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Foreign direct investment flows in South-East Asia: a region between China and the United States

Since 2018, the countries that comprise the Association of Southeast Asian Nations (ASEAN) have attracted more than 10% of global direct investment flows. They have benefited enormously from the globalisation of value chains as the global economy's centre of gravity shifts towards the Asia-Pacific region. The United States continues to be the leading investor country in the region, accounting for 19% of the stock of foreign direct investment (FDI) in ASEAN countries, compared with just 3% for China (8% if Hong Kong is included). However, Chinese investment is ramping up: according to ASEAN balance of payments data, in 2021, China accounted for 8% of FDI flows (13% if Hong Kong is added), compared with 23% of total flows for the United States.

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The Banque de France's Singapore office

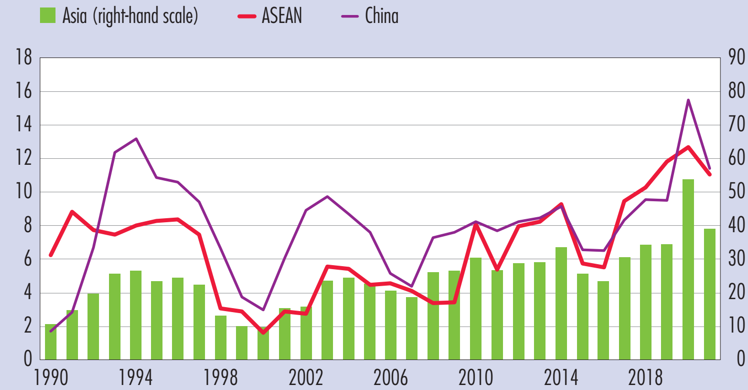
JEL codes
F13, F14,
F15, F18

Foreign direct investment inflows in 2021

40% to Asia

11% to ASEAN, i.e. USD 174 billion

Foreign direct investment inflows
(% of global total)



Sources: United Nations Conference on Trade and Development (UNCTAD), authors' calculations.
Note: ASEAN, Association of Southeast Asian Nations (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar (formerly Burma), the Philippines, Singapore, Thailand, Vietnam).

The ASEAN region[1] has benefited enormously from the globalisation of value chains and **accounts for over 10% of global foreign direct investment (FDI) since 2018**.

This trend reflects the shift in the global economic centre of gravity towards the Asia-Pacific region, underpinned by the rise of China and the region's own internal momentum which should increase in intensity over the coming years. This is all the more remarkable as the countries of the region differ widely in terms of their economic development, legal systems and political stability.

1 Trade integration among ASEAN countries preceded the boom in FDI

The economic success of ASEAN countries is based around their ability to integrate global production chains and attract direct investment. Back in 1992, the ASEAN countries signed a free trade agreement (AFTA – the ASEAN Free Trade Area) that initially brought together six members (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand), before adding Vietnam (1995), Laos and Myanmar (formerly Burma) (1997), and Cambodia (1999). This free trade agreement between ASEAN members was rounded out by bilateral and multilateral agreements with other partner countries (China, Japan, South Korea, India, Australia, New Zealand and Taiwan), culminating in the creation of the Regional Comprehensive Economic Partnership (RCEP) on 1 January 2022.[2] The agreement promotes direct investment and is largely based around existing arrangements within ASEAN, however it is not as exhaustive as the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership).

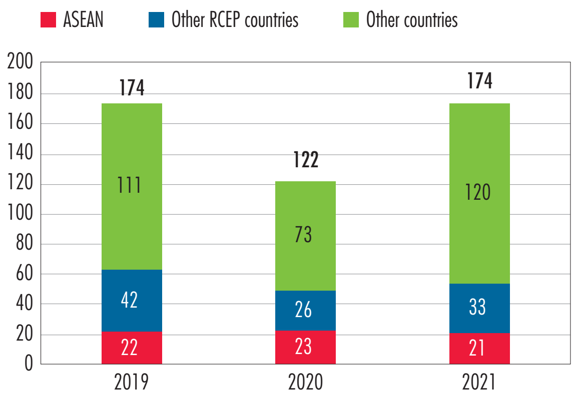
ASEAN has among the highest number of international investment agreements per member country. As of April 2021, ASEAN member states had signed 221 treaties containing investment provisions as part of free trade agreements (FTAs), and 287 bilateral investment treaties with non-ASEAN countries, reflecting the determination of member states to attract FDI and strengthen investment ties with partner economies.

