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BUSINESS PROSPECTS IN INTEGRATING MARKETS? EXPERIENCES OF FINNISH COMPANIES ON REGIONAL ECONOMIC INTEGRATION IN ASEAN AND THE BALTIC SEA REGION

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1. INTRODUCTION

The purpose of the paper is to discuss the regional economic integration processes in two distinct parts of the world; the Association of Southeast Asian Nations (ASEAN) in developing Asia, and the Baltic Sea Region (BSR) in Northern Europe. The choice of these two regions for the study is based on their characteristics as investment destinations, both of them including rapidly growing economies that are members in regional 'trade blocs'. ASEAN is one of the few larger free trade areas in Asia, while the Baltic Sea Region has a functional role as a business environment for companies located in the region (PMC 2007).

As a background, we note the considerable reorganization that the global trade regime has been undergoing since the turn of the 21st century. Changes have been manifest both in the governance of trade between nations, and in the underlying restructuring of global production systems. In the 1990s, regionalism was intensified by the deepening of regional economic integration within some of the regional organizations, particularly the European Union (EU) the North American Free Trade Agreement (NAFTA) in the developed world. They often had a role of being models for regional economic integration among emerging economies, such as the Southern Common Market (Mercosur) and ASEAN (Frankel 1997, Yeung et al 1999, World Bank 2000, Kettunen 2004a). Several of the latter comprise of countries that are in various stages of economic development, and are, at the same time, important investment targets for foreign companies. This is also reflected in the contents of the regional trade agreements (e.g. Shadlen 2005, Lindberg & Alvstam 2007) and implies the significance of inward investments to the economic development of the countries.

Specifically, in this study we aim to make a comparison between the regional economic integration processes of ASEAN and the Baltic Sea Region, and the experiences of companies on these integrating markets.[1] The two regions include countries that are emerging economies and have experienced long-term economic growth based on attracting inward foreign direct investments (FDI) mainly from industrialized economies (Kettunen & Kosonen 2009). Multinational companies (MNC) have established operations in, for example, Malaysia and Thailand, as well as the three Baltic States, Estonia, Latvia and Lithuania, thanks to low cost production and investment incentives provided by the host states. Often, the relocated MNCs have established regional production systems whereby they have engaged in importing intermediate goods from one country and exporting final products to another. The result has been a rapid growth of foreign trade in many ASEAN countries and Baltic States. New exports have also been promoted by the host governments through various incentives.

In addition, both ASEAN and the Baltic Sea Region represent relatively recent processes of state-led regional economic integration: the gradual elimination of import tariffs since 1995 in the ASEAN free trade area (AFTA) was to a large extent accomplished by 2010, and the Baltic States and Poland joined the EU single market in 2004. These developments make the two regions an interesting pair for comparison. Since regional economic integration implies the liberalization of regional trade and investments, it can be assumed that the integration processes have direct effects on the MNCs operating in the two regions: the operations of companies should ease especially in intra-regional exports and imports.

In this vein, we examine the two regions as business environments for international companies, by seeking to answer the question: *How has regional economic integration enhanced the operations of multinational companies in ASEAN and the Baltic Sea Region?* Doing so, we analyse the impact of regional trade agreements on companies' cross-border trade, i.e. imports and exports inside the two regions. Hence the study highlights both the formal aspects of regional

[1] Originally, ASEAN was established in 1967, and includes the five founding members, i.e. Indonesia, Malaysia, the Philippines, Singapore, Thailand, as well as the newer member countries Brunei (since 1984), Vietnam (1995), Laos and Myanmar (1997), and Cambodia (1999). In comparison, the Baltic Sea Region comprises of eight EU member countries, i.e. Finland, Estonia, Latvia, Lithuania, Poland, Germany, Denmark and Sweden, and a non-EU country Russia.

integration, i.e. regional trade agreements (RTA) that set the rules for regional trade, and the experiences of companies in their regional operations as to the implementation of the RTAs. The focus is on whether regional economic integration has improved companies' intra-regional trade, such as imports of raw materials or components, and exports of intermediate goods or finished goods.

To do this, we select from both regions one case country - a host country for MNCs - to study the impact of regional economic integration on the companies' cross-border operations. Regarding ASEAN, we concentrate on Malaysia that belongs to the AFTA and is an important host for foreign direct investments. In the Baltic Sea Region, we focus on Estonia that is a recent EU member country and an investment destination for companies from neighbouring countries. Both Malaysia and Estonia have become important production bases for foreign companies, and have experienced fast economic growth based on inward FDI (Table 1). For example, the GDP of Estonia doubled from 2003 to 2007, and, similar to Malaysia, it suffered from the global financial crisis in 2008. Both countries recovered from the slowdown and reached pre-crisis GDP levels – Malaysia in 2010 and Estonia, a year later. They also experienced a small decrease in the stock of inward FDI due to the crisis. However, Malaysia's inward FDI stock grew considerably in 2010 to a new record high, whereas Estonia experienced a more subtle development.

Table 1. Basic indicators of Malaysia and Estonia, 2010.

	Area (km2)	Popul. (mill.)	GDP (bill. USD)	GDP/ capita (USD)	Exports (bill. USD)	Imports (bill. USD)	Inward FDI flow (bill.USD)	Inward FDI stock (bill.USD)
Malaysia	330,000	28.3	237.8	8,420	231.4	189.0	9.1	101.3
Estonia	45,000	1.3	19.2	14,350	15	13.8	1.5	16.4

Sources: ASEAN Secretariat, EIU, Estonia.eu, UNCTAD
Note: GDP and GDP/capita at current prices.

While Malaysia is a bigger economy as to its gross domestic product (GDP), population, and foreign trade, Estonia's GDP/capita is on a somewhat higher level (Table 1). However, both countries are relatively dependent on foreign trade and inward FDI which makes them a good pair for comparing the effects of regional economic integration.

1.1. Data and method

Empirically, the study draws on various documents and statistical sources, as well as a set of company interviews. Data sources include the ASEAN and EU websites, the Trade policy reviews published by the World Trade Organization, and national and international statistics on FDI and foreign trade. In addition, business newspaper archives were used to find information on Finnish companies' operations in Malaysia and Estonia. This was combined with information from Finnish trade associations and confederations, such as Finpro and the Confederation of Finnish Industry and Employers.

In addition, we employ a set of interview data from Finnish companies, discussing their experiences on regional economic integration in ASEAN and the Baltic Sea Region. For the study we conducted altogether 24 semi-structured interviews with managers of Finnish companies, of which 11 are established in Malaysia, 12 in Estonia, and one in Russia. Anonymity was provided for the interviewees. The companies represented various sizes and sectors mostly in manufacturing industries. Interviews were conducted as semi-structured theme interviews between autumn 2004 and spring 2011 either as face-to-face discussions or though telephone; usually they lasted for about one hour. Interviews were tape-recorded, transcribed, and stored in the CEMAT databank.

The semi-structured interview was chosen as the data collection method to guide the discussion but at the same time to allow the respondents to identify issues, problems or challenges that they faced in the specific business environment. The interviewees were asked about their view on the importance of the market (ASEAN or BSR) for their companies' operations, their opinion about the formal regional economic integration, such as the level of tariffs, as well as their experiences on the ease of trade in practice, such as customs procedures, administrative practices and bureaucracy that companies face in their dealings with the customs officials. To analyze the data, it was coded, i.e. broken into discrete chunks using NVivo software, and analytical categories were produced from the respondents' statements. Findings were grouped according to relevant categories. We do not differentiate between firms in various lines of business, but analyze the questions on an aggregate level. To illustrate the findings, we refer to data by presenting direct quotations from the interviews.

The study also benefits from previous studies (e.g. Kettunen 2007, Heliste et al. 2008) where we have analysed Malaysia and Estonia, respectively, as investment destinations for foreign companies. Importantly, both countries have experienced simultaneously a process of regional economic integration and the inflow of foreign direct investments. Malaysia has been one of the major recipients of foreign direct investments since the signing of and the gradual establishment of the ASEAN free trade area. In fact, it has been argued that the aim of launching the AFTA was to attract investments in the region to face growing global competition for FDI in other parts of the world, particularly in Europe and in North America (Ariff 1995, Lee 1997, Sandrey 1997, Kettunen 1998; Kettunen 2004b). Foreign companies set up export-oriented manufacturing operations in the ASEAN countries, thereby generating new imports of raw materials and components, and exports of intermediate or final products.

