

## Research Report

# FDI Variations in Emerging Markets: The Role of Credible Commitments—With Special Reference to Asia<sup>1</sup>

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### Abstract

*What accounts for variations in foreign direct investments (FDI) in emerging telecommunications markets? This article shows that the key to capturing FDI flows is making and enforcing credible commitments both internationally and domestically toward liberalization reform in telecommunications sectors: the differences in such commitments account for FDI variations. The commitments made by emerging markets in the World Trade Organization's (WTO) telecommunications accord are first examined. Furthermore, a qualitative analysis of four important Asian markets seeks to correlate such commitments with FDI flows. The case of China is conceptually and empirically interesting: the country's size, growth rate, and state-led coordination mechanisms create a credible commitment illusion, at least in the short run.*

### Introduction

What accounts for variations in foreign direct investments (FDI) in emerging markets? This article shows that the key to capturing FDI flows is making credible commitments both internationally and domestically toward liberalization reform in telecommunications sectors. Optimal credible commitments entail provision of rules or property rights that are impartial, transparent, enforceable, and, in the case of telecommunications, interoperable.<sup>2</sup> Rule of law, an independent judiciary, and an effective regulator are keys to ensuring that property rights meet all these conditions.<sup>3</sup>

Answers to the questions above are instructive for emerging markets hoping to attract FDI into telecommunications. FDI flows are crucial for many of these markets to expand their infrastructures and gain access to necessary capital and technology. The article examines international and domestic commitments made by emerging markets in general, and then focuses on four specific cases in East Asia for detailed analysis. The cases are chosen with respect to the size of their internal market and the degree of strength of the commitment made. Here the case of China is par-

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1. A previous version of this article was presented at Columbia Institute for Tele-Information (CITI), Columbia Business School, May 8, 2003, Workshop on "Turmoil in the Telecommunications Industry: Implications for Developing Countries." Thanks to Eli Noam and two anonymous referees for helpful comments on an earlier draft.

2. For the theoretical rationale for such property rights in telecommunications, see Singh and Gilchrist (2002); Singh (2000). For an important work on credible commitments in telecommunications, see Levy and Spiller (1996). The general framework on credible commitments is attributed to new institutional economics. See, especially, Williamson (1985).

3. The 2004 World Development Report highlights the importance of credible property rights in investment as "central to growth and poverty reduction" (World Bank 2004).

ticularly interesting: its success with high overall levels of foreign direct investment is often seen to come at the expense of dwindling flows in other emerging markets; thus, such flows into China continue to alarm other emerging markets hoping to be large recipients.<sup>4</sup> In 2003, China received US\$53.5 billion out of a global total of US\$560 billion and in 2002 it received US\$52.7 out of US\$580 billion, beating out the United States as the first place recipient (UNCTAD 2004a). This is remarkable growth given that global FDI flows have registered negative growth rates since 2001 and most emerging markets—even those formerly ranking high such as Brazil, Russia, and India—face a number of challenges and downturns.<sup>5</sup> China's performance is anomalous but may also be instructive in gauging the determinants of FDI in emerging markets. Is it due to the economic downturn elsewhere in the world, the liberalization commitments China has made, or something else?

The credible commitments argument applies to China with two twists. First, China comes nowhere close to the optimal conditions of property rights provision but it is adept at faking them: we can call China a case of *credible commitment illusion*. Its tightly-knit political system, involving closely-knit business–government networks of influence, sometimes termed *guanxi*, allow for contractual obligations to be honored, albeit without the force of any explicit law (see Wang 2002). Coupled with the effects of *guanxi* is the size of China's internal market and workforce, high economic growth rates, relative political stability, and its distance from security threats that plague many of the other Asian markets. The second twist is that while the overall size of FDI into China is quite high, China does not as yet allow FDI into basic telecommunications service provision (although it is required to do so under its accession agreement to the WTO).

The two twists above can be taken as helpful lessons for other emerging markets. China's liberaliza-

tion hinges on a somewhat autonomous state that can command a great degree of resources.<sup>6</sup> The stability of such a state-led reform model in the long run or its general applicability elsewhere as a model are always moot points (Singh 1999). In the meantime, to the extent that other countries can make credible commitments toward telecommunications property rights, they stand to gain in the long run. In terms of vying for FDI flows in telecommunications with a country like China, they are even better off; attracting FDI into basic telecommunications service provision is not a reality in China yet. Many emerging markets cannot, of course, compete with the size of China's internal market, but the growth rates of telecommunication infrastructure indicators bode well for emerging markets in general.

The links between FDI and credible commitments are explained in the next section by examining the latter's role in reducing transaction costs. The subsequent section examines credible commitments on telecommunications made by developing countries via the World Trade Organization's telecommunications accord. This section concludes that while most of these commitments reflected domestic liberalization schedules, they nonetheless made such schedules binding, transparent, and somewhat enforceable via several measures such as commitments to independent regulation. The subsequent section analytically correlates the impact of credible commitments on FDI in telecommunications in four East Asian markets with particular reference to the twists—the credible commitment illusion—in China's case.