To continue to attract FDI and boost trade integration, ASEAN countries need to work together to maintain an investment-friendly environment for foreign investors. However, these countries differ widely in terms of their political, institutional and regulatory frameworks. Reducing internal political risk is also a prerequisite for more effective integration. Moreover, while it is possible to ease the restrictions on FDI (see below), governments need to act together to make environmental, social and corporate governance standards more effective.

The boom in socially responsible investment is also a key issue in which FDI has a specific role to play, especially in terms of greening the economy and financing the climate transition. As such, data do not yet provide any tangible proof of such a boom. For example, the renewable energy sector still only attracts a limited amount of FDI and the energy transition has been slow to take off across ASEAN member countries, who are still heavily reliant on fossil fuels (two-thirds of their energy mix in 2020).

The pandemic resulted in a 30% decline in FDI flows in 2020, followed by a return to 2019 levels in 2021. RCEP signatory countries accounted for between 30% and 40% of FDI received by the ASEAN community when flows between signatory countries are included, a significant

C1 Foreign direct investment in ASEAN countries by region of origin
(USD billions)



Source: ASEANstats.
Note: RCEP, Regional Comprehensive Economic Partnership, comprising 15 members: the 10 ASEAN countries plus Australia, China, Japan, New Zealand and South Korea.

1 The Association of Southeast Asian Nations (ASEAN) was created by Indonesia, Malaysia, Singapore, Thailand and the Philippines in 1967, and has gradually expanded to include Brunei (1984), Vietnam (1995), Laos and Myanmar (formerly Burma) (1997), and Cambodia (1999).
2 The RCEP has 15 members: the 10 ASEAN countries plus Australia, China, Japan, New Zealand and South Korea. See also Box, Article No. 246/4, *Banque de France Bulletin*: "South-East Asia: on a par with the United States in terms of global exports", May-June 2023.

proportion but still a minority when compared with flows from third (mainly non-Asian) countries, which continue to provide the bulk of all flows[3] (see Chart 1).

ASEAN countries attract an increasing share of global FDI

The globalisation of trade has gone hand in hand with an increase in global FDI flows.[4] However, this growth is by no means linear as it is contingent on the economic cycle and the stock market. FDI flows include both greenfield investments and mergers and acquisitions. Cross-border direct investment flows are positively impacted by the strength of the economy and stock market valuations of companies (see Chart 2). In 2020, RCEP member countries accounted for 15% of the global stock of foreign direct investment (FDI) and a third of global flows, which highlights their growing importance within global investment volumes.

The Asia region – especially ASEAN countries – is becoming increasingly attractive

Asia as a whole has become the main destination for global FDI, accounting for almost a third of all flows since 2010 (see table), a trend that has intensified more recently (35% in 2019, and 54% in 2020, before falling back to 39% in 2021). This is both driving and being driven by its growing importance within the global economy (i.e. 39% of global GDP in 2021, in current dollars). The gradual increase in global FDI flows illustrates the globalisation of trade and the extension of global value chains. The Asia region receives 20% of the total global stock of FDI and this figure has remained virtually stable since 2011.

The Asian financial crisis (1997-98) had a major impact on ASEAN countries, triggering a lasting decline in FDI over a ten-year period. It was not until 2010 that FDI flows as a proportion of global flows began to grow once again and there has been a marked increase in recent years (see Chart 3).

Conversely, China has not experienced any major shocks of a specific nature over the past forty years, although the development of the ASEAN countries is even more remarkable than China's, especially over the 2010-21 period. China's admission to the World Trade Organisation (WTO) in December 2001 was a powerful catalyst in attracting foreign investment, to the detriment of investment in the rest of emerging Asia, at least until the early 2010s.

