehensive Economic and Trade Agreement (see below). See EU-Canada Comprehensive Economic and Trade Agreement, available at: <http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf>. <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1409>. See also: M. Daly and J. Ahmad, The EU-Vietnam FTA: What does it all mean? What does it mean for the future? (Kluwer Arbitration Blog, 2015), available at: <http://kluwerarbitrationblog.com/2015/12/14/the-eu-vietnam-fta-what-does-it-all-mean-what-does-it-mean-for-the-future/>.} Other states have chosen to significantly reduce the scope of issues that can be submitted to arbitration, while still others require such disputes to be submitted first to their own domestic courts.

In addition, the G20 recently released its “Guiding Principles for Global Investment Policymaking” (“G20 Principles”) which insist that “[i]nvestment policies should provide legal certainty and strong protection to investors and investments, tangible and intangible, including access to effective mechanisms for the prevention and settlement of disputes, as well as to enforcement procedures” (Annex III: G20 Guiding Principles for Global Investment Policymaking). The Principles also emphasize the importance of adequate and modern dispute resolution mechanisms: “[d]ispute settlement procedures should be fair, open and transparent, with appropriate safeguards to prevent abuse.” While the ramifications of the Principles are yet to be seen, it is expected that they will have a significant resonance in the Asia-Pacific region.

The first investment arbitration arising out of an IIA was filed in 1987 by a Hong Kong corporation against an Asian state, Sri Lanka.\footnote{ICSID, 50 Years of ICSID, available at: <www.icsid.worldbank.org/apps/ICSIDWEB/Documents/ICSID%20Timeline%20-%20Featured.pdf>. See also Asian Agricultural Products Limited v. Democratic Socialist Republic of Sri Lanka (ICSID Case No. ARB/87/3), Award, 27 June 1990.} Since then, there have been close to 750 investment claims.\footnote{Behn, D., T.L. Berge and M. Langford, Poor States or Poor Governance? Explaining Outcomes in Investment Treaty Arbitration, 38 Nw. J. Int’l L. & Bus. (2018).} Significantly however, a recent study found that no investment dispute has arisen under more than 90% of the BITs presently in force.\footnote{S. Miller and G. Hicks, Investor-State Dispute Settlement: A reality Check, Available at: <https://www.csis.org/analysis/investor-state-dispute-settlement-reality-check-working-paper>.} This Section reviews the global trends in order to
assess the significance of the ISA related developments in the Asia-Pacific region.

The large number of investment claims led to a number of studies to identify and analyze trends in investment arbitration. While these studies have not always reached the same conclusion (because of different units of analysis and different sources of data), largely they conclude that most disputes are decided in favor of the state. According to a study recently conducted by UNCTAD, 444 investor–state proceedings have been concluded up to 2015. Of these, 26% were settled, approximately one third were decided in favor of the state and about one fourth were decided in favor of the investor. 32 About half the cases that were favorable to states were dismissed for lack of jurisdiction. Where cases moved beyond jurisdiction to the merits (i.e., where a tribunal made a determination of whether the state breached any of the IIAs substantive obligations), 60% were decided in favor of the investor and 40% in favor of the state. 33 In another recent study, Franck and Wylie observed that states “win” approximately 60.4% of the time and investors “win” approximately 39.6% of the time. 34 Miller and Hicks came to largely similar conclusions: about one-third investment claims settle amicably, and for those that do not, states generally win twice as many times as investors. Further, they conclude that when investors do prevail, they are usually awarded a small fraction of their initial claim – usually less than 10% of the amounts claimed. The most recent study of 676 public international investment arbitrations filed from the 1990’s too reached similar conclusions: cases are settled about one-third of the time, and states win more than one-third of disputed cases. 35 While this empirical analysis has been criticized by some, it cannot be denied that states are more likely to be successful than investors in investment arbitration, a conclusion that undermines arguments that the investment arbitration system is biased in favor of investors. 36

Unlike the global trends in investment arbitration considered above, it is difficult to identify particular trends in investment arbitration in Asia. Prominent