### Why FDI? Demand and Transaction Costs

Telecommunications FDI flows into emerging markets have gone through three phases. During the *first phase*, starting in the mid 1980s, cash-strapped governments under pressure—especially from busi-

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4. Consider the following statement from the New York Times: "China is grabbing much of the new foreign investment in Asia, leaving its once-glistening neighbors—Thailand, South Korea, Singapore—with crumbs." Quoted in Wu et al. (2002:96).

5. Brazil, Russia, India, and China have been dubbed Brics in the trade media; their collective identity refers to the size of their markets and emerging importance in global economic affairs. In 2003–2004, the falling value of the dollar and the overall economic health of the United States did make a few emerging markets attractive for investment funds. However, the total value of these flows remains stagnant.

6. State autonomy is defined as relative independence of the state from societal and international pressures (see Evans, Jacobson, and Putnam 1985).

ness users to improve their telecommunications infrastructures—sought to kill two birds with the same stone: they could privatize and liberalize their telecommunications sectors while adding monies to state coffers by selling off these lucrative enterprises. Traditionally, state-run telecommunication monopolies had been cash cows for national treasuries with economic rates of return ranging between 20% and 40% and could thus attract investors (Saunders et al. 1994:16). In the equity-rich early 1990s, such a rationale led to a spate of FDI flows into telecommunications sectors, especially in Latin America. Asia remained cautious about letting in foreign investors; its domestic industrial businesses and labor groups, often supported by the state, resisted such moves. One study notes that while Latin America sought private participation (including FDI) in infrastructural investments via divestiture, East Asia favored greenfield investments (Roger 1996).

The *second phase* of FDI during the mid 1990s was marked by the competition for growing FDI funds as countries liberalized. By this time, Asian markets—such as Korea, Singapore, and Malaysia—deemed as quite attractive, were beginning to open up to FDI, and Eastern Europe had joined the list of liberalizing economies.<sup>7</sup> Foreign investors began to look seriously at the size of markets and the kinds of commitments countries were making toward the reform process. A good proxy for the size of markets was unmet demand for services as well as the rate at which the telecommunication infrastructure was expanding.<sup>8</sup> The latter itself served as an indicator for the commitment toward the reform process. Thus, while the Indian government had committed itself to prioritizing telecommunications since the mid 1980s, this prioritization had not resulted in high growth rates for infrastructure expansion in the late 1980s at least as compared to countries like Malaysia, which also started its reform process at the same time (Table 1). At this time, both domestic

and foreign investors began to emphasize clear enunciation of property rights governing proposed telecommunications investments. Here the US model of an independent regulator and strong judicial traditions was seen as particularly effective. Countries did make such commitments—many Asian markets thus became favored destinations for FDI flows.

The East Asian financial crisis, political instability in Asian countries such as Indonesia and the Philippines, and the economic downturn in developed countries starting in 2000, made investors more cautious. This investor caution in the midst of declining or stagnant FDI funds marks the *third phase* of FDI in telecommunications. Trade reports now consistently emphasize not just the enunciation of commitments as many countries did in the mid 1990s, but more importantly, question the evidence for their substantiation in reality. One foreign index ranked government regulation as the number one concern for foreign investors; the top five list of concerns included political and social disturbances and the absence of a rule of law (Global Business Policy Council 2003). There is evidence that host countries now take such commitments quite seriously. A number of countries that saw their ranking slip have taken steps to make credible commitments. In the survey just cited, India was ranked fifth in 1998 by the FDI Confidence Index, fifteenth in September 2002, but was back up to sixth in 2003, and a remarkable third after China and the United States in 2004.<sup>9</sup> The Philippines and Malaysia fell out of the top 25 rankings, but Malaysia crawled back up to twenty-third in 2003. The Philippines was especially seen as poised for growth in the mid-1990s but lack of credible commitments prevented such growth; trade media reports suggest that reforms by the Philippine government may be paying off by 2004 when the growth rate was expected to be above 6%, its highest in 15 years (Manila predicts 2004). The fact that China's FDI was increasing

7. Of the 1700 infrastructural projects amounting to \$496.2 billion tracked in World Bank's Private Participation in Infrastructure (PPI) Project Database, East Asia and the Pacific accounted for US\$147.2 billion, Latin America and Caribbean for US\$236.5 billion, and Europe and Central Asia for US\$52 billion. Telecommunications and energy were the leading sectors accounting for US\$214 billion and US\$177.1 billion, respectively, out of the total of US\$496.2 billion. Private participation began to fall after the East Asian financial crisis. Data from Roger (1996).