In comparison, Estonia and the other Baltic States have entered at the global marketplace after their regained independence due to the collapse of the Soviet Union in 1991. They represent post-socialist transitional economies that quickly opened their markets to foreign investors. Socialist legacies were apparent in their institutional environments, leading to challenges faced by foreign enterprises. However, Estonia took a direct course "to return to the Europe" and rapidly modeled its formal institutions in view of the coming European Union membership (e.g. Heliste et al. 2008). From foreign enterprises' viewpoint the opening of its markets provided good business opportunities, and companies from the neighbouring Finland and Sweden invested heavily in

Estonia. Often these investments involved regional cross-border imports in the form of sourcing and subcontracting (CEMAT 2005), implying the growth of regional trade.

This paper presents a research approach and empirical findings on the status of regional economic integration and Finnish companies' experiences in the two regions. The structure of the paper is as follows. After this introductory section, we will review theorizing on regional economic integration and regional production chains in relation to ASEAN and BSR as business environments for Finnish companies. This provides a framework for our investigation into the regional economic integration. In addition, we apply the institutional approach to investigate into the informal norms and practices in implementing regional trade agreements from the companies' perspective. The multidisciplinary approach highlights the potential impacts of regional economic integration on companies' operations, and combines elements from classical integration theory and the institutional approach. Based on this, we present empirical findings on the two regions. The potential for cross-border trade operations for foreign companies is considered by analysing the status of formal regional economic integration in ASEAN and BSR, respectively, and the investment climate in the chosen case countries, Malaysia and Estonia. The discussion includes a brief look at the internationalization of Finnish companies in the two countries, and our findings on their perceptions on regional integration in ASEAN and the Baltic Sea Region. We also note the national-level implementation of regional trade agreements, including the possible country- and sector-specific exceptions to the free trade policy. Finally, the findings of the paper are summarized and its implications discussed.

2. THEORIZING ON REGIONAL ECONOMIC INTEGRATION

From the perspective of the investing company, locating in a country that is a member of a regional trade agreement is a good option since it will provide more opportunities for regional operations. Most countries of the world are, in fact, members of some type of regional trade agreements (WTO 2009a, WTO 2011) by which they are committed to preferential trade with other RTA member countries. According to the WTO, the number of RTAs has increased steadily since the early 1990s, and in 2011, already 313 agreements were in force. Most of these are bilateral agreements, comprising of only two parties, but also a bulk of multi-partite agreements exist. Regarding the surge of regional trade agreements, it has been suggested that regionalism is largely a result of nation states that respond to globalization by choosing regional-level cooperation over multilateral cooperation, mainly to overcome the problems of multilateralism (Michalak and Gibb 1997). Multilateral negotiations within the WTO are regarded as too complex and too slow because of the large number of countries and the conflicting interests involved. Since the number of ongoing bilateral and regional negotiations and concluded agreements is increasing at a fast pace, the resulting web of RTAs has been named the 'spaghetti-bowl' or the 'noodle-bowl' of regional trade agreements, the latter referring to the number of initiatives in Asia. To overcome the problem of multi-layered agreements, a counter-proposal has been the so-called 'open regionalism' whereby countries would engage in trade agreements that do not discriminate against outsiders (Garnaut & Vines 2007).

Regional trade agreements come in different types which result in different trade opportunities for companies. The scope and depth of RTAs define the extent of the removal of trade barriers within a region. Following this, the classical integration theory distinguishes the 'stages' of economic integration according to the deepening of integration (Balassa 1961). The first stage is a *preferential trade area* (PTA) where countries lower their import tariffs only on some products and sectors, i.e. selectively on an item-by-item basis. For example, the ASEAN countries' Preferential Tariffs Arrangements from 1977 represented this stage. The countries nominated only certain products to enjoy lower barriers to imports, and the resulting effect on companies' actual trade was minimal.

The second stage of integration is a *free trade area* (FTA), where participating countries remove tariffs and quotas on basically all imports from other member countries, but each country can apply its own trade barriers with respect to third countries. For companies this means basically free trade when they export and import inside the region.[2] Examples of free trade areas include the European free trade agreement (EFTA), the North American free trade agreement, as well as AFTA. In the current world economy, the two aforementioned types of agreements are the most common forms of regional economic integration, as PTAs and FTAs account for over 90 % of all regional trade agreements that countries engage in. [3]

The third stage of integration is a *customs union* (CU) where, in addition to the FTA, the member countries agree upon one common external tariff that is applied to imports from outside of the region. The European Economic Community (EEC) since 1968 represents this stage. Inside a customs union, companies will face 0 % tariffs on intra-regional imports, but will face a unified tariff level in their external imports regardless of the location they are importing in. This is different from a free trade area where, depending on the host country, companies have to pay varying tariffs in their imports from outside of the region. When it comes to regional trade flows, the customs union is the deepest form of integration.

In this vein, the next stages of regional economic integration deal with production factors, rather than trade flows. The fourth stage of regional integration is the *common market* (CM) which,

[2] However, FTAs among developing countries, such as AFTA, often come with sector-specific exclusions announced by individual member countries that may keep high trade barriers on some sectors.

[3] It must be noted, however, that these categories represent ideal formulations of economic integration. In practice, large variations exist as to the implementation or coverage of the arrangements. The existing free trade agreements and customs unions are remarkably varied regarding coverage, number of parties, and geographical extent.

according to the theory, is a customs union where also capital and labour can move freely. The European Single Market established in 1993 represents this stage.[4] For companies, the cross-border transfers of capital become easier thanks to the elimination of previous restrictions, and labour becomes more mobile inside the common market.

The fifth stage, in turn, is an *economic/monetary union* that implies a unification of economic policy, market regulation, macro-economic and monetary policies, and income redistribution policies. In monetary union, one common currency is created for all member states, such as in the European Monetary Union with its single currency *euro* introduced in 2002. Companies benefit from this through the abolition of previous currency exchanges thanks to a single currency.

All in all, companies engage in exports and imports in different locations in a trade policy environment that is characterized by a less or a more deep integration. According to the basic proposition of the classical customs union theory (Viner 1950), regional trade agreements increase trade between the member countries thanks to the removal of trade barriers on a regional basis. Thus RTAs enable the companies to engage in regional exports and imports with decreased customs tariffs and procedures, based on the scope of the agreement in question. However, in their imports from and exports to countries outside of the RTA, companies will face various national trade policies that may remain as barriers to trade, i.e. tariffs and the so-called non-tariff barriers. The latter include policies such as specific duties and taxes, quantitative restrictions, prohibitions, licensing, state trading, standards and technical requirements, safeguarding measures, anti-dumping measures, export promotion, export guarantees, and subsidies. These are applied in each country and on various sectors according to national trade policies.

[4] There also exist several common market arrangements that differ as to the scope of the 'free flow of factors', that is, the movement of capital and labour among the member countries.

2.1. Regional production networks: the firm level

From the companies' perspective, the state-specific trade policies shape the rules for their foreign trade operations. These are particularly important in regional production chains, where the company engages in regional exports and imports in sourcing raw materials and components, and in selling intermediate or finished products. In Asia, empirical evidence has showed a locational specialization between different stages of production chains since the 1980s, when the Southeast Asian countries appeared as 'production platforms' for Japanese manufacturers. Observing this, Alvstam (1995) sketched a model of a regional production system where raw materials and intermediate goods were imported for processing in a host country, such as Malaysia. Processing would involve either one or several stages of production, and intermediate goods would be exported for further processing to other countries, or to Japan. With the future AFTA in sight, Japanese companies developed regional strategies for their operations in ASEAN based on benefitting from the forthcoming free trade area (Mirza et al. 2000).

The same holds for the Baltic States that became part of global value chains in the early 1990s after the collapse of the Soviet Union. They soon became investment targets for companies from neighbouring Finland and Sweden, for example. Later, Estonia and the other Baltic States joined the EU trade regime which further made them attractive low cost production bases as part of the internal market and its institutional base for external trade, i.e. the EU's common trade policy.

While many Western companies have regarded ASEAN a group of separate national markets, not a regional market (Mirza et al. 2000), their region-wide strategies are nevertheless subject to the possible liberalization of regional trade. Companies should benefit from locating in a free trade area, as there will be fewer barriers for cross-border trade within the region. This is even more the case as AFTA is gradually being completed. In addition, government incentives and policies, such as preferential taxes at the national level, have been important motivators for companies' investments in ASEAN (Giroud & Mirza 2010).