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33 Ibid.
34 A “win” is defined as the awarding of US$1 or more, even if de minimus or less than the investor’s unrecovered expenses, S. Franck and L. Wylie, *Predicting Outcomes in Investment Treaty Arbitration*, 65 Duke Law Journal (2015), 459.
scholars have reached often contradictory conclusions on trends in investment arbitration in Asia. In terms of the likely number of investment claims involving Asia, in 2012, Nottage and Weeramantry predicted that there would be few Asia-centric claims possibly because of “institutional barriers”, including costs and a paucity of experienced counsel and arbitrators in Asia, rather than any specific “cultural aversion” to adversarial forms of dispute resolution (such as arbitration).38 A study conducted a few months later, however, reached a different conclusion. On the basis of the higher number of claims seen in 2011, it predicted that the future would see more claims against Asian states as well as claims being made by Asian investors.39 In 2015, Chaisse conducted a comprehensive review of investor–state claims involving the Asia-Pacific. Like the other studies mentioned above, he noted a sharp jump in 2011 (10 claims, compared to five each year over the previous decade), which was maintained in 2012 and 2013 (13 claims each). He observed that the growth in investment claims could be explained by increased FDI, a larger number of IIAs as well as a better understanding of these instruments by both Asian states and Asian investors. He too predicted an increasing number of claims involving Asia.40 Other authors have come to the same conclusion, while still others submit that it is simply too early to tell whether investor–state arbitration will proliferate in the region.41 Few studies have been conducted examining claims brought by Asian investors. Salomon and Friedrich observe that 29 investment arbitrations have been brought by investors in the East Asia and Pacific Region, 22 of which were under the ICSID Convention.42 19 investment arbitrations were based were based on an IIA, two of these on the ASEAN Agreements.43 They note that after a period of decline in the 1990’s where only one claim was brought, there were nine new cases between 2000 and 2010, and 16 cases from 2010 to 2015.44 Overall, 81 cases have been initiated by Asian

claimants, 50 of which (61.7%) have been initiated in the past five years alone. In terms of subject-matter, oil, gas and mining has traditionally been the dominant sector for claims in Asia. 2015 however saw a considerable increase in the number of disputes in the electric power and “other energy” sector, possibly as a result of the industrial diversification in Asia.45

It is then possible to take a finder look at the RCEP scenario (Table 4). As of 1 December 2017, the RCEP countries have been quite much involved in ISA as they acted as respondent in 103 cases while their investors initiated no less than 22 disputes. Although these numbers would only reflect a marginal involvement of RCEP states with regard to global statistics, it represents a significant share of Asia states involvement.

**Table 4: RCEP involvement in ISA.**

<table>
<thead>
<tr>
<th>Respondent</th>
<th>Claimant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>2</td>
</tr>
<tr>
<td>Brunei Darussalam</td>
<td>0</td>
</tr>
<tr>
<td>Cambodia</td>
<td>3</td>
</tr>
<tr>
<td>China, People’s Republic of</td>
<td>3</td>
</tr>
<tr>
<td>India</td>
<td>22</td>
</tr>
<tr>
<td>Indonesia</td>
<td>8</td>
</tr>
<tr>
<td>Japan</td>
<td>0</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>3</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>2</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1</td>
</tr>
<tr>
<td>New Zealand</td>
<td>0</td>
</tr>
<tr>
<td>Philippines</td>
<td>5</td>
</tr>
<tr>
<td>Singapore</td>
<td>0</td>
</tr>
<tr>
<td>Thailand</td>
<td>1</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>103</strong></td>
</tr>
</tbody>
</table>

Source: compiled by the authors.