8. Studies continue to document the importance of rising demands from businesses and societal interests for telecommunications restructurings and prioritizations. In the latest study, Wilson (2004) documents empirically how such demands are often articulated by activists, individually and collectively, in the developing world.

9. The 2004 ranking is based on a press release from AT Kearney in October 2004. Retrieved December 2, 2004 from [www.atkearney.com/main.taf?p=1,5,1,151](http://www.atkearney.com/main.taf?p=1,5,1,151)

## FDI VARIATIONS IN EMERGING MARKETS

Table 1. Network Expansion Indicators

	Years	Malaysia	India	China	Philippines
Main Lines (Per 100 Population)	1980	2.95	0.3	0.2	0.9
	1985	6.11	0.39	0.3	0.9
	1990	8.97	0.6	0.6	1.0
	1995	16.56	1.29	3.35	2.09
	2001	19.6	3.6	13.7	4.2
Compound Annual Growth Rates	1985–90	7.98	9.0	14.86	2.12
	1990–95	13.0	16.5	41.1	15.86
	1995–2001	2.84	18.65	26.46	12.34
Waiting List (000)	1980	133	447	164	—
	1985	183	839	274	173
	1990	82	1,961	689	567
	1995	122	2,227	1,620	900
	1999	160	3,680	812	900.2
Cellular Mobile Subscribers (Per 100 Population)	1990	0.5	0.008	0.0016	0.06
	1995	5.1	0.008	0.3	0.73
	2001	31.41	0.62	11.03	14.96

Sources: International Telecommunication Union, *World Telecommunications Indicators on Diskette*; International Telecommunication Union, *Yearbook of Statistics, Telecommunication Services, 1986-1995*.

just as that of other East Asian countries was declining became increasingly apparent. Two years ago, a Motorola executive was quoted as acknowledging Southeast Asia's misfortunes: "In early 1990s, 18% of foreign investment in Asia went to China while 61% to South East Asia. In 2000, 61% went to China, while 18% to South East Asia" (Malaysian Companies 2003).

Thus the current phase of FDI flows, which includes the rebound of emerging markets in 2003, features Asian markets where the infrastructures are clearly poised for expansion, not only in basic telephony but also in cellular and Internet-based services (see Table 1). However, these indicators are not sufficient to ensure investment; investors are looking toward credible commitments. These expectations are generally expressed in the trade media as honoring of contractual obligations, reduction of bureaucracy and red-tape, frustrations with corruption, lack

of independent regulators, political instabilities, and honoring and making of international obligations. For example, China's accession to the WTO is now widely viewed as the most credible international commitment it has made to keep its economy open and transparent.<sup>10</sup>

### Making Credible Commitments at the WTO

Countries can make commitments toward reform at both international and domestic levels. In fact, most often the commitments made at the international level in some way reflect commitments made domestically.<sup>11</sup> One of the formal ways in which countries have made international commitments has been through the framework developed by WTO's General Agreement on Trade in Services (GATS) during the Uruguay Round of trade talks (1986–1994).<sup>12</sup> These commitments are deemed important

10. In general, the World Bank report notes: "Growth was ignited by introducing a rudimentary system of property rights that gave farmers and township and village enterprises incentives to take risks and invest" (2004:57)

11. Literature on international negotiations and relations often refers to the logic of this two-level game (see Evans, Jacobson, and Putnam [1993]).

12. For an early debate on this issue, see Drake and Noam (1998).

by investors looking at emerging country markets. Inasmuch as they reflect domestic practices (not just rhetoric or pronouncements and policies that are not implemented), they can be seen as credible.<sup>13</sup>

While the GATS framework is complicated, it generally extends most favored nation (MFN) and national treatment principles developed for international trade to services. It also asks for liberalizing schedules in market access for foreign service suppliers. While the WTO's, and its predecessor GATT's, approach to MFN and national treatment has been to apply them *carte blanche* to sectors negotiated, the GATS framework allows for a more tailored approach. Signatories to the GATS agreement can list the sectors in which they are making commitments (known as the positive list) and then note restrictions on particular aspects (known as the negative list). This tailored approach is what has in fact allowed many countries to often make binding commitments reflective of their domestic liberalization programs.

During the Uruguay Round, countries were only able to reach agreement and make commitments on value-added services: the basic services negotiations took place from 1994 to 1997 and were formalized as WTO's Fourth Protocol to the Agreement on Trade in Services.<sup>14</sup> This regime, signed by 69 countries including 40 less-developed countries (LDCs), accounts for over 90% of the world's telecommunications revenues.<sup>15</sup> Historically, telecommunications sectors were controlled or operated according to domestic priorities. The new regime, effective since January 1, 1998, allows this sector to be governed by global rules such as national treatment, MFN, and market access. Thus, cross-national investments in telecommunications are allowed (or hastened given that this process precedes 1997), and trade in basic and many value-added telecommunications services are governed by free trade norms, both features backed by WTO rules of transparency and MFN. Most importantly, 63 of the 69 governments also committed to introducing "regulatory disciplines," via the so-called Reference Paper, to observe

the WTO rules to ensure against anti-competitive practices, enforce interconnection agreements, make public policy transparent, and ensure enforceability via an independent regulator. However, the Reference Paper focuses on ensuring outcomes and only asks that the regulator be independent of the operators, thus making it possible for the regulator to be situated in a government ministry.