It is not only that the regional trade policies are likely to have an effect on the companies' regional strategies, but also vice versa. The enterprise strategies to create regional value chains have had an impact both on the governments' need to liberalize regional trade and the subsequently changing patterns of trade within a region. It has been noted that the companies' FDI strategies have three types of effects on the geographical patterns of trade for the host country (Alvstam 2001). These are based on the company's market strategies, i.e. the decision to start production intended either (a) for the host market, (b) for exports back to the home country, or (c) for exports to third countries. The first strategy, distribution in the host market, does not affect the total exports of the host country, while the second strategy increases the exports of the host country and the imports of the home country. The third strategy increases the exports of the host country, and possibly also the overall regional trade (ibid.). Overall, regional production networks have had a major role in shaping the international geography of trade (e.g. Grant 2000; Kettunen 2004a).

In this way international companies are vital in modifying the regional patterns of trade through their subcontracting, sourcing, and exporting across national borders. The changes in international trade patterns have been manifested in the growing interrelation between foreign direct investments and foreign trade in Asia (Alvstam 2001, Andreosso-O'Callaghan & Bassino 2001, Urata 2001, Min 2003). This has been especially evident in rapidly developing economies. An example is Vietnam, a less-developed ASEAN member country that receives one fifth of its inward FDI from fellow member countries. The investments mainly originate from Singapore, Malaysia and Thailand and are made by local and foreign firms based in these countries (Mirza & Giroud 2004a). The investing companies engage in regional exports and imports as part of their production chains. Also statistical analysis has indicated that after joining ASEAN in 1995, Vietnam experienced a strong trade creation with regional neighbours between 1996 and 2001 (Bui 2008).

Overall, regional trade networks in ASEAN were intensely connected already two decades ago and the density of networks has further increased since then (Iapadre & Tironi 2009, Poon 2003).

2.2. Institutional approach to regional economic integration

After companies establish operations in new locations, they face the institutional environment of the host economy. North (1990) defines an institutional framework of a nation as 'the rules of the game in a society'. Institutions can be divided into *formal institutions* that include, for example, laws, regulations, and contracts, and *informal institutions* that point to norms, cultures and practices. Both provide constraints for actors when they pursue their own interests. The formal rules provide the 'rule book' for the game, whereas informal practices represent a commonly understood way in which the written rules are interpreted and applied when playing the game. In transitional and post-socialist economies, such as Russia, informal practices are often decisive due to the uncertainty caused by the turbulence of formal institutions (e.g. Kosonen 2002).

Hence the institutional approach stresses the distinction between the formal rules and the informal practices which may, in the case of developing countries, be distinct or even contradicting each other. As regards regional economic integration, this could indicate that despite formal agreements on free trade between countries, the implementation of agreements might lag behind. At the practice level, companies may experience difficulties in the customs procedures or when being posed higher than expected tariff levels. Indeed, it has been suggested in previous literature (e.g. Lindberg 2007b) that the research on regional economic integration largely lacks the notion of institutions. The institutional environment should be taken into account when considering the strength of a regional organization and the provision of common rules and policies. This is important considering the actual functioning of a RTA from the perspective of 'users', i.e. the companies. Recent research has indicated that in East Asia, only about 28 % of the over 800 firms surveyed were actually using the preferences (e.g. lower tariffs) provided by the agreements, mainly because of the hard bureaucracy involved (Kawai & Wignaraja 2011).

When it comes to studying institutions, we note that it is relatively easy to access empirical data on the formal side of regional economic integration, such as regional trade agreements and documents. However, there is little public data available on the informal institutions, such as unwritten norms or everyday practices regarding the ease of trading across borders or the implementation of customs tariffs. Since these are something that are experienced by the companies that engage in trade in integrating markets, the best way to find about them is to interview the firms. Hence we will discuss the experiences of Finnish firms on regional economic integration in ASEAN and BSR following the approach that takes into account also the informal practices in the implementation of trade policies.

In the next section, we move on to discuss the characteristics of the ASEAN and the BSR as business environments for foreign companies. The investigation is based on the approach presented above combining the formal and informal views on regional economic integration. We have selected one case country from both regions to analyze the actual business environment for companies operating in regions characterized by economic integration. Based on the data employed for the study, we will discuss the differences and similarities of the two regions according to:

- the level of formal regional economic integration in ASEAN and the BSR, referring to:
    - the type of RTA and the speed of putting it into practice, and
    - national-level implementation of RTAs, including the possible country- and sector-specific exceptions to the free trade policy
- the investment climate and policies on inward FDI in the two case countries, Malaysia and Estonia, as well as the characteristics of Finnish investments in the countries
- Finnish companies' experiences of regional economic integration in the two regions

As regards the discussion on both ASEAN and the Baltic Sea Region, we begin by delineating the level of formal regional integration and the characteristics of regional trade agreements. This includes the examination of national-level implementation of the RTAs, such as the possible sector-specific exceptions to the free trade principle which are determined by individual countries belonging to the regional trade area that can greatly restrict imports and exports in some sectors. Then, the investment policies of the two case countries are presented in view of their attractiveness for international companies, related to the ease or difficulty to engage in FDI in these host countries. We continue by discussing the internationalization of Finnish companies in the two countries, i.e. the stock of Finnish investments and the types of companies established in Malaysia and Estonia, respectively. Finally, we discuss the findings from our interviews with Finnish companies especially as to their experiences on the regional economic integration of ASEAN and BSR, and the effects of integration on their operations.

3. THE ASSOCIATION OF SOUTHEAST ASIAN NATIONS (ASEAN)

3.1. Level of formal regional economic integration

In ASEAN, the predecessor to the current trade framework was the *ASEAN Preferential Tariffs Arrangements* from 1977 that was the first scheme to liberalize intra-regional trade in Southeast Asia, including Malaysia. Limited tariff preferences were granted to imports from other ASEAN participants on a product-by-product basis. However, due to the small number of products taken into the scheme by each member country, the product coverage ended up being only about 2-5 % of all trade among the ASEAN countries. Thus there was practically no liberalizing effect to the actual trade flows.

In 1992, the ASEAN countries signed an agreement on the next stage of trade liberalization, the *ASEAN free trade area, AFTA* that guides the current regional trade framework. The preparation of the AFTA agreement was largely a reaction to economic integration processes elsewhere in the world, particularly Europe and Northern America. The agreement implied that for most manufactured goods imported from another ASEAN country, import tariffs were gradually reduced from their original levels to the level of 0-5 % of the products' value.[5] The member countries were free to determine the speed of tariff reductions on a national basis. As to the time schedule, the aim was to fully realize AFTA by 2010 for the ASEAN-6 countries and by 2015 for the less-developed member countries.[6]

The AFTA scheme covered, according to its 'Inclusion List', all manufactured products and processed agricultural products. Fifteen product groups were identified for faster tariff reductions, and some of these, e.g. textiles and electronics, were also major product groups in the actual trade

[5] According to the rules of origin, at least 40 % of the product's value must originate from an ASEAN member country in order to be eligible for tariff reductions.
[6] The so-called ASEAN-6 comprises of Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand, i.e. the older and more developed member countries of the grouping. The less-developed ASEAN countries include Cambodia, Laos, Myanmar/Burma and Vietnam.

between the member countries. Some products were among the most protected sectors at that time, including furniture and cement, as well as electronics and textiles.[7] Yet there were a multitude of exceptions and varying timetables for liberalization on product-by-product and a national basis.

Many important product categories were excluded from the AFTA scheme altogether. These included electrical products, transport equipment, paper products, iron and steel products, and petroleum (GATT 1995, 55). Also non-processed agricultural goods, being generally highly protected, were omitted from the scheme (ibid., 30), such as livestock, rice, coffee, and natural rubber. Many of the products excluded from the AFTA were vital for the national economies; notably, electrical products, transport equipment, natural rubber and rice. As a result, trade in these sectors is still not liberalized and may remain so taken into account the so-called 'General exclusion lists' announced by the individual ASEAN countries.