Share of foreign direct investment inflows

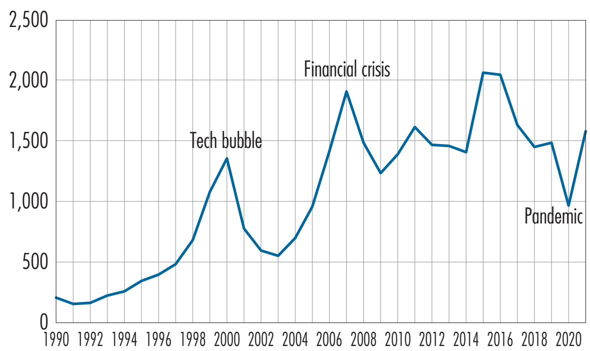
(% of global total)

	Average 1990-99	Average 2000-09	Average 2010-21
Asia	**19.1**	**20.4**	**32.5**
o/w China	*7.8*	*7.9*	*8.3*
o/w ASEAN countries	*6.8*	*3.8*	*8.8*
European Union (excluding United Kingdom)	**31.7**	**32.8**	**21.9**
United States	**20.2**	**15.7**	**16.9**

Source: United Nations Conference on Trade and Development (UNCTAD).

C2 Global flows of foreign direct investments

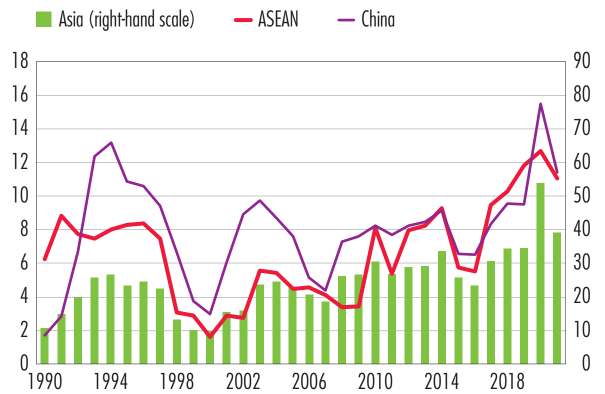
(USD billions)



Source: United Nations Conference on Trade and Development (UNCTAD).

C3 Foreign direct investment inflows

(% of global total)



Sources: United Nations Conference on Trade and Development (UNCTAD), authors' calculations.

3 Hong Kong is not yet a member of RCEP, however it applied for membership in March 2022.
4 See ASEAN (2022).

At the same time, The United States' share has shrunk, but not by as much as that of the European Union (EU), which declined by 10 percentage points over the 2010-21 period, when compared with the 1990s, illustrating the tendency to redirect investment – particularly manufacturing investment – towards emerging Asian countries.

2 Singapore is the main host and exporter of direct investment in South-East Asia

This growing attractiveness is mainly attributable to a few countries thanks to the quality of governance and size of their domestic markets.

As such, ASEAN as a whole presents a mixed picture with two extremes: on the one hand, Singapore, ranked second in the world in the World Bank's annual "Ease of Doing Business" survey, and on the other Myanmar (formerly Burma), languishing at the very bottom of the rankings (i.e. 165th in the world). Malaysia and Thailand score well but are hampered by infrastructure deficits and insufficient labour force training. Indonesia and Vietnam occupy an intermediate position although both countries enjoy specific advantages. Vietnam benefits from proximity to China and a low-cost, relatively well-trained workforce (97 million inhabitants and a labour force of 56 million people).[5] Indonesia is the largest domestic market in ASEAN, with a population of almost 275 million, and very strong growth.

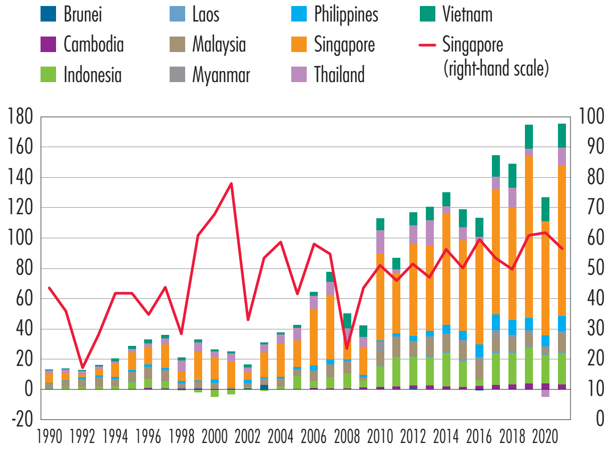
Singapore now receives over 50% of FDI destined for ASEAN countries