Table 2 correlates the strength\weakness of commitments made by 31 developing countries that were original signatories with the state of liberalization in each of these countries, and also that of China whose commitment came in 2001 when it acceded to the WTO. For the purposes of commitments, the summary of commitments available at the WTO Web site on the World Wide Web were used. *Strong commitments* refer to those opening up their markets in a considerable number of market segments (including voice telephony) within two years of the 1998 implementation date and observe, fully or partially, the regulatory principles. *Reasonably strong commitments* were those seeking to adopt market-opening measures in several segments within two to four years and a commitment to observe regulatory principles in the future. *Weak commitments* delay implementation to after four years with a weak commitment in the future toward regulatory principles. For the purposes of domestic liberalization, the description of individual countries as presented in an important study by the World Bank published in 1994 was used (nine of the WTO signatories are not described in this book, therefore, not included here) (Wellenius and Stern 1994). While published in 1994, future predictions are included throughout the book allowing one to make reasonable estimates of telecommunication markets in these countries in 1996–1997 when they made offers at the WTO. For China's commitment, made formally in 2001 during its WTO accession, published trade media and scholarly reports were used. *Strong domestic liberalization* means private competition in voice (thus precluding cases which may have privatization but feature a monopoly operator)

13. Based on interviews at the WTO secretariat and trade reports. A somewhat similar conclusion is reached by Low and Mattoo (1999).

14. For a comprehensive account, see Sherman (1999).

15. Others joined later. Ninety-one governments have now signed on. Retrieved December 2, 2004 from [www.wto.org/english/tratop\\_e/serv\\_e/telecom\\_e/telecom\\_e.htm#commitments](http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_e.htm#commitments) and [www.wto.org/english/tratop\\_e/serv\\_e/recap\\_e.xls](http://www.wto.org/english/tratop_e/serv_e/recap_e.xls). The European Union schedule covers 15 governments.

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*Table 2. The WTO Telecommunication Liberalization Commitments and Domestic Telecommunication Liberalization Programs of Developing Countries*

<b>Domestic Liberalization</b>	<b>WTO Liberalization Commitments</b>		
	<b>Strong Commitment</b>	<b>Reasonably Strong Commitment</b>	<b>Weak Commitment</b>
Strong Liberalization Program in Place	Argentina Chile Dominican Republic Korea Peru		
Reasonably Strong Liberalization Program in Place	Colombia Malaysia Mexico Philippines Singapore Venezuela	Bolivia Brazil Hong Kong Sri Lanka	Indonesia India
Weak Liberalization Program in Place		China (committed in 2001)	Antigua Barbuda Bangladesh Belize Brunei Côte d'Ivoire Dominica Ghana Grenada Jamaica Morocco Pakistan Thailand Trinidad & Tobago

Source: Adapted from Singh (2002:261).

and other services and significant presence by foreign operators. *Reasonably strong liberalization* means at least liberalization of markets in value-added and specialized services with some foreign entry for operators and users allowed. In some cases, such as India, liberalization in voice telephony was also underway. *Weak liberalization* refers to those countries still waiting to introduce any significant competition in any market segment of telecommunications and waiting to pass major laws changing the role of their monopoly operators.

The correlations in Table 2 provide significant comparisons. Mostly those countries that had undertaken significant liberalizations of their domestic markets made strong commitments. Similar correlations can be observed between reasonably strong commitments and reasonably strong liberalizations, and weak commitments and weak liberalizations.

The deviant cases (shown in the middle row, except China) are interesting. Those countries making strong offers but possessing reasonably strong liberalizations had actually put in place strong liberalization schedules to take effect in the future but hoped to hasten this process by tying their domestic programs to international commitments. On the other hand, India was constrained by elections in 1996 and then a fragile coalition in power after June 1996, which constrained the government's hand in making even a reasonably strong commitment. Indonesia was on its way to a reasonably strong liberalization program but it had not really taken off as yet. And while making a weak offer, it committed itself to the possibility of allowing additional suppliers in the future. Thailand and Turkey committed themselves to review after pending national legislation while Pakistan, another country facing domestic po-

litical uncertainty, allowed only weak competition in telex and fax and delayed market access to 2004. Another deviant case is that of China, which made a reasonably strong commitment, in response to international—specifically the United States—pressures during its WTO accession negotiations although its telecommunications sector was state-run and managed at that time.