Considering the stages of economic integration as categorized by Balassa (1961), the ASEAN grouping has thus progressed close to the second stage, with AFTA almost fully realized. The ASEAN Secretariat has claimed that about 99 % of all products in ASEAN trade have been brought to the Inclusion list by 2007, hence being subject to AFTA tariff cuts, and that tariffs of almost 94 % of these products had been reduced to the range of 0-5 %. With the global financial crisis, however, the implementation of the remaining tariff cuts was supposedly facing difficulties, as the pressure for national protection increases during times of economic downturn.

For companies, the current status of the ASEAN free trade area indicates that an integrated market area is gradually in the making. However, the possibility of member countries to apply exclusions to the scheme makes the progress of AFTA somewhat difficult to foresee and thus non-transparent for companies. This means that for a company located in one ASEAN country, intra-regional imports or exports may be hampered by the sector-specific restrictive trade policies announced by individual member countries – in spite of what was formally agreed in the FTA.

[7] The fast schedule was also applied to pharmaceuticals, plastics, vegetable oils, fertilizers, rubber products, leather products, pulp, ceramic and glass products, gems and jewellery, and copper cathodes.

These restrictive policies often protect the domestic sectors that are considered strategically important, such as the automobile sector in Malaysia.

In addition, as Severino (2008) notes, while the "tariff-cutting exercise" is almost done in AFTA, the non-tariff barriers to trade still remain high. These include the lack of coordination in customs procedures among the ASEAN countries, the lack of harmonization of product standards, and the enduring restrictions to trade in services. The slow progress in removing these trade barriers has kept ASEAN a 'disintegrated region' in the eyes of traders and investors, and has partly been a result of the lack of institutional capacity in some of the member countries to carry out the agreed policies (ibid.)

It must be noted, too, that AFTA only refers to intra-regional trade. Each ASEAN member country exercises national trade policies against external trading partners, which is in contrast to the EU that has a harmonized trade policy towards third countries. However, in recent years ASEAN as a grouping has engaged in a number of partnership and free trade negotiations with third countries, notably China, Japan, South Korea, India, Australia, New Zealand, and the US. An example is the so-called ASEAN+3 that refers to ASEAN negotiating on free trade jointly with China, Japan and Korea. The first bilateral trade partner to sign an 'ASEAN+1' free trade agreement in 2002 was China.[8] The agreement aimed at an ASEAN-China FTA in trade in goods to be fulfilled gradually by 2015 (for China and the older ASEAN members, by 2010) with "flexibility on sensitive commodities". This provides significant trade opportunities for companies located either in China or in the ASEAN region.

Similarly, ASEAN has negotiated on a FTA with the EU since 2007, with a cut in talks, however, because of political problems over Burma/Myanmar.[9] The negotiations have continued at a bilateral basis between the EU and individual ASEAN countries (Singapore and Malaysia) since

[8] China had approached ASEAN in 2000 to propose a FTA in view of its soon-to-be membership in the WTO. On ASEAN-China FTA: http://www.aseansec.org/13197.htm
[9] For more on EU-ASEAN free trade negotiation, see e.g. Lindberg & Alvstam (2008; 2010).

2009 (Ahnlid et al. 2011). In comparison, ASEAN has reached a looser arrangement with the US that, in turn, has concluded a bilateral agreement with Singapore and started negotiations with Malaysia and Thailand (Severino 2008). All this indicates the emerging 'noodle bowl' of bilateral and regional trade agreements in Asia. When it comes to the individual ASEAN countries engaging in trade negotiations and agreements, it has been noted that Malaysia is more inclined towards the regional neighbours than external trade partners. This is in contrast to what has been witnessed from some other ASEAN members, such as Singapore, that has an extensive global network of bilateral trade agreements largely for security reasons (Hoadley 2007).

There are three other fields of ASEAN cooperation that can have an impact on companies' regional operations. Firstly, the member countries agreed in 1998 to establish a so-called ASEAN Investment Area (AIA) with the aim of extending national treatment in investments to investors from all ASEAN countries by 2010, and subsequently to all investors by 2020 (WTO 2000). This has been complemented with the recent "comprehensive" agreement,[10] but it seems that in practice, the investment regimes of individual ASEAN countries have remained quite diverse.

Secondly, a farther-going integration scheme was initiated in 2003 when the member countries decided to establish an 'ASEAN Community' by 2020.[11] This would include the creation of an ASEAN Economic Community by 2015, the declared aim of which is to create a region with a "free flow of goods, services, investment, and a freer flow of capital". By contents this would refer to a common market as defined by Balassa (1961), but its realization seems a far-reaching aim, however, given the diverse structures of the ASEAN economies and the absence of a customs union among the members.

Thirdly, there have been aims to strengthen the grouping's legal position. The so-called ASEAN Charter came into force in 2008 and established a legal personality for ASEAN with the aim of evolving towards a community, based on an EU model. The absence of a legal body has

[10] On the ASEAN Comprehensive Investment Agreement: http://www.aseansec.org/22218.htm
[11] The Declaration of ASEAN Concord II (Bali Concord II): http://www.aseansec.org/15159.htm.

rendered cooperation difficult, and it has not been possible to ensure that agreements were really complied with (Lindberg 2007a). The lack of a treaty or legal obligations is considered a major problem in ASEAN's future, especially regarding the plans for the Economic Community which cannot be fulfilled without a legal system for its implementation (Pelkmans 2009).

3.2. Investment climate and policies on inward FDI: the case of Malaysia

Malaysia is one of the founding members of ASEAN and an active proponent of regional cooperation. Its rapid economic growth has continued since the 1970s, curbed only by the financial crises in 1998 and 2008. Growth has been supported by Malaysia's *export-oriented industrialization policy* based on five year plans that work towards the declared objective of attaining the status of a developed industrialized economy by the year 2020. The business environment is generally characterized by a fairly developed infrastructure and a relatively good level of business services, while challenges include the bureaucracy of the state sector, corruption and the slow restructuring of the local business sector (Finpro 2010).

The opening of the Malaysian economy to FDI has coincided with the regional economic integration process. At the time of the signing of the AFTA agreement in the early 1990s, the Malaysian government relaxed two central regulations concerning foreign companies' operations. The previous requirement to export all production of totally foreign-owned manufacturing companies was decreased to 80 % of exports, and in the liberalized sectors, a 100 % foreign ownership was allowed for the first five years of operating in the country.

The incentives led to a surge in inward FDI especially in electronic industries, and soon, Malaysia hosted about 140 foreign companies in the electronics sector and became a significant producer of various computer components, such as mother boards. One of the major investors was Intel that produced about 30 % of its microprocessors in Penang. The industrial policy led, however, the Malaysian economy being heavily based on one sector, the export oriented electronics industry that composed the bulk of manufacturing output. The other major export sector is agriculture, consisting largely of palm oil. Since Malaysia has liberalized its various trade policies according to the ASEAN free trade area framework, many trade preferences are related to promoting inward foreign direct investments (Kettunen 2004b). The economy has also become very dependent on foreign trade that accounts for over 150 % of the GDP for some years.

Currently, Malaysia allows foreign investments in most sectors. Restrictions exist in telecommunications, where foreign investments are eligible only through acquisitions, and foreign ownership is limited to 30 %. An exception is the government-led scheme on developing the so-called Multimedia Super Corridor (MSC) zone close to Kuala Lumpur where full foreign ownership is allowed in companies that develop multimedia technologies. In 2009 the new government announced the liberalization of the services sector, as well as the lifting of the previous requirement of a 30 % Malay ownership in listed companies. Malaysia also provides tax privileges to foreign companies, and various kinds of investment incentives are provided through the tax system to promote particular industries. The promoted industries include resource-based industries, high-tech, new and emerging technologies, strategic industries, skills and human resource development, research and development, integrated logistics, and information technology (WTO 2006, 60).

Nowadays, new foreign investments are made especially in the electrical and electronics industries, oil industry, food production, and finance and insurance. Most of the new investments are reinvestments by MNCs. The importance of inward investments to the Malaysian economy is highlighted by their share of the GDP: during 2001-2008, the value of annual inward FDI flows was over 3 % of Malaysia's gross domestic product. At the same time, the stock of inward FDI rose to over 34 % of its GDP. (WTO 2009b, 11) The reliance on foreign-owned export-oriented sectors has made Malaysia very vulnerable to global economic fluctuations. However, research on the effects of FDI indicates that because of the very high level of inward investments, they clearly provide various positive direct effects on the Malaysian economy. These include employment, training, and skill development, which, in turn, feed into increased consumption and tax revenues (Mirza & Giroud 2004b).