Asia-Pacific is in the midst of unprecedented economic growth. Foreign investment inflows and outflows are at historic highs. Investment protection instruments like

IIAs continue to be critical to the investment framework of the region. In addition, the G20 Principles explicitly place foreign investment very high in terms of international economic policy by indicating that the G20 has “the objective of (i) fostering an open, transparent and conducive global policy environment for investment, (ii) promoting coherence in national and international investment policymaking, and (iii) promoting inclusive economic growth and sustainable development.” The combination of favorable regional and global drivers suggests that investment flows and investment policies will gain in importance in the years to come as a key driver of the world economy. A vast majority of Asian IIAs provide for investment arbitration, both as an element of the regional trade and investment treaty architecture as well as a practical means for resolving disputes. Nearly 21% of all investment disputes involve Asian states, and these numbers are likely to rise. Investment arbitration has however been facing a considerable backlash, which is leading to a recalibration of substantive investment disciplines as well as dispute settlement procedures. This backlash has been particularly significant in Asia, with some Asian states exiting from the system altogether and others altering it in material ways. Several reforms to the present investment arbitration framework have been proposed to reaffirm state control while at the same time retain investor interest. These reforms are particularly significant for Asia, and it is heartening to note that some Asian states are adopting a more refined approach toward investment arbitration. Asia-Pacific is, however, lagging in some respects. Having considerable investment jurisprudence before them, Asian states are uniquely placed now to benefit from the experiences of others. Besides, the increase of Asia-centric investment flows places Asian states in an increasingly important position to determine the future of global investment governance. This is certainly an exciting time for those dealing with international investment law, particularly in the Asia-Pacific region.

While investment arbitration has developed considerably over the last two decades, few Asia-Pacific states have faced foreign investors’ claims before an international tribunal. This is a rather surprising phenomenon in light of economic reforms and inflows of the FDI into countries like PRC, India, Thailand, Indonesia, Malaysia, and Vietnam. This disconnect may be explained through an analysis of three parameters, and Asia-Pacific’s only recent acquiring of all three elements. Overall, arbitration requires instruments (e.g., the IIAs), the legal knowledge of these instruments (i.e., the lawyers capable to use them), and a significant volume of the FDI invested in the host countries. These three parameters currently exist in most Asian states. Moreover, these three parameters must be combined to understand the prospects for investment claims against Asian states. In light of recent reforms, increased FDI stocks, and the

multiplication of investment negotiations in recent years, there exists a great potential for future arbitration within the Asia-Pacific region, which hitherto has been marginalized.

Finally, an emerging trend of Asia-Pacific international investment rulemaking is the increasing regionalization of negotiations, which will likely modify the current Asia-Pacific investment regulation. The current negotiation of broader multi-country pacts that involve a large number of economic areas will have an effect on the core BITs and bilateral PTAs currently making up the international investment of the Asia-Pacific region. The recent rise in plurilateral agreements, such as ACIA, “ASEAN +” agreements, RCEP, and the RCEP, is likely to produce greater economic effects while also spreading the basic principles of foreign investment protection to most Asia-Pacific economies. This means that future research effort’s work should be more focused on these new plurilateral instruments, which remain largely ambiguous in their anatomy, life, and future economic and legal effects. In this light, further needs emerge that require economic and policy research such as the feasibility of an advisory center for investment disputes and/or the development of sustainability indicators for FDI.

The normative quality and geographic scope of the RCEP, however, places the agreement among the most detailed and important investment treaties. In this light, it is possible to return to the question raised in the beginning of this article, asking whether the RCEP will strengthen or fracture current investment treaty regimes. As the RCEP negotiations proceeded successfully, and as a broad preferential trade agreement, the RCEP presumably supersedes ACIA and other existing IIAs identified in Table 3 where there is overlap. Interestingly, the RCEP may be read as a strengthening a de facto renegotiation of ACIA and many other agreements, such as the 2010 AANZ FTA.

3 Impacts of Regional Comprehensive Economic Partnership on Foreign Direct Investment: Implications for Small and Medium-Sized Enterprises

The literature on the impacts of RCEP is sparse, and quantitative estimates practically non-existent. The most careful general equilibrium modeling has been done as a by-product of studying the TPP and includes only one scenario, i.e., RCEP as a generalization of the ASEAN-China FTA, which restricts the
exercise to the trade effects.\textsuperscript{47} The lengthy section in that same book begins with a clear statement: “we cannot predict with any confidence the trajectory of two-way foreign direct investment (FDI) following a major reduction of policy barriers, nor can we quantify the benefits”.\textsuperscript{48}