Domestic politics also influenced the commitments in terms of state autonomy and legitimacy in developing countries. India was constrained by its elections and democratic politics in making any kind of a strong commitment.<sup>16</sup> Brazil, on the other hand, under the strong leadership and window of opportunity given by President Cardoso, used its reasonably strong commitment to put pressure toward passing its domestic legislation.<sup>17</sup> Peruvian officials used their WTO commitment to break out of a political deadlock at home on the liberalizations issue. Such a move was in fact suggested to visiting Peruvian regulatory officials on a trip to the FCC in Washington, DC.<sup>18</sup> Many states, in making telecommunications a development priority, are also using the sector as a way of maintaining their legitimacy. Telecommunications operators and equipment manufacturers from Singapore, Malaysia, and Korea perceived themselves at the forefront of telecommunication service exports in the developing world, and this influenced their strong commitments at the WTO. Singapore touting itself as an “intelligent island” is the most noticeable here.

## Network Expansion, FDI, and Commitments in Four Asian Countries

Credible commitments should ultimately lead to network expansion and to increased FDI—at least in countries desiring such flows. While a comprehensive analysis of network expansion and FDI is not

possible for all developing countries, a few preliminary observations are offered for four Asian countries. Tables 3 and 4 provide a summary of the criteria used for choosing these four countries. As large internal markets are often taken to be a key factor in attracting FDI, countries are first distinguished at this level. The total number of main lines and their compound annual growth rates (see Table 1) can be taken as market size proxies. Second, as Table 3 shows, the four countries chosen here are the deviant cases (see Table 2) and, therefore, theoretically interesting.<sup>19</sup> China makes reasonably strong commitments even though it only has a weak domestic liberalization program. India is the opposite and makes weak commitments even though it has a reasonably strong liberalization program in place. Both Malaysia’s and the Philippines’ international commitments are stronger than their domestic liberalization programs but exhibit different rationales: the Philippines hopes to attract FDI, Malaysia hopes to become an international investor in telecommunications. Third, as explained later, commitments must be enforced to be credible. When the latter is taken into account, we get a different picture of the four cases examined here (Table 4).

### **China**

China acceded to the WTO on December 11, 2001 and made commitments in goods and services including telecommunications. On the whole, using the methodology developed for Table 2, China’s commitment may be seen as reasonably strong with a weak internal liberalization program in place at the time of accession. Prior to the accession, China allowed joint ventures with foreign firms in equipment manufacturing and infrastructure building, and invited portfolio investments in mobile telephony and Internet-related firms. The accession agreement allows joint ventures for Shanghai, Guangzhou, and Beijing in value-added services up

16. Since then, however, India has liberalized its telecommunications market and instituted both an independent regulatory authority and a dispute settlement body.

17. Telebras, the Brazilian monopoly, was liberalized in late 1998.

18. Interview with Peter Cowhey, who was chief of international bureau at the U.S. Federal Communications Commission during the period described here, on April 28, 1999.

19. The case study method in political science provides the rationale for studying deviant cases: if something holds true in these cases, then it is likely to hold in other cases as well. Thus, in three of our cases above, it would be instructive to see whether FDI flows increase if the international commitment is stronger than the domestic liberalization program. The fourth case, India, allows us to examine the opposite scenario. If these correlations hold in these cases, then they are likely to also hold for cases where the commitments and domestic liberalization programs are symmetric. For the rationale on the case study method, see Eckstein (1975); George (1979); George and Bennett (2005).

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*Table 3. Factors in Selecting Cases: WTO Commitment*

<b>Type of WTO Commitment</b>	<b>Type of Internal Market</b>	
	<b>Large Internal Market</b>	<b>Small Internal Market</b>
Strong or Reasonably Strong	China (made during accession in 2001)	Philippines, Malaysia
Weak Commitment	India	Countries listed in Table 2; not discussed here.

*Table 4. Factors in Selecting Cases: Credibility of Commitment*

<b>Type of Commitment</b>	<b>Type of Internal Market</b>	
	<b>Large Internal Market</b>	<b>Small Internal Market</b>
Credible Commitment	India (some aspects) China (value-added services and passage of laws)	
Weak Commitment	India (some aspects) China (some aspects)	Philippines, Malaysia

to 30%, and up to 25% for basic (terrestrial and wireless) voice and data services. The geographical restrictions are removed and foreign equity caps raised to 49% or 50% for value-added services within two years of accession, within three years for mobile and data services, and within six years for domestic and international services (Pangestu and Mrongowius 2002).

While there are three licensed operators in fixed line telephony and two operators in mobile, China Telecom dominates the former market and owns most of the infrastructure while China Mobile (a spin-off of China Telecom) dominates the cellular market with a 60% market share. The powerful State Council and the Ministry of Information Industry are the de facto policy maker and regulator. While significant liberalization of the Chinese economy has come about in various sectors, especially manufacturing, the Chinese state has jealously guarded its control over telecommunications.