3.3. The characteristics of Finnish investments in Malaysia

Compared to others, Finnish firms have been relatively late investors in Malaysia. In the early 1990s, when the creation of AFTA was started, about 20 companies from Finland were located in Malaysia. This reflected the general trend of Finnish direct investments, which took off only during the 1990s in Southeast Asia. In contrast, companies from some other Nordic countries, particularly Sweden, were early investors in Asia and had soon established a large number of overseas units in the region. Companies from Finland, however, continued to grow in Malaysia gradually in the 2000s. According to the Malaysian Industrial Development Authority (MIDA), Finnish investments in approved projects in Malaysia totaled 10 million USD from 2000 to 2005.

At that time, the investment motives of Finnish firms in Malaysia were based on the business opportunities especially in telecommunications, oil industries, and construction. The telecommunications networks and mobile phone manufacturer Nokia was one of the first companies from Finland to establish large scale operations in Malaysia in the early 1990s. Major Finnish investors also included the large oil refining company Neste (later Fortum). Neste engaged by value in the largest investments in a joint-venture with the Malaysian oil giant Petronas to set up production of MTBE (a component of unleaded fuel) in Pahang. Also the Finnish construction element manufacturer Partek established manufacturing in Kuala Lumpur, and became the largest producer in its line of business in Malaysia in the 1990s. Most of Partek's clients were Japanese companies that were building manufacturing spaces and factories in Malaysia. In addition, the Finnish metal producer Kuusakoski established a recycling aluminium factory in Malaysia together with Japanese and Singaporean partners, using metal scrap, such as used cars, as raw material and producing aluminium for steel factories.

The number of Finnish companies doubled in the next two decades, and over 40 firms from Finland had established operations in Malaysia by 2010.[12] Most Finnish companies operate manufacturing production and/or sales or services, and some also have their regional representation in Malaysia (e.g. Southeast Asian regional headquarters). The combined turnover of Finnish firms in Malaysia was over 300 million euros in 2009. The number of employees in Finnish firms in Malaysia has somewhat increased, being almost 2,000 employees in 2010. (Finpro 2010)

In the 2000s, Finnish companies that have engaged in business operations in Malaysia include, for example, Tecnomen that delivers communications solutions to teleoperators, and Comptel that provides telecom software and has a research and development unit in the country. In addition, F-Secure has established its Asian head-quarters in Kuala Lumpur to scan global threats to IT security and to provide protection against computer viruses. Also Nokia has delivered the expansion of the mobile phone (gsm) network of Time dotCom in Malaysia. Some Finnish companies have also acquired the 'Multimedia Super Corridor status', such as Nokia and Comptel, and receive the benefits of locating in the MSC zone. The Finnish sports products company Amer Sport has established a regional distribution centre in Malaysia. In contrast, some have withdrawn from the country: e.g. the producer of mobile phone covers Perlos announced a closing of its antenna factory in Johor Bahru to relocate it in Guangzhou, China, and to move the production of prototypes to its Singaporean unit.

The cumulative value of Finnish investments in Malaysia reached 93 million euros by 2010. With this figure, Malaysia hosted the second largest stock of Finnish direct investments within ASEAN. However, the share of Finnish investments is relatively minor of all FDI in Malaysia. According to MIDA, the value of approved Finnish investments was 123.8 million RM (appr. 35 million USD). This was only about 0.6 % of all inward investment flows, since the value of total approved FDI was about 22 billion RM (6.3 billion USD) in 2009.

[12] These include, for example, Ahlstrom, Amer Sport, Comptel, Fortum, F-Secure, Halton, Huhtamäki, Kemira, Kone Corporation, Konecranes, Nokia, Nokia Siemens Networks, Pan Oston Group, Polar Twin Advance, Stora Enso, Tecnomen, Tekla, UPM-Raflatac, and Vaisala. (Finpro 2010, MIDA 2009).

3.4. Finnish companies' experiences of regional economic integration in ASEAN

Most of the interviewed Finnish companies in Malaysia consider Southeast Asia an important market in their operations; only two managers mentioned that China and other BRICs (particularly India and Russia) are clearly their main focus. Seven interviewees characterized Southeast Asia either as "*the most important growth market*", a "*potential market*" or a stable market where operations will remain as before. Growth prospects were foreseen especially in Vietnam and Malaysia. Only for two firms, Southeast Asia is a small or "*a saturated market*". The reason for regarding Southeast Asia a potential market was its size and other characteristics: "*…there are more than 600 million people, a generally good infrastructure – not everywhere but mostly, the GDP growth is 6-7 %, and English is widely spoken*." Echoing this, many respondents also mentioned that the ASEAN countries are relatively easy business environments, especially compared with China or India.

While many of the companies have units in several ASEAN countries, their location decisions are not based on the prospects for regional economic integration: most of the respondents do not regard AFTA as central in their investments decisions. Instead, investments are based on the companies' global strategies where China has a central role. Respondents explained this by the fact that it is hard to build strategies on a FTA that is only in the making. According to one interviewee, "*…we cannot make decisions based on these expectations of a FTA which are unsure. So, the possible advantages, if there are any, are realized only afterwards*". Quite surprisingly, the same seems to apply to the recently established free trade area between China and Southeast Asia. When managers were enquired about the China-ASEAN free trade agreement, many did not see it having any practical impact on their operations. This was despite most firms had regional production chains between China and the ASEAN countries.

There was a clear difference between large and small companies, however, in the general awareness about free trade areas. Typically the managers of larger companies were better aware of the FTA developments and the overall trade policy front than were the managers of small firms. "*It is hard to tell whether ASEAN would affect our business, because I do not understand much about these… We do not have any big problems there, either*." This might also reflect the recent outburst in the number of FTAs which makes the regional trade regimes complicated, and almost impossible for the companies to follow.

As regards the trade of the Finnish companies, only two of the interviewed firms were engaging in intra-ASEAN trade: one company exports from Malaysia to Singapore (and several other East Asian countries), and the other had some trade from Singapore to Indonesia. In addition, one company has some intra-regional trade indirectly, through its distributors. Several of the firms are importing mainly from Europe and/or from China, and one from India, for their Malaysian operations. "*Most of the material for our products comes from China, and we install them locally*." One interviewed company imports all of their products from Finland for the local market in Malaysia.

Hence the companies face various kinds of trade policies and barriers, depending on the geography of their trade. The company that exports from Malaysia to Singapore and East Asia (e.g. South Korea, Japan, China, Hong Kong) has not faced any particular problems: "*…so the products move very easily, and the payments move [easily]*." Most of the interviewees mentioned one or several types of barriers, however, such as burdensome customs procedures, high level of import tariffs, national standards, anti-dumping accusations, and "*tariff wars*". Two companies reported that their industry had reasonable tariff levels – between 5-10 % - thus "*not causing any headaches*" for them. The level of protectionism varies from one industry to another, as does the level of competition - some Finnish companies seemingly operate with less regional competition than others.

To tackle the trade barriers, the interviewed managers mentioned some potential solutions that they would use to solve problems caused by local trade policies. These included using Finnish authorities as intermediates: if the issue was a broader question related to Finnish industries in general, the company would turn to the Finnish Embassy who helps in negotiating the problem with the host country officials. Alternatively, the company might make use of a Finnish ministerial visit to take up the issue of trade barriers: "*When the minister's speech is being prepared, I could talk to the minister and hint about the problem*".

In sum, the interviewed firms regarded ASEAN mostly as a stable and an important market. A couple of companies were assured that their operations would grow in Southeast Asia. Based on the interview data, the process of ASEAN integration did not seem to be a major factor in the companies' strategies or location decisions. Trade barriers exist, but they are relatively moderate. Most of the interviewed firms considered the future potential of the Southeast Asian market positive for their operations.

4. THE BALTIC SEA REGION

4.1. Level of formal regional economic integration

When it comes to the Baltic Sea Region as a regional unit, the situation is fragmented compared to ASEAN because of the lack of a free trade agreement between the EU and Russia. Eight countries in the Baltic Sea Region are currently members of the European Union, while Russia is not. Trade barriers between the two remain relatively high; the EU applies a restrictive trade policy towards Russian imports of steel and textiles, for example. However, some preferences are provided by the EU to imports from Russia e.g. in the chemical industries and base metals[13] (WTO 2009a). Although the EU and Russia have engaged in cooperation on a broader level within a partnership agreement, the prospects for trade negotiations have been hampered by continuous trade disputes and disagreements over various sectors, such as Russian energy exports to the EU. In addition, the fact that Russia has not been a WTO member - until agreement was reached in late 2011 - has further diminished the likelihood of liberalizing trade on a regional basis.