The main reason for this gap is that with deeper integration FDI is just one of a variety of modes for expanding GVCs, and it is impossible to isolate the role of FDI as a cause or consequence of GVC proliferation within a deep integration arrangement such as RCEP. This is not to say that the FDI channel is unimportant. There is considerable evidence and case studies in the annual \textit{ASEAN Investment Reports} of increasing FDI in recent years, which the Reports relate to the establishment of the ASEAN Economic Community (AEC), and in particular the ACIA. Table A1 shows the rapid growth over the decade 2005–15 in both inward and outward flows and stocks of FDI. Table A2 reveals the large increase in FDI in manufacturing from $18 billion in 2014 to $29 billion in 2015.

The theory of FDI has never been completely satisfactory, because most FDI decisions are the result of a conjuncture of circumstances rather than a single cause. The most popular approach, Dunning’s OLI model, is often referred to as the eclectic theory of FDI due to this multi-causality. Ownership-specific advantages of the investor (O), locational advantages of the host country (L), and internalization advantages that make FDI preferable to exporting, franchising, subcontracting or other market access methods (I) all need to fall in place, like the numbers in a combination lock or icons on a fruit machine, for FDI to be the best mode of operating. Since none of O, L or I is easily measurable, and weights and trade-offs between the three are unspecified, it is difficult to test the OLI theory against macro FDI data or to use it to explain aggregate FDI flows.

Thus, this section of the Report will be case-study driven, providing examples of recent FDI flows that may be further stimulated by RCEP. Particular attention will be paid to FDI involving SMEs, which have been a major target for promoting inclusive development within the AEC.\textsuperscript{49} Evidence will be drawn from the sector studies in Section A because those sectors have been prime areas of FDI by SMEs following the parent company of a GVC, or more often a RVC. As with the macro FDI data, there are some clear patterns, e.g., Singaporean or Malaysian SMEs are


\textsuperscript{49} SME promotion is specifically included in AEC documents as a path towards inclusive growth, and ASEAN has a \textit{Strategic Action Plan for SME Development, 2016–2025}. 
more likely to invest overseas, while SMEs from Indonesia, the Philippines, Thailand and Vietnam are relatively more likely to invest within ASEAN, and to be slower to internationalize because of their larger home markets.

Data and definitional difficulties must be noted from the start. When a component manufacturer follows Toyota or Samsung to an ASEAN country the nature of the FDI is clear. However, when restaurant companies establish franchises in several ASEAN countries or a software company from an ASEAN country goes regional, there may be little FDI, and yet these are prime examples of SMEs taking advantage of the AEC – and potentially RCEP – to expand beyond their domestic market. SMEs in traditional sectors such as apparel tend to take longer to internationalize. However, even in these areas the response to market opportunities is becoming stronger, e.g., Thai manufacturers have moved production to special economic zones (SEZs) near the border with Lao PDR or Myanmar to take advantage of lower wage costs in their neighbors; in the Lao case this involves FDI if the production facility is located in a Lao SEZ, whereas in the Myanmar case the facility is likely to be in a Thai SEZ with special arrangements for workers to cross the border daily – the economic motivation and outcome is essentially the same in both cases.

3.1 Following the Customer

The simplest process of GVC-related FDI by SMEs occurs when a large company relocates offshore and suppliers follow. This occurred when Japanese car firms moved assembly operations to Thailand, and SEZs like Hemaraj facilitated the relocation of suppliers (Figure A3). That example was driven by currency movements and involved a single host country. Recent FDI by Korean firms can be more closely related to deeper integration, i.e., the AEC, which provided an improved setting for the process.