Singapore has gradually consolidated its role as a financial centre for South-East Asia. This is particularly the case for FDI, with **over 50% of flows to ASEAN countries since 2010 going to Singapore**, which accounts for only 12% of the region's GDP (see Chart 4). The city-state is well ahead of Indonesia, Malaysia and Vietnam in terms of popularity among foreign investors. However, this figure needs to be put into perspective, as many foreign investors avail of Singaporean legal structures (i.e. private equity funds, regional head offices, regional cash pooling centres) before reinvesting in other countries within or even outside of the region.

5 World Bank data (2020).

C4 Foreign direct investment flows in ASEAN countries

(left-hand scale: amount USD billions; right-hand scale: % of total)



Source: United Nations Conference on Trade and Development (UNCTAD).

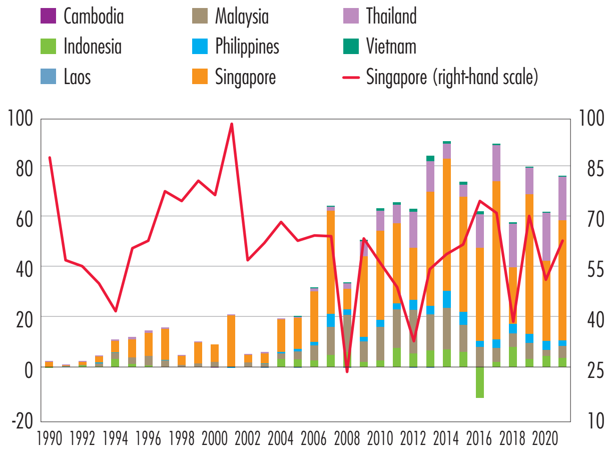
Singapore currently hosts two-thirds (64%) of the stock of FDI received by ASEAN countries (see Chart 6 below), a figure that is constantly increasing, having already risen from 43% in 2000 to 55% in 2010.

Singapore has also emerged as the region's leading direct investment export gateway

Singapore is way out in front in terms of FDI outflows, followed by Thailand, which has a number of groups with an international focus, especially in the agri-food and retail sectors (see Chart 5).

C5 Foreign direct investment outflows from ASEAN countries

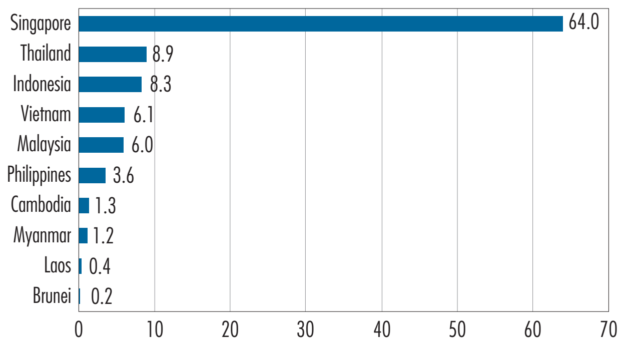
(left-hand scale: amount USD billions; right-hand scale: % of total)



Source: United Nations Conference on Trade and Development (UNCTAD).

C6 Breakdown of stock of foreign direct investment between ASEAN countries in 2021

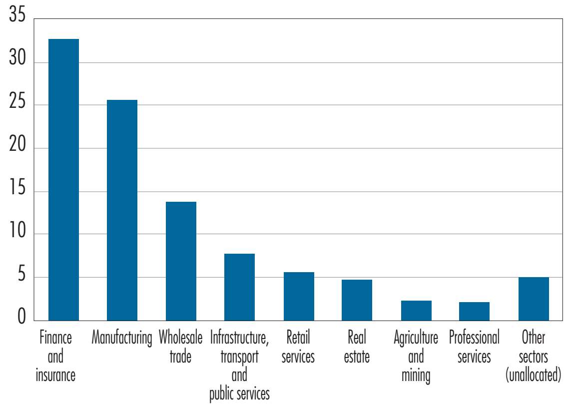
(% of total)



Source: United Nations Conference on Trade and Development (UNCTAD).