However, looking at the integration process of the three Baltic States and the rest of the BSR, excluding Russia, one can see a very different picture. After the Baltic States had been part of the Soviet Union for several decades, they re-gained independence in 1991 and started to work towards integrating with the European Community (EC). At the same time, the internal integration of the EC was developing towards *the European Union, EU*. Finally, Estonia's membership in the European Union in 2004 meant that it joined the customs union and the common market, and that all (previously national) trade policies were harmonized with the EU policies. In practice, this implies that there are no trade barriers in the EU internal market and that also a common external trade policy is applied vis-à-vis third countries.

[13] These are based on the EU's Generalized System of Preferences (GSP) applied towards developing countries.

For companies, the EU thus provides an internal market without border controls in intra-EU trade. The union does not allow national deviations to the common trade policy; these were eliminated by 1993 for the establishment of the Single European Market. This makes the trade regime uniform for the firms regardless of the country that they are located in inside the EU. Also, the EU's common trade policy in relation to third countries means that individual EU countries do not decide on trade agreements.[14] The member countries have given up their sovereignty over trade policies to the supranational EU institutions; for example, the European Community has exclusive competence over the common trade policy of the EU and its negotiations with external partners. For companies, this implies that the political decisions on trade policies are made at the EU level: there is a multilayered network of lobbying for trade policies through the national and the EU-wide institutions in case companies want to have a say in the decisions.

There had been several preceding stages of EU integration before 2004, though. Originally, the EU's commercial policy framework was based on the Rome Treaty from 1958 that has undergone only one major reform ever since: the Single European Act of 1987 that set the target of forming a common market, the 'European Single Market' by 1992. Border controls and customs procedures were gradually removed in intra-EU trade, and differences in trade regulations and all national trade restrictions against third countries were abolished.

Formally, the European Single Market was established in 1992 by the Maastricht Treaty. The resulting 'EU Treaty' combined together the existing agreements and spheres of cooperation.[15] It also set forth new objectives, most notably the establishment of an economic and monetary union. These aims were realized, first, with the introduction of a single currency in 1999, and further, with the launch of euro banknotes and coins in 2002 for the European Monetary Union (EMU) member

[14] The EU's common trade policy covers several fields: changes in tariff rates (i.e. the 'common external tariff'), the conclusion of tariff and trade agreements with external trade partners, achievement of uniformity in measures of liberalization, export policies, and measures to protect trade, such as those in the case of dumping or subsidies.

[15] Including: the European Communities (comprising the European Coal and Steel Community, the European Economic Community, the European Atomic Energy Community, and the Single European Act), common foreign and security policy, and 'home affairs and justice'.

countries. The European integration process has thus followed the stages distinguished by Balassa (1961), evolving from a customs union (EEC) to a common market (the European Single Market), and to a monetary union (EMU). Reflecting the theory, the European internal market is based on four 'freedoms': the free movement of goods, services, capital and people.[16]

The enlargement of the European Union by new member states, such as the Baltic States, has led to country-specific timetables for integrating into the various fields of cooperation. For example, membership in the EMU, or the Eurozone, is based on jointly agreed economic standards that the candidates must fulfill, as well as on national decision-making whether to join or not. Currently, the Eurozone includes 17 members, including Estonia, since 2011.

Thus for business companies, locating in the Baltic Sea Region brings two options that are based on where the companies want to export and/or import. First, there is a lot of potential for cross-border trade within the EU area, where firms can benefit from free trade inside the union, as well as fewer restrictions on moving capital and labour, and a single currency among some of the countries (i.e. Finland, Estonia, Germany). Second, the other option is to engage in trade between Russia and an EU country, where relatively high barriers to trade exist. This makes it hard for companies to integrate their operations between the Baltic States and Russia, for example.

4.2. Investment climate and policies on inward FDI: the case of Estonia

In Estonia, the economic environment for inward FDI was characterized by a transition from socialism to capitalism and a sudden opening of the economy in the early 1990s. The Estonian economy was, however, facing serious troubles at the time of the opening directly after the independence. This was because during socialism, the Baltic States had produced low quality products for the Soviet Union markets, and their industrial structure was based on heavy industries

[16] These form the core of the European competition policy, the declared objective of which is to improve the efficiency of the European economy by removing economic barriers among the member countries. On European internal market: http://europa.eu/pol/singl/index_en.htm

serving the Soviet military forces. After independence, the majority of these factories had to be shut down because of the loss of markets, and because the products could not compete against Western producers. As a result, Estonia's GDP declined, prices increased rapidly, and the living standard declined in 1991. The government opened the economy for inward foreign direct investments and began actively to attract foreign companies to the country. At first, the value of annual inward FDI remained modest because investors were suspicious about the institutional turbulence related to the transition period. (Heliste et al. 2008; Kosonen et al. 2008)

Soon, however, foreign investments especially from Finland and Sweden started to flow into Estonia, and the economy began to grow rapidly. Since Estonia's future integration into the EU was already in sight, investors became more confident in the Estonian business environment. The local industrial capacity was transformed into new manufacturing operations by foreign investors who were drawn to the country by the low costs of production and labour. Estonia became characteristically a production base for foreign companies that engaged in manufacturing and exporting the products to third markets (e.g. Heliste et al. 2007). The government regarded FDI as an important factor in bringing wealth into the national economy. Also Estonia's tax policy favoured small and medium sized companies, which was a significant factor in the inflow of FDI.

The second wave of FDI into Estonia was witnessed in the early 2000s just before and after the integration into the EU. After becoming part of the EU internal market in 2004, Estonia's inward investments grew explosively over 2.5-fold in only one year. Growth in FDI was reflected in the rapidly growing total production, as well as in the income levels. For example, the GDP per capita increased from about 500 euros in 1992 to about 12,000 euros in the peak year 2008 just before the global financial crisis. At that time, the Estonian economy was overheating with a high inflation rate (10 %), a worsening lack of labour force, and rapidly increasing wages. The crisis cooled down the Estonian economy: in 2010, inflation had dropped to 3 %, and GDP per capita to

10,700 euros. Similar to Malaysia, a continuing problem for Estonia is the dependence on FDI that is a major source of capital and employment.

4.3. The characteristics of Finnish investments in Estonia

Finnish companies have been early operators in Estonia, and by the value of FDI, also a major source of investment. Already during the Soviet Union era, Finns were engaged in foreign trade that was directed to Estonia. Finnish firms began to establish also joint-ventures in Estonia as soon as it became possible in 1987. In the early 1990s, Finland faced a severe recession that led companies to find cheaper sites for manufacturing abroad. Since the neighbouring Estonia had opened its economy for FDI, Finnish companies started to increasingly invest in the country. Between 1992-2003 the share of Finnish direct investments was almost one third of all inward FDI in Estonia; only Swedish companies engaged in more foreign direct investments. As Finns and Swedes were early movers, they managed to saturate the relatively small Estonian economy soon, leaving little possibilities for other foreign investors to enter the market. There were sectoral differences between the two, however: while Finns focused on export-oriented manufacturing aimed for the Finnish market, Swedish firms operated mostly in the banking sector.

At that time, the Finnish industries that moved to Estonia included the construction sector, textiles and furniture, foodstuffs, wholesale and retail, electronics, telecommunications, and business services. The construction industry provided significant investment opportunities which benefited Finnish firms, such as Lohja and Partek that were already established in Estonia. In addition, several others established subsidiaries in the country, such as the paint producer Tikkurila and the construction company Viitoset. In the textiles and furniture industries, Finnish companies engaged especially in subcontracting operations and started to export products from Estonia to Finland.

Investments in the food sector were in the early 1990s concentrated in breweries and bakeries, and companies were the largest ones in the field, e.g. Hartwall, Olvi, Vaasan&Vaasan, and Fazer Leipomot. Similarly, Finnish wholesale and retail companies that expanded into Estonia included some of the major actors, i.e. SOK, Kesko and Rautakirja. The Estonian electronics sector was dominated by a Finnish enterprise, the electronics manufacturing services company Elcoteq whose operations quickly grew in the country. (CEMAT 2005) Based on the expansion of manufacturing companies to Estonia, also the Finnish business services were quick to follow their customers, to provide e.g. banking, accounting and financing services.