Large Korean companies such as Samsung, LG, Hyundai and POSCO have specific ownership advantages and in recent years have seen locational advantages to investing within ASEAN as wages in China have increased. They have typically made greenfield investments and been followed by Korean SMEs who are trusted suppliers. The AEC facilitated these new investments’ ability to supply ASEAN-wide markets and to source inputs from across ASEAN. For some inputs, local SMEs may be suppliers. Korean FDI in industries such as apparel, footwear, automobile, electronics, and food production increased between twofold and 5.5 times between 2006 and 2015.50

Samsung’s increased activity in Vietnam since 2009, culminating in a $2 billion smartphone facility in Thai Nguyen Province in 2013, led to mobile phones and accessories accounting for over a fifth of Vietnam’s exports in 2015, overtaking garments. Nearly one hundred existing existing suppliers followed Samsung to Vietnam, including Korean SMEs making keypads, cameras, cases, etc., for phones. An estimated 97 Vietnamese firms are supplying components.\footnote{Samsung invested in education programs and actively transfers skills to strengthen local suppliers’ capabilities. The firm has also invested in local R&D facilities.} LG opened a $1.5 billion facility in Haiphong to assemble televisions, with the expectation that suppliers currently in Korea or China will either move to Vietnam or be replaced by Vietnamese, or other ASEAN, suppliers. Both these examples of assembly at the final stage of GVCs suggest that in the 2010s Vietnam has become a location of choice for such activity.

Hyundai, which has limited exposure in ASEAN despite being the world’s third-largest car producer (Table A4), announced in 2016 that it was considering investing in the Philippines as a location for manufacturing components and assembling cars. These, and other Korean FDI in ASEAN, are driven by factors beyond ASEAN, but it is likely that increased ease of doing business within ASEAN as a result of the AEC and the ASEAN-Korea FTA contributed. RCEP would add a further facilitator as Korea would be in a larger integrated area with ASEAN, giving firms greater sourcing options.

Similar patterns could be found with Japanese FDI, although the regional networks established by firms such as Toyota long predate the AEC. Nevertheless, the clusters of suppliers to the car industry on Thailand’s eastern seaboard or to the electronics industry in other zones in Thailand indicate the potential for production networks containing domestic and foreign-owned SMEs. A 2015 JETRO survey of 941 Japanese SMEs found that 523 had facilities in China and 506 in ASEAN, led by 231 in Thailand and 140 in Vietnam reflecting the presence of Japanese auto mobile companies in Thailand and attractive labor costs in Vietnam.\footnote{Japan External Trade Organization, FY 2015 Survey of the International Operations of Japanese Firms, JETRO Overseas Business Survey, Tokyo.} To the extent that RCEP fosters GVCs by reducing trade costs and other transactions costs, the attractiveness of such clusters will increase.

3.2 Joining – and Becoming Players in GVCs

There are many examples of ASEAN SMEs joining GVCs, with the most successful outgrowing the SME label. Armstrong Industrial was established in Singapore in
1974 to make die-cut foam and rubber products for firms like Bridgestone. By 1995 it was listed on the Singapore Stock Exchange Mainboard, and since expanded into Indonesia, China and Vietnam, as well as opening three factories in Malaysia. Since 2014 Armstrong no longer has manufacturing facilities in Singapore, but coordinates value chains.

The car industry is a fertile ground for SMEs to become suppliers to foreign companies. In the *ASEAN Investment Report 2016*, Table 4.7 lists twenty-two Indonesian firms supplying a large variety of components to the fast-growing automobile industry described in Section A1.3. All these suppliers are SMEs with fewer than 300 employees, and the 22 are surely only a partial count. A similar story could be found in Thailand, where the car industry has been longer established and some of the suppliers have long since ceased to be SMEs.

The Malaysian firm Eng Teknologi started as a contract manufacturer for companies like Western Digital, but by the late 1990s it was producing a range of hard disk drive actuators and peripheral assemblies in factories in China, the Philippines and Thailand, and in 2016 had 3,000 employees. JCY (Malaysia) started up in 1996 as an SME, but by 2006 it had production facilities in Thailand supplying products to Seagate, and by 2016 it had subsidiaries in Singapore, China and Mauritius, with most of its facilities located close to Western Digital or Seagate facilities.

Hana Microelectronics of Thailand started in 1978 with thirty employees assembling LED watch modules. In 1982 Hana opened a second factory to assemble electronic modules for the Swiss company SMH (the Swatch Group). Today Hana employs over 10,000 people in facilities in China, Cambodia, and the USA.