C7 Sector breakdown of foreign direct investment flows in ASEAN countries in 2021

(% of total)



Source: ASEANstats.

Concerning foreign direct investment outflows, Singapore's dominant position is attributable both to the importance of its financial centre and to the specific role played by Temasek and GIC, Singapore's two sovereign wealth funds, which have become major players in foreign equity investment.

Overall, intra-ASEAN flows (i.e. FDI provider and host countries) remain stable year after year (between USD 20 billion and USD 25 billion per year), although the trend is downwards in relative terms due to the growing attractiveness of other countries in the region.

3 Investments are diversified across different sectors, but constrained by ongoing government restrictions

The financial and manufacturing sectors account for the bulk of direct investment in ASEAN countries

The financial and manufacturing sectors account for over half of annual investment flows within the ASEAN area, a fairly stable proportion, although major transactions may occasionally alter the relative share of the different sectors in any given year (see Chart 7).

The financial sector (i.e. banking and insurance) accounts for the highest proportion of FDI flows with more than a third of all annual investment, however the manufacturing sector attracts nearly a quarter of all investment, reflecting the importance of ASEAN countries as a production platform.

The sectoral distribution of FDI inflows has changed little over the past decade. Services in the broad sense absorb around two-thirds, while manufacturing averages around a quarter of the total. With the exception of Singapore, the share of FDI within ASEAN countries absorbed by services over the past five years has averaged 40%, in line with the share of services in the overall economy.

Conversely, the natural resources sector (agriculture and mining) has received only a very small portion of FDI (2% to 4% since 2016), reflecting both the extent to which these sectors are closed to foreign investment and the shift in the region's economies towards higher value-added sectors.

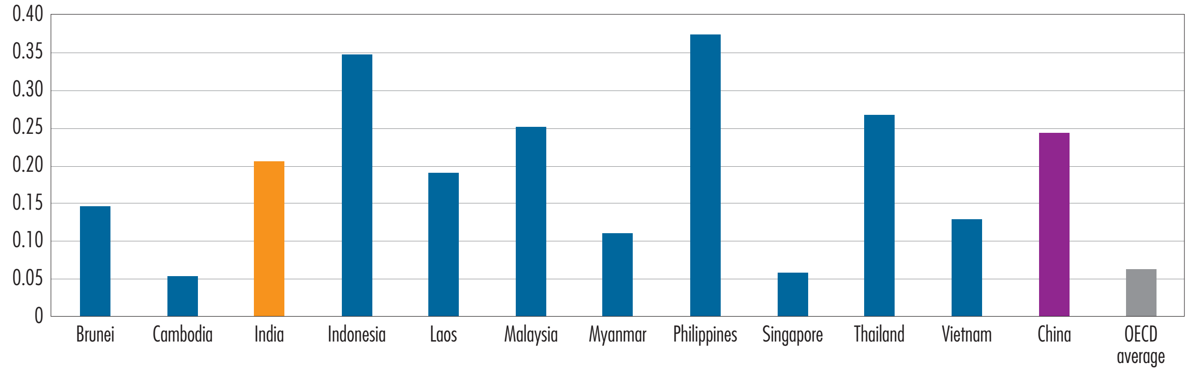
The level of regulatory restrictions varies by country and by sector

The Organisation for Economic Co-operation and Development's (OECD) FDI Regulatory Restrictions Index[6] highlights a contrasting picture across ASEAN countries. Singapore and Cambodia have the lowest levels of regulatory restrictions, while Indonesia and the Philippines have the highest – even higher than India, a country not reputed for its openness to foreign investment (see Chart 8 below).

6 See OECD (2019) and ASEAN FDI Regulatory Restrictions Database.

C8 Foreign direct investment regulatory restrictions index in 2019

(scale of 0 to 1)



Source: Organisation for Economic Co-operation and Development (OECD).

Restrictions vary from one sector and from one country to another. For example, Singapore severely restricts and even forbids foreign ownership in the media sector, while Malaysia prohibits foreign investment throughout most of its retail sector. In general, media is the most restricted sector across ASEAN countries, followed by retail, the primary sector and transport. Conversely, the secondary sector has the lowest levels of restrictions, which is consistent with the industrial policy of those countries looking to attract foreign manufacturing companies.