During Estonia's negotiations for the EU membership, some new Finnish industries appeared in the scene of the Estonian economy, including forestry, information technology and energy (Heliste et al. 2007). Large Finnish companies moved to Estonia in these sectors, such as UPM Kymmene, Stora Enso and Fortum. In addition, smaller Finnish engineering companies entered Estonia and established both subcontracting operations and subsidiaries. Overall, Finnish companies had a major impact on developing the Estonian economic structure since its independence. For example, Elcoteq grew to be the biggest single employer in the capital city Tallinn, and the largest exporter of the country. The Finnish teleoperator Sonera had dominated the Estonian tele-sector together with its Swedish competitor Telia. After the two companies were merged in 2002 into TeliaSonera, the new company owned altogether 49 % of the Estonian Eesti Telekom.

Investor confidence was further strengthened by the regional economic integration of the Baltic States into the EU. After Estonian membership, Finnish investments almost doubled in the country. New investments were made also in new sectors, such as hotels and restaurants, as well as logistics. The Finnish retail and wholesale corporation SOK acquired one of the major hotels in Tallinn and established a fast food chain in Estonia. In logistics, Finnish companies were involved in the transito-transport of e.g. automobiles into Russia. Hence there have been some changes in the sectoral distribution of Finnish investments during the last decade.

In 2010, the stock of Finnish foreign direct investment in Estonia reached 1.5 billion euros (Bank of Finland 2011). More than 3000 firms and organizations from Finland have a representation in Estonia, of which about 470 are subsidiaries of Finnish companies.[17] Many Finnish companies consider Estonia a 'home market'. Some major investors have left or are leaving the country, however, because of various reasons.[18] Of the Baltic States, Estonia has remained the most important investment destination for Finnish firms thanks to cultural and geographical proximity and the EU incentive.

4.4. Finnish companies' experiences of regional economic integration in the BSR

The countries belonging to the Baltic Sea Region have a significant role for Finnish businesses: they account for over one third of Finland's total trade,[19] and over one third of the stock of Finland's direct investments abroad.[20] Most of the interviewed Finnish companies considered the Baltic States, especially Estonia, an important production base because of lower costs, geographical proximity, and its integration into the EU. For these reasons, the companies regarded it important for their competitiveness to expand to Estonia. Several companies benefitted from the changes in the business environment already in the late 1990s as Estonia was harmonizing its legislation towards the EU framework. Hence the changes were gradual: "*It was not any kind of a 'big bang'.*

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[17] Major Finnish companies in Estonia include e.g. Nordea, TeliaSonera, Sampo, HK Scan, Finestlink, Olvi, Fortum, Stora Enso, Cargotec, Kuusakoski, Kesko, Kitkovest, Vestikit, If Insurance, Ruokakesko, Skanska, Vaasan & Vaasan, YIT, and Lemminkäinen. (Finpro 2008)

[18] For example, Elcoteq's Swiss parent company was declared bankrupt in late 2011.

[19] Of Finland's total exports in 2010, almost 12 % went to Sweden, 10 % to Germany, and 9 % to Russia, and of Finland's total imports, 18 % originated from Russia, 13 % from Germany, and 10 % from Sweden (National Board of Customs, 2011).

[20] In 2010, the stock of FDI from Finland was EUR 25.8 billion in Sweden, 4.8 billion in Germany, 2.7 in Russia, 1.5 billion in Estonia, and 1.2 billion in Poland, while the total stock was EUR 102.4 billion (Bank of Finland, 2011).

These countries have worked hard for at least a couple of years to come closer to EU standards", as one manager put it.

At that time, Finnish companies engaged in trade between Finland and Estonia as part of their sourcing, subcontracting, or production. The firms reported about a variety of trade barriers, including slow customs procedures, bureaucracy, and high levels of customs tariffs that took place before 2004. These affected their imports of raw materials or components to Estonia, as well as the exports of intermediate or final products to Finland or elsewhere in Europe.

In this regard, the respondents' experiences on Estonia's EU membership were very positive. All of the interviewed Finns stated about the significant easing of trade between Estonia and other EU. The customs procedures were minimized, and all kinds of border formalities and bureaucracy were notably simplified: "*Now, raw materials move quickly across borders without customs tariffs; we don't have to clear them anymore. This has given us possibilities to sell products, to rationalize production, and to increase the efficiency of our production clearly. This has been a big positive thing.*" In addition, several interviewees mentioned the drop in tariff payments in their product lines. The fastened transportation of exports and imports enabled the companies to boost their logistics, too. This applied to all Baltic States: "… *Latvia and Lithuania, in these businesses, we know that logistics is an easy issue when there is the EU.*"

In addition, the Estonian EU membership resulted in several positive effects on the general business environment for the firms. These included, according to the interviewed companies, the increased security in doing business, reduced corruption, possibility to buy land, increase in quality criteria, and improvements in Estonia's jurisdiction and legislation. Also the increase in transparency was felt as improving the general business culture. Half of the companies nevertheless pointed that the changes were not sudden for them in 2004, either because their operations were already global in nature or because the changes in Estonia's formal business environment had started already some years earlier.

Several interviewees also mentioned some new challenges in the Estonian business environment. For example, the general price level – including wages – increased notably after the membership in the European internal market. At the same time, the Estonian workforce was increasingly moving to work elsewhere in the EU which made it harder to find qualified employees. There were also negative experiences of the falling of the previous 'Soviet bloc': two managers brought up the abolition of the previous Estonia-Ukraine FTA that affected their trade between the two countries.

In contrast, companies that engaged in production and/or trade in Russia commented about difficulties in border formalities and customs procedures: "*Although Russia's production costs are lower, it is not flexible. Deliveries are always late, partly because of the subcontractor and partly because of the customs. You cannot expect anything from there in less than four weeks*." Customs is, in fact, one of the most problematic issues for Finnish firms in their operations in Russia, and Finnish companies consider the Russian customs very bureaucratic and arbitrary (e.g. Heininen et al. 2008). Companies also had relatively few cross-border operations between Estonia and Russia, in spite of the geographical proximity between the two.

To sum up, most of the interviewed firms considered Estonia's joining in the EU internal market a significant factor in making the business environment notable easier. The effects of the Estonian EU membership were sensed already before, and especially after 2004, in cross-border trade and in the general business environment that became more transparent. The Baltic States, particularly Estonia, developed into a 'home market' for many Finnish firms. Major investors from Finland had a significant role in the development of Estonia's economic structure, total production, and foreign trade. In contrast, companies faced difficulties in trade with Northwest Russia. The border between the EU and Russia remained high inside the Baltic Sea Region, too.

5. COMPARISON OF THE TWO REGIONS

Based on the above discussion on the integration processes in ASEAN and the BSR, we can make some comparative remarks of the two. It must be noted that the regions are very different as to their origins and formal status, while both have a functional role as a business region for firms. We have investigated, in particular: the level of formal regional economic integration and the possible national-level deviations to the regional trade agreements; the investment policies applied by the two countries; the internationalization of Finnish companies in Malaysia and Estonia, as well as the companies' experiences on regional economic integration in the two regions. These were discussed in more detail in the previous chapters, and the discussion is summarized in Table 2.

It has been found that the two regions are characterized by regional trade agreements that represent different levels of *formal regional economic integration*. The ASEAN integration has proceeded gradually as guided by the regional trade agreements made among the member countries. While the 10 ASEAN countries have liberalized regional trade policies based on the AFTA framework, many trade preferences in Malaysia, for example, are also related to attracting inward foreign direct investments. The overall change in the ASEAN countries' trade regime has been slow. Quite the opposite, Estonia has directly integrated into the EU common market which has implied rapid and more profound changes in trade policies. As to the speed and nature of regional economic integration, the policy changes in Estonia have been faster and deeper than in Malaysia.

Currently, the two regions are characterized by different stages of regional economic integration: ASEAN is an almost-complete free trade area of ten member countries, whereas the Baltic Sea Region consists of eight EU member countries combined into a common market, as well as Russia that does not engage in formal trade agreements with regional neighbours. On the one hand, regional economic integration is 'less deep' in Southeast Asia, but on the other hand, the

Baltic Sea Region is internally more fragmented. For companies, this means varying possibilities for regional trade.