FDI in the telecommunications sector can be examined in two phases: before and after the WTO accession. Prior to accession, FDI suffered from being marginalized to mostly manufacturing and infrastructural rollout but encouraged in service provision for a brief period with the ambivalent regulations for the newly-licensed state competitive provider, China Unicom. Pressures on China for telecommunications led to equipment needs that were met with FDI and joint ventures. By 1997, there

were 16 joint ventures in telecommunication equipment manufacturing that featured an international who's who list: Alcatel, AT&T, Northern Telecom, NEC, Nokia, Philips, Samsung, Mitsubishi, Seimen's, Hitachi, Fujitsu, and Motorola (Singh 1999:94). Through such ventures, the Chinese state hoped to acquire technology and prop up domestic production capabilities; the continued liberalization of the equipment manufacturing sector remained in doubt.

In the 1990s, it was the treatment of FDI in China Unicom that cast doubt on the credibility of any kind of implicit or explicit commitments made toward FDI in telecommunications. China Unicom was established in 1992 and included the ministries of railways, electronic industry, and energy. Infrastructural rollout for terrestrial and mobile telephony started in 1995 but foreign equity was not allowed. Nevertheless, loopholes in regulation allowed for equity to come in via what widely came to be known as the China-China-Foreign model whereby foreign investors indirectly invested funds via a Chinese holding company in which they invested directly. Forty-nine joint ventures came about that included AT&T, Singapore Telecom, and British Telecom. However, these joint ventures were abruptly halted in 1998 resulting in "the broadest dismantling of foreign investment in a sector since reforms began" (DeWoskin 2001:633).

The second phase of FDI in telecommunications featuring WTO accession negotiations and there-



after was heavily influenced by the China Unicom experience and pressures in the United States and European Union to make China commit to liberalization of the telecommunications sector in the long run. It is too early to gauge the effectiveness of China's WTO commitment implementation; most reviews, however, remain cautiously optimistic noting the number of laws and regulations China has passed to put these commitments in practice.<sup>20</sup> Foreign investments exist in value-added services, infrastructural provision, and equipment manufacturing but it is not clear if effective foreign investments will be forthcoming in basic services. While foreign investment regulations are being eased, concerns about the lack of independent regulation are also often expressed. The State Council remains entrenched in its role of licensing providers and most reports posit it as tilting toward domestic providers; moves in breaking up the incumbent China Telecom and strengthening of China Unicom can be seen in this regard. A recent report on FDI earnings in China that calls attention to its overreaching regulation, notes Studewell (2004):

In fact, a large proportion of foreign enterprise earnings ends up in the hands of a tiny number of companies that enjoy "luck breaks" in China's heavily regulated operating environment. The biggest winner used to be mobile telecommunications, a 1990s business that ran up against no vested interests in China and contributed as much as half of US companies' mainland-reported earnings as recently as 2001. But, from 2002, domestic companies, bankrolled by the state, moved into the mobile handset business and their cut-throat pricing destroyed profits for everyone.

Two patterns in telecommunications FDI in China in the second phase can be observed. First, while statistics on telecommunications FDI are not available, one study calculated that of the US\$271 billion of total FDI in the 1997–2002 period, only 2.83%, or US\$7.7, was in transportation, storage, postal, and telecommunications. Most of the overall FDI went to manufacturing, which accounted for 63% of the total US\$271 billion. Thus, telecommunications FDI was not high. However, this same study finds that the record highs in FDI into China after 2001 are linked to the WTO commitments. Second,

there is some evidence that the risk for telecommunications FDI in China has led to a choice of contractual relationships that are less binding; it would mean that the Chinese commitments are not as yet seen as credible. Of the 161 telecommunications alliances examined in this study for China, Hong Kong, and Taiwan, nearly 48% of the alliances were recurrent defined as "short-term episodic cooperation that is characterized by certain transaction purpose" (Tsai and Chen n.d.:8). This finding is supported by another study, which notes that despite the WTO commitments, China's regulations remain "uncertain and unpredictable" and thus it would be too optimistic to expect FDI in core terrestrial and mobile telephony sectors (Zhang 2001:467).

How should we then account for China's success with FDI in general? As far as WTO commitments are concerned, industries cite China's accession agreement as a positive factor in going to China. Other often-cited factors include China's relative political stability, absence of terrorist violence (especially compared to South and South East Asia), low labor costs, large domestic market, suitability of infrastructure, and high growth rates (7% to 8%). Most notably, business confidence in China remains high. China now hopes to achieve US\$100 billion annually in FDI in the future. In October 2004, FDI in China surpassed the US\$53 billion mark of 2003.