In this regard, Singapore's key economic strengths as an international financial centre with a big manufacturing sector focused on technology and pharmaceuticals make it a prime destination for foreign investment.

4 US FDI remains dominant across the ASEAN countries

The US is still the dominant player

The United States continues to be the dominant foreign investor in ASEAN countries. Its share increased to 23% in 2021 (see Chart 9), up from 19% in 2019, based on almost identical total investment flows of USD 174 billion.

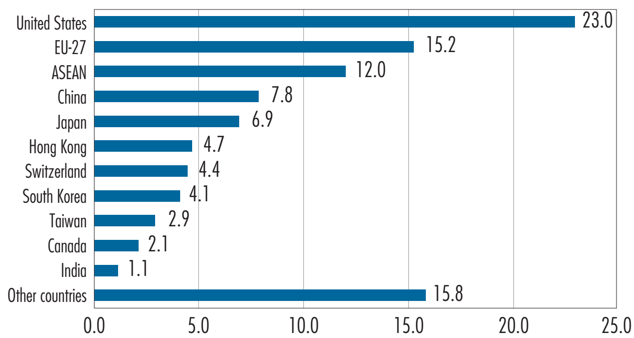
China's share rose significantly in 2021 to almost 8%, which was around twice its share in pre-pandemic investment flows (i.e. around 4-5%). This remains modest when compared with the share of the United States. Nevertheless, it is fast catching up with the EU and has already overtaken the United Kingdom, which accounted for around 5% of FDI flows until 2019, however its flows have been negative since then following a number of divestments in 2020 and 2021.[7]

Lastly, an analysis of intra-ASEAN FDI flows highlights the growing importance of industrial and financial groups from ASEAN countries, especially from Thailand in the manufactured goods and professional services sectors, and from Singapore in the financial and real estate sectors.

An analysis of the stock of FDI clearly highlights the dominance of the United States, ahead of the EU, followed by cross-shareholdings between other ASEAN countries (see Chart 10 below).

C9 Geographical origin of foreign direct investment flows in ASEAN countries in 2021

(% of total)



Source: ASEANstats.

7 In late 2020, the retailer Tesco sold all of its businesses in Thailand and Malaysia to a Thai group.

US investment focuses mainly on the technology sector

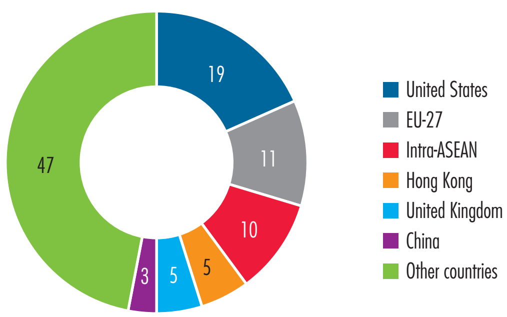
The breakdown by sector shows that US FDI[8] is particularly focused on data centres, technology, manufacturing and the wholesale trade sector. With the rapid development of digitalisation, data centres have become one of the main investment vectors for major American and Chinese technology companies.[9] Facebook, Microsoft, Google and TikTok are deploying ambitious investment policies in the region, especially in Singapore where many new facilities have been located.

In Singapore, which accounts for almost two-thirds of the stock of FDI in ASEAN countries, the breakdown between investors leans slightly in favour of Western countries when compared with the ASEAN region as a whole. China's share is smaller (2%, compared with 3% for the ASEAN region as a whole) and the United States' larger (25%, compared with 19%), while that of the EU is marginally larger than for the region as whole (12% versus 11%).

This reflects both the structure of Singapore's economy – focused more on finance and hi-tech than the rest of the ASEAN region – as well as a political environment that is potentially easier for Western firms to deal with than that of other ASEAN countries (a more straightforward and stable regulatory environment, absence of corruption, more effective protection of intellectual property, quality of infrastructure, etc.) together with the perception that Singapore is closer to the West due to its strategic alliances.

C10 Geographical origin of stock of foreign direct investment in ASEAN countries in 2020

(% of total)



Source: ASEANstats.