Table 2. Comparison between ASEAN and the Baltic Sea Region as to regional economic integration.

	ASEAN	**Baltic Sea Region**
Level of formal regional economic integration according to the regional trade agreement	ASEAN free trade area formally completed in 2010 with gradual removal of trade barriers by national timetables; Malaysia one of the founding members.	All countries, except Russia, part of the EU customs union and common market; Estonia since 2004 with fast implementation of laws and policies.
National-level deviations to the RTA	Country- and sector-specific exceptions to AFTA based on 'sensitive sectors'.	No country-specific deviations to the EU customs union or common market.
Investment climate and policies on FDI in the host country	Liberal in Malaysia, with no restrictions to foreign ownership on most sectors.	Very liberal in Estonia, with no restrictions on foreign ownership.
Characteristics of Finnish investments in the host country	EUR 93 million in Malaysia, e.g. in telecommunications, construction, and engineering.	EUR 1500 million e.g. in electronics, construction, food sector, tele-operators, and hotels.
Experiences of Finnish companies on regional economic integration	Various types of trade barriers still exist. No particular effect on the firms' regional strategies or location decision.	Significant easing of trade alongside the EU internal market in Estonia; problems remain in trade with Russia.

It can be expected that the ASEAN integration continues to evolve gradually, and that its plans to ease cross-border investments and to create a legal entity for the association will take time. Also the possible *national-level and sector-specific exceptions to RTAs* affect the companies' possibilities for regional trade, notwithstanding the type of the formal regional economic integration (Table 2). Here, the two regions are rather different: the ASEAN scheme includes various national sector-specific exclusions, while the EU does not allow such at all. However, the Baltic Sea Region includes Russia that has a distinct trade policy vis-à-vis the regional neighbours, and vice versa.

The *investment climate* is liberal both in Malaysia and Estonia, but the pace of policy changes has been much faster in Estonia. After its independence from the Soviet Union in 1991, Estonia opened its economy to FDI and adopted a capitalist economic system with abrupt adjustments in legislation and the policy framework. This is in contrast to Malaysia that has gradually liberalized its investment policies throughout last decades. Both countries have, however, suffered from the lack of investor confidence due to the global economic crises in 1998 and 2008 that have negatively affected the inflow of FDI. The recession has decreased the profitability of investments and has led to lay-offs of labour force in Estonia, in particular. It seems, though, that companies regarded the crisis to be temporary and were engaging in, or planning further investments into the two economies soon after.

Furthermore, the *characteristics of Finnish investments* in Malaysia and Estonia are quite dissimilar. Finnish firms have very different roles as investors in the two regions. Companies from Finland entered Southeast Asia relatively late and engaged in direct investments in the region only gradually, despite the massive investment potential in the rapidly growing ASEAN economies. In contrast, Finns were among the first ones to invest in Estonia and the other Baltic States directly after their opening. The cumulative value of Finnish investments in Estonia grew to be over 50 times larger compared to Malaysia by 2007, but dropped somewhat in Estonia due to the global financial crisis while was still growing in Malaysia. In 2010, Finnish FDI was 16 times larger in Estonia than in Malaysia. In fact, Finnish FDI had accounted for almost one third of all foreign investments in Estonia for many years, and Finnish companies were imperative in the industrial development of the country. This is in stark contrast to Malaysia that has been a major recipient of global FDI, while Finnish investments have remained relatively modest. Within Asia, Finns have later on turned to e.g. China that surpassed Southeast Asia as a main target for international direct investments.

The *Finnish companies' experiences* also echo the differences in the regional economic integration of the two regions. In Southeast Asia, Finnish firms do not refer to AFTA as a motive to invest nor do they expect any radical changes in the regional trade regime. The overall integration process in ASEAN remains obscure to the companies, and many firms face various trade barriers in the region regardless of AFTA. Some of these seem to result from informal institutions and practices, such as that burdensome customs procedures or bureaucracy related to cross-border trade despite of the free trade agreement. This is in stark contrast to the situation in the Baltic Sea Region. Especially in Estonia, Finnish companies reported about clear changes both in the trade regime and in the general business environment after Estonia's joining in the EU. However, firms regard the border to Russia as a difficult one, which makes the BSR broken into two sub-regions: the eight EU members and non-EU country Russia. Overall, the two regions seem to be quite different in terms of foreign companies' perceptions about the functioning of the regional trade agreement.

6. SUMMARY AND DISCUSSION

This paper has compared between the Association of Southeast Asian Nations and the Baltic Sea Region as business environments for companies with cross-border operations. Both regions include emerging economies that have been major recipients of foreign direct investments during the last two decades. The aim of the study was to elaborate on the impact of regional economic integration on the companies' cross-border operations in the two regions. To do this, we chose Malaysia and Estonia to be examined as host countries for international companies. The discussion was based on theorizing on regional economic integration, particularly the various levels of formal integration, and the role of foreign investors in creating regional trade flows by way of their regional production networks. This was combined with an institutional approach to study the companies' experiences of integration, especially the informal practices related to cross-border trade, such as customs procedures. Empirically, the study was based on formal documents, statistics, as well as interviews with Finnish companies operating in the two regions.

It was found that the level of formal regional economic integration differs considerably between ASEAN and the Baltic Sea Region. The ASEAN free trade area represents an early stage of integration, and, being still in the making, it also remains somewhat obscure for companies. In contrast, the Baltic Sea Region is composed of highly integrated EU members and Russia that remains outside of formal trade agreements. Thus the BSR is characterized by an internal border-line between Russia and its EU neighbours. There is another major difference between the two regions: the presence of possible sector-specific trade restrictions is geographically more widespread in ASEAN than in the Baltic Sea Region. A multitude of national exclusions to the free trade principle still exist in ASEAN. These are built into the AFTA agreement itself, and include several 'sensitive sectors' announced by individual member countries. An example is the automobile industry in Malaysia. In comparison, the Baltic Sea Region consists of two disparate sub-regions; the EU countries without any exclusions to the free intra-EU trade, and Russia with notable sector-specific restrictive policies in its trade with the EU.

Both ASEAN and the Baltic Sea Region include emerging economies, such as Malaysia and Estonia that have experienced fast economic growth based on international investments, cut only by the financial crises of 1998 and 2008. In both regions, the investing firms are engaged in exports from their production bases to regional markets, which affects trade patterns on a regional scale. The investments in turn have been facilitated by a favourable investment climate and incentives offered by the host countries.

In the two case countries, Malaysia and Estonia, the general investment climate favours foreign investors. Both countries apply a liberal policy towards FDI and actively promote inward foreign investments as a source of capital, employment, and national wealth. There have, however, been differences in how the policies have evolved in the two countries. Malaysian investment policies seem to have changed gradually, whereas in Estonia, the policies have been amended more rapidly, even abruptly. The political change from socialism towards capitalism and the concurrent revision of legislation after the independence in 1991 was the first step in policy changes, which was continued with the EU membership in 2004. Hence the overall institutional change has been much faster and more profound in Estonia than in Malaysia.

However, there is a big difference in the relative importance of the two countries for Finnish investors: the stock of investments from Finland is manifold in the nearby Estonia than it is in Malaysia. The same applies to the significance of Finnish investments for the host economies. In Malaysia, investments from Finland represent a minor share of the total incoming FDI, while in Estonia, Finns are the second biggest foreign investors. Yet, there are some similarities as to the sectoral emphasis of Finnish investments in the two countries; for example, the telecommunications sector has been important.

The two regions appear as quite different when it comes to the companies' perceptions about regional economic integration. According to our findings based on the company interviews, the AFTA process has had a neutral impact on Finnish firms' operations in Malaysia. In contrast, the EU membership has positively affected the companies' experiences on the Estonian trade regime. It seems that regional economic integration has had a clear impact on Finnish investments in Estonia. Investments have also been greatly affected by geographical distance, and Estonia has become a 'home market' for Finns. Hence, to answer the question put out in the study, our data points towards the importance of regional economic integration in the Baltic Sea Region, but not so in the ASEAN region. It must be noted, however, that the observations are tentative and must be interpreted with caution, while they nevertheless indicate a clear difference between the two regions. Whereas the EU has had a major impact on companies' businesses in the BSR, especially Estonia, the ASEAN free trade area is not central in corporate strategies, and firms still face various trade barriers in the region. This is reflected in the firms' strategies, FDI decisions, as well as investment plans for the future.

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