### 3.3 Finding A Niche Too Small for Purely Domestic Sales

Vela Diagnostics is a Singaporean SME supplying integrated molecular solutions for the diagnosis of infectious diseases and cancer and offering profitable niche services to a narrow range of customers. Vela has only 200 employees worldwide, but already operates in Germany, the USA, and Malaysia. Many less specialized Singaporean firms also operate in Malaysia, where market access is relatively easy given the contiguity and shared history. Similarly, Efficient Technology, a Malaysian SME supplying specialized mechanical services to energy markets, operates in Singapore to be close to lead firms in the energy industry.
Particularly in ICT software supply, it is difficult to define SMEs’ presence in multiple markets when borders are virtual. SMEs like Thailand’s Zanroo (social listening technology for big data processing) or ADI Group (contract management and payroll services, with offices in Indonesia, Singapore and India) have many international clients. Eatigo, a Thai restaurant reservation platform, also provides its services for Singaporean restaurants without needing a physical presence. Many Singaporean e-logistics or fintech firms fit into this category of borderless activities. Some have offices in other countries in order to have face-to-face communication with clients, but for many that is unnecessary.53

Food and lifestyle start-ups may prove so successful in their own country that they expand across borders either by owning facilities (FDI) or franchising. Examples include:

- J.CO Donuts and Coffee – an Indonesian firm established in 2006 now with outlets in Malaysia, Philippines and Singapore,

- Secret Recipe lifestyle cakes and café started in Malaysia in 1997 and now operates in Brunei Darussalam, Cambodia, Myanmar, the Philippines, Singapore, Thailand, Australia, Canada, China, and Hong Kong,

- Black Canyon coffee-shops from Thailand operate in Cambodia, Indonesia, Malaysia, Myanmar, the Philippines, and Singapore.

- Jollibee fast food started by a 22-year-old entrepreneur from the Philippines in 1975 has 80 restaurants outside the Philippines, including 11 in Brunei Darussalam, and 32 in Vietnam, as well as in Saudi Arabia, Qatar, and the USA, and Hong Kong.

Examples outside food include SMEs such as Barong Batik from Indonesia, Human Nature (natural bath products) from the Philippines, and Love and Madness (clothing) from the Philippines.

53 ASEAN, ASEAN Investment Report 2016: Foreign Direct Investment and MSME linkages (Jakarta: Association of Southeast Asian Nations, 2016), pp. 147–148 identifies a set of successful ASEAN SMEs that were “born global”, operating internationally from the start. These include ZALORA (Singaporean online fashion company), HappyFresh (Indonesian online grocery platform), CleverAds (Vietnam), Orami (Indonesian e-commerce platform for women), Garena (Singapore), Grab (Malaysia) and FashionValet (Malaysian online clothing retailer). See also the case studies in Annex 5.3
3.3.1 Servicification

Recognition of the significance of servicification is recent, and we do not yet have good understanding of its importance or of the policy implications.\textsuperscript{54} Gereffi and Fernandez-Stark described services as the glue of GVCs, and OECD, and Lodefalk provided evidence of the increasing share of services in trade in value-added.\textsuperscript{55} Anukoonwattaka \textit{et al.} focus on Asia.\textsuperscript{56}

Thangavelu and Oum show that although services account for less than a third of RCEP countries’ exports when measured in gross terms, they account for almost two thirds when measured in value-added terms.\textsuperscript{57} Among RCEP countries, the service content of exports is highest for Singapore and New Zealand, and lowest for Indonesia, and it is highest in manufacturing exports, especially electrical equipment, and textiles and apparel.\textsuperscript{58} Although not conclusive, initial results strongly point to increasing services content being related to proliferation of GVCs. Thangavelu and Oum also find that improved information and telecommunication technologies (ICT) reduce the cost of business services and increase their tradability, as well as being a service input in their own right.\textsuperscript{59}