### **India**

Even though India had announced a reasonably strong liberalization program and many measures were in place, India made a relatively weak offer at the WTO. Since then, it has moved toward instituting an independent regulator, the Telecommunication Regulatory Authority of India (TRAI), and a dispute settlement authority, the Telecom Dispute Settlement and Tribunal (TDSAT). However, in contrast to China, its liberalization program—allowing for private competitive provision of basic as well as value-added services with foreign equity caps of 49% in basic services until 2004—has been anything but streamlined. It has involved lengthy legalistic battles for investors involving opaque policies and regulations, predatory interconnection regimes, bu-

20. See, for example, [www.uschina.org/public/wto/](http://www.uschina.org/public/wto/) from the US-China Business Council and a report by Deloitte Touche Tohmatsu at [www.deloitte.com/dtt/cda/doc/content/WTO\\_12.pdf](http://www.deloitte.com/dtt/cda/doc/content/WTO_12.pdf). Retrieved May 6, 2003.

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reaucratic red tape, lack of adherence to contractual obligations and laws, etc.

India's slow and halting commitments toward making credible commitments have resulted in slow FDI flows, too, but India still remains one of the top destinations for such flows. Compared to China's US\$52.7 billion in FDI for 2003 alone, India had attracted only US\$31.62 billion in FDI from 1991–2002 of which US\$1.98 billion was in telecommunications (US highlights 2002; India must 2003). Policy makers have also been clear in their intent to invite FDI in telecommunications, raising the equity cap to 74% from 49% recently in both terrestrial and mobile telecommunications. India offers a slightly contradictory picture in terms of honoring its commitments: its liberalization program underway outpaces the commitments it made at the WTO but foreign investors, in exercising caution, regularly cite significant regulatory and policy-making hurdles, including corruption. Nevertheless, India's reform process is not likely to be derailed and the underlying infrastructural expansion indicators remain strong, too. The democratic stability of India's property rights reform accounts for the enthusiasm for the India market among foreign investors (Foreign inflows 2004).

### **Malaysia**

Malaysia made a strong offer at the WTO in the hopes of both attracting foreign investments as well as being a foreign investor itself in international, especially regional, markets. To its credit, it was one of the first countries to start privatizing its dominant carrier Telekom Malaysia in 1990 and to introduce competition in mobile telephony starting in 1989. Its potential for receiving high amounts of FDI is often noted by analysts. However, its privatization and liberalization programs were marred by preferential schemes and later by the Asian financial crisis. Telekom Malaysia is a state-run entity still, and preferential schemes continue to favor domestic over foreign businesses. As Table 1 shows, the compound annual growth rate of its network is lower than the other three cases examined here. However, it can boast of a cellular density of 31.41 per 100 people in 2001 (see Table 1), even as people often complain of the poor quality of the network. Its much touted Multimedia Super Corridor, covering a 750 km<sup>2</sup> area in and around Kuala Lumpur with a broadband network, has not taken off or attracted investors.

While foreign investors have been welcome to

Malaysia since the 1990s, the government has neither attracted the much hoped for FDI nor put in place strong measures that would help to increase it. Apart from the economic downturn and slow growth rates since 1998, security concerns have also plagued investors looking at Malaysia. In terms of the telecommunications sector itself, regulation and policy-making functions are not entirely separated and Telekom Malaysia continues to be favored. In March 2003, the hostile takeover of Celcom, the dominant mobile telephony provider, by the government-dominated Telekom Malaysia bodes ill for foreign investment. Deutsche Telekom, which had an 8% stake in Celcom, opposed the takeover and other foreign investors examining the Malaysia market shared its concerns.

Malaysia has been somewhat inconsistent in its positioning toward foreign investments. It must decide between its role as wanting foreign investors and/or making such investments abroad itself. Government reports often emphasize that the 7.3–10% growth rates in the decade preceding 1998 were in large part due to foreign investments. Recently, government pronouncements have encouraged investments abroad because of low stock prices, while at the same time indicating that Malaysia is not interested in FDI flows for itself. However, it has also sought to play its regional ethnic cards in trying to become a hub for Islamic financial markets like Bahrain and in attracting investments from Chinese entrepreneurs. In July 2003, it hosted around 3000 members of the World Chinese Entrepreneurs Convention.

Meanwhile, its FDI flows have slowed down, although Malaysia claims that it received more than US\$5 billion in FDI in 2002 (the actual figures were US\$3.2 billion for 2002 and US\$2.5 billion for 2002 and 2003 [UNCTAD 2004a, 2004b]). It is clearly worried about FDI flows to China. However, most ASEAN economies also realize that they can gain from an economically strong China. The negotiations over the ASEAN–China Free Trade Zone are indications of this.

### **Philippines**

The Philippines made a strong commitment at the WTO. At that time, its domestic liberalization program was just beginning to take hold. In 1993, the Philippines introduced a critical deregulatory legislation, which led to the creation of the National Telecommunication Commission. Meanwhile compe-

tion was introduced though the historic monopoly, Philippine Long Distance and Telephone Company (PLDT), remained dominant. Table 1 shows the spurt in Philippine infrastructural expansion as a result of these policies after 1995.