\textsuperscript{57} S. Thangavelu and S. Oum, \textit{Servicification in Global Value Chains: Comparative analysis of East Asian countries with OECD}, paper prepared for ERIA project on Services Supply Chain: Implications and opportunities for RCEP (Jakarta: Economic Research Institute for ASEAN and East Asia, 2017).
\textsuperscript{58} S. Thangavelu and S. Oum, \textit{Servicification in Global Value Chains: Comparative analysis of East Asian countries with OECD}, paper prepared for ERIA project on Services Supply Chain: Implications and opportunities for RCEP (Economic Research Institute for ASEAN and East Asia, Jakarta 2017) point out that the services content is higher in RCEP exports than in OECD countries’ exports. Cambodia stands out for its high foreign services content, which they relate to low GDP per capita.
\textsuperscript{59} S. Thangavelu and S. Oum, \textit{Servicification in Global Value Chains: Comparative analysis of East Asian countries with OECD}, paper prepared for ERIA project on Services Supply Chain: Implications and opportunities for RCEP (Jakarta: Economic Research Institute for ASEAN and East Asia, 2017).
3.4 Creating a Regional Network

Cool Group is a Thai SME that manufactures and distributes commercial freezers, coolers and cold-chain products for the food and beverage industry and for retail outlets. As a reliable specialist equipment provider, the Cool Group established links to customers such as Nestlé, Unilever, Haagen-Dazs, the CP Group, and S&P restaurants, as well as leading supermarket and convenience store chains. To better serve these partners across the region the Cool Group established service centers in Malaysia in 2008, Indonesia in 2009, Vietnam in 2011, and the Philippines in 2012, and invested in warehouse facilities in Indonesia. Manufacturing remains in Thailand to ensure quality control and manage new product development, and the company also produces for a leading European brand under contract. The result is that it has a regional market with revenue of $50 million while still employing fewer than 200 people. Further examples of SMEs which were able to access a wider regional market in order to leverage their niche skills include Applied Total Control Treatment of Singapore (specialized in cutting-edge surface coating technologies) and Eftech Malaysia (specializing in pipeline technologies for oil and gas).^60

3.5 Bringing in Cambodia, Lao PDR and Myanmar

The FDI activity in ASEAN overwhelmingly involves the five original members and Vietnam. There is some investment in clothing in Cambodia, but otherwise little incorporation of the poorest ASEAN Members into GVCs. One modality for changing this is SEZs, and specifically SEZs on borders. One function of such SEZs, christened Early Reform Zones by Richard Auty, is to showcase the benefits of good infrastructure, business-friendly services, property rights, and the rule of law. Shenzhen played such a role on China’s border with Hong Kong in the 1980s.

In Southeast Asia the prime examples are on Thailand’s borders. In Mae Sot on the western border, Thai firms have set up factories for clothing and other labor-intensive activities using equipment that can no longer be operated profitably in Bangkok. The labor in Mae Sot is provided by day-workers from across the border in Myanmar. On Thailand’s eastern border, Lao PDR has established an SEZ in Savannakhet, which hosts foreign firms, from Japan, Korea, China, Thailand and elsewhere. The incentive is the same in Mae Sot, combining capital and expertise from middle- and high-income countries with labor from low-wage country;

depending on which side of the border the activity is on, it involves either FDI or labor migration. The success of both SEZs was not instant and required provision of good road connections to Bangkok, as well as appropriate services in the SEZ.  

4 Conclusion

FDI comes in many forms and within ASEAN it is hard to generalize about causes or even to find specific causes for individual FDI choices. Nevertheless, the growing number of internationalizing SMEs in ASEAN has coincided with regional integration and increased awareness of the regional market through the AEC. There is also a clear pattern of cumulative causation, as greater internationalization strengthens RVCs and regional production networks encouraging more SMEs to think of joining such chains or networks – or of starting their own regional operations. The growing presence of foreign SMEs within ASEAN, especially from + 6 partners Korea and Japan, provides an example to ASEAN SMEs of what can be done, even by a small or newly established firm. The rapid scaling-up of SMEs which started with modest tasks in GVCs is also a good role model. This article has placed RCEP squarely in a role of deep integration. Going beyond tariff reduction into WTO+ areas is the reason why RCEP negotiations are drawn out; areas such as FDI raise sensitive issues for policymakers. At the same time, negotiators recognize the benefits of fostering GVCs in the ASEAN and ASEAN+ 6 regions. They are keen to enhance their own country’s participation in GVCs, and especially to see entry into GVCs as an opportunity for SMEs, hence contributing to inclusive growth.