By 2003, the reform process, which began in 1993, had mostly come undone or, at best, proceeded in half measures. NTC was increasingly ineffective in checking PLDT, which introduced a maze of predatory interconnection agreements. The government also allowed a merger between PLDT and the dominant two mobile providers, Smart and Piltel (the latter a subsidiary of PLDT). The merger would lead to a firm controlling over two thirds of the total subscribers in terrestrial and mobile telephony (Aldaba 2000).

The same chorus of complaints that plagues the telecommunications sectors of India and Malaysia can also be seen in the Philippines. Thus, FDI flows into the Philippines have lagged behind other South East Asian countries such as Malaysia, Singapore, Thailand, and even Vietnam. The great variation in FDI flows might reflect investors' uncertainty and fears about the Philippine enforcement of the commitments made. The FDI figure was US\$1.34 billion for 2000, US\$0.98 billion in 2001, US\$1.8 billion in 2002, and US\$0.3 billion in 2003 (UNCTAD 2004a).

## Conclusion

Making and enforcing credible commitments or property rights are important in explaining the variations in FDI. International commitments in telecommunications—such as those at the level of the WTO—are important in that they make country commitments transparent; their enforcement is nonetheless contingent mostly upon domestic institutions.<sup>21</sup> When enforcement is taken into account, countries examined here diverge from the WTO commitments they made.

A preliminary conclusion is advanced. If the domestic institutions do not make commitments credible, the mere presence of international commitments will not attract FDI. This conclusion is based on the mix of domestic and international factors for the four deviant cases studied here, where the international commitments diverged from the domestic liberalization program in place. In fact, the

degree of divergence accounts for the variations in the patterns of FDI flows. We observed this to be the case not just in the Philippines and Malaysia but, surprisingly, also in China. Its overall level of FDI notwithstanding, FDI in core sectors of telecommunications seems to be limited. The spike in FDI and joint ventures in telecommunications service provision in the mid 1990s and their subsequent halt in 1998 comes close to what this article termed the credible commitment illusion in China. India's case is interesting in that its liberalization program is ahead of its domestic commitments, leading to increasing levels of FDI in telecommunications. The irony is that while India's democratic system is adept at making the commitments credible over the long run, the workings of its bureaucracy and politicians can often undermine such credibility through hurdles and corruption in the short run.

Size of markets by itself will also not lead to telecommunications FDI. While the size of the Chinese market remains a big lure, and accounted for FDI in telecommunications in the 1990s, these same investors pressured their home governments to force the Chinese to make these commitments credible—in terms of seeking transparency and impartiality—starting with China's WTO accession talks. Similarly, in India's case, no FDI was forthcoming in the 1990s but began to trickle in after India passed crucial legislation in 1999 that jump started provision of mobile and terrestrial telephony by, among other things, creation of an independent regulator and a dispute settlement mechanism.

India and the Philippines are trying to attract FDI now with many measures, while Malaysia has a somewhat ambivalent stance toward it. Both India and the Philippines have announced increases in foreign equity caps to 74% from existing 49%. Incumbent foreign providers, who often lobby for them, favor such increases. It is not clear, however, if increases in FDI caps will matter much for increasing FDI in the future if the underlying incentive structure of property rights is lacking. Malaysia seems to both import and export FDI but is not doing much to attract it. In fact, both the Malaysian and Philippine governments have allowed mergers between their dominant terrestrial and mobile providers, creating behemoths that can hardly reverse the charges of

21. This does not rule out the possibility of particular international pressures for implementation or the use of WTO's dispute settlement mechanism to make countries conform. However, so far the use of these instruments has been limited.

favoritism leveled against them even before the mergers took place.

The road to FDI needs impartial, inclusive, transparent, enforceable, and interoperable property rights. Malaysia and the Philippines made WTO commitments that would allow them to meet these conditions but the implementation record was different. The FDI flows have declined in both countries. India made weak commitments and while its implementation record remains sketchy, it is slowly inching toward credibility. China made reasonably strong commitments but the degree to which they will be implemented remains unclear; in the meantime, FDI in telecommunications remains limited.

In general, however, international agreements signed by host countries are important to investors: "For most home countries, it [international investment agreements] is mainly to make the regulatory framework for FDI in host countries more transparent, stable, predictable and secure—and to reduce obstacles to future FDI flows" (UNCTAD 2003). But, such commitments are only a starting point. To make them credible, enforcement is necessary. The latter accounts for the differences in the positions of the four cases in Tables 3 and 4.

Meanwhile, the importance of FDI in telecommunications or the context for attracting such FDI cannot be underestimated. UNCTAD's 2004 report singles out telecommunications, electricity, water services, and business services as a few of the most dynamic FDI sectors and notes that "FDI can help link developing countries to global value chains in services. Such chains comprise international service production networks that are increasingly important to access international markets" (UNCTAD 2004b). ■

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