The ASEAN Community is built on three pillars: the AEC, the ASEAN Political Security Community, and the ASEAN Socio-Cultural Community. RCEP will be less far-reaching, at most matching elements of the AEC. However, it is not certain how far RCEP will go toward deep integration, and the difficulties of negotiating WTO+ measures with six non-members are clear from the length of negotiations. A minimum scenario is reduction of barriers to trade in goods and standardization of rules of origin, plus progress on trade in services and an investment agreement, as set out in Part B. This would be a significant step beyond most ASEAN+ 1 agreements in promoting regional economic integration. However, in a world of GVCs that still resembles a twentieth-century trade agenda. Best case scenario would be deeper integration to support the region’s strong role in GVCs and to facilitate SME participation in GVCs.

61 For more details, see GMS Secretariat, The Role of Special Economic Zones in Improving Effectiveness of GMS Economic Corridors (Manila: Asian Development Bank).
SMEs face challenges in domestic markets, and even more so in internationalizing, especially when the foreign market is unknown, as many ASEAN markets are to ASEAN firms. The organizational culture in SMEs is often focused on survival, and even in highly profitable SMEs the owners may be risk-averse, and hence miss opportunities for international expansion. SMEs often face financial constraints, as banks are reluctant to make loans for FDI to SMEs without a track record of operating internationally. They may also lack information about foreign markets or data about economic conditions, real-estate markets, and legal charges and obligations. By deep integration the AEC is reducing these obstacles, and RCEP can be expected to strengthen that process.

GVCs vary considerably in structure but require low costs of international trade to justify cross-border fragmentation of production, as well as good connectivity in transport and ICT. Coordination of GVCs has also increased the portion of trade in value-added that consists of services, and if GVC participants are to have access to best-practice service providers then services must be included in the deep integration agreement.

The servicification literature helps to explain the rapid growth of some of the ICT SMEs mentioned in previous sections of Part Three. Firms that can help participants in GVCs to smooth out relations, logistics and communication are likely to find niches, while manufacturing firms focus on the physical production process of their contribution to the GVCs. As with the more general discussion of FDI, the service providers may physically cross-borders and invest capital, but that is a minor aspect of their contribution.

Thus, the best-case scenario is not just about reducing barriers to trade in goods or to movements of capital and skilled labor, but includes broader deep integration to allow, inter alia, agile and high-quality business service providers to operate throughout the RCEP region. There is no single magic formula for GVC success, but business service providers can play a crucial role oiling the chains.

Finally, it is worth mentioning that after the failure of the OECD-backed multilateral investment agreement and discontinuation of TPP ratification by the USA, the RCEP negotiators could set the standard for international investment regimes.⁶²

The Joint Leaders’ Statement on the Negotiations for the Regional Economic Comprehensive Partnership (“RCEP: A Vehicle for Economic Integration and Inclusive Development”) on 14 November 2017 in Manila set out eighteen distinct characteristics of the intended agreement.⁶³ This expands on the eight

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objectives set out in the original Guiding Principles (see Annex) in areas most relevant to GVCs. Thus, in addition to the original emphasis on trade in goods and services, investment, intellectual property, competition, and economic and technical cooperation, the new features include trade facilitation, sanitary and phytosanitary rules and standards (aiming to enhance the WTO’s SPS and TBT codes), finance, telecoms, movement of natural persons, e-commerce and public procurement. There is also a chapter on SMEs, and greater attention to dispute settlement and trade remedies. The impression is clearly of greater understanding of the interconnection between elements of deep integration, which has extended and complicated the negotiating process but with greater promise of delivering a valuable outcome. Especially in a year of diminished significance for the TPP, RCEP has the potential to play a standard-setting role in an increasingly globalized economy.

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