5 China is gradually ramping up

Chinese FDI flows are steadily increasing

Chinese investment is still growing at a steady pace. In 2021, China accounted for almost 8% of inflows, while the stock of FDI was still only 3% of the total stock of investments (2% in 2015). However, there is no doubt that this figure significantly underestimates the scale of Chinese investments as some of these are channelled through offshore structures in Hong Kong or the British Virgin Islands. Conversely, the EU-27 countries have lost a considerable amount of ground: their share of 11% of the stock of FDI in 2020 is well down on the 17% recorded in 2015.

Despite growing trade integration, China still accounts for a modest – albeit increasing – share of FDI flows and its overall stock of FDI is still very low when compared with those of Western countries.

But Chinese FDI should continue to grow, in line with growing flows of goods and services. In 2020, ASEAN became China's main trading partner, overtaking the EU for the first time. China had been ASEAN's main trading partner since 2009.

A number of factors are expected to drive the future increase in Chinese FDI in ASEAN countries:

1. Trade flow momentum, which will eventually lead to the development of local subsidiaries;

2. Trade tensions with the United States, which are diverting some commercial traffic and encouraging players to relocate part of the value chain to ASEAN countries, with Vietnam the main beneficiary so far;

3. The rapid economic development of the region, whose growth potential will continue to attract all types of foreign investment. The focus of Chinese investment strategy reflects a growing interest in the region.

8 "U.S.- ASEAN-10 Trade and Investment Facts", United States Trade Representative.
9 40% of data centres in ASEAN countries are foreign-owned or joint ventures.

The "new silk road" initiative and climate transition challenges are helping to boost Chinese investment in ASEAN countries

Chinese FDI and construction projects in ASEAN countries have increased by 85% and 33%, respectively, since the new silk road initiative was launched in 2013,[10] with investment concentrated in four countries: Indonesia, Malaysia, the Philippines and Vietnam.

In 2020, in the midst of falling Chinese foreign investment, South-East Asian countries became the main destination for Chinese FDI. Seven South-East Asian countries figure among the top ten recipients, namely Singapore, Indonesia, Malaysia, Vietnam, Laos, Thailand and Cambodia, alongside the United Arab Emirates, Bangladesh and Kazakhstan.

Based on a recent study of the 95 Belt and road Initiative (BRI) projects launched in ASEAN countries before and during the period between January 2021 and March 2022, more than 40 projects were deployed in Indonesia, the main host country, with Cambodia and Laos in second place with 10 projects each. While China itself is involved in financing projects, it also frequently invests through its corporations, whose projects are helping to drive the overall increase in Chinese FDI.

The breakdown by sector indicates a focus on energy, transport, metal mining and construction, largely in response to host country infrastructure requirements as well as China's need to secure supplies of raw materials.

As a result of the pandemic and problems encountered by certain infrastructure projects, China channelled some of its new investments towards lighter infrastructure projects in the health sector and the digital economy. For example, TikTok,[11] one of China's leading social networks, is now focusing primarily on ASEAN countries, following its enforced exit from the US market. It is continuing with investments in Indonesia, Thailand, Vietnam and Malaysia and has made Singapore its regional hub, where it plans to make substantial investments.

At the same time, whereas in most ASEAN countries, Chinese state-owned enterprises (SOEs) have until recently played a major direct investment role due to the type of sectors traditionally targeted, the shift towards digital should boost flows with the private sector in both directions.

At the November 2021 summit, China and the ASEAN region pledged closer cooperation around the green, circular and low-carbon economy. As part of a joint venture with an Indonesian partner, one of China's leading electronic battery manufacturers (CATL) has pledged to invest USD 6 billion to develop electric vehicles using Indonesia's lithium resources. More generally, Indonesia has also used its nickel and cobalt reserves to attract some USD 15 billion of investment into the electric vehicle value chain. Climate transition challenges should encourage bilateral cooperation between manufacturers in ASEAN countries and China.

Going forward, ASEAN countries should consolidate their attractiveness in terms of foreign direct investment through three growth sectors: **electric vehicles, electronics and digital technology**, sectors in which they are already nicely positioned.

They should also continue to benefit from partial relocation of value chains currently centred on China. Increased delinking is already apparent between production sites in China focused on the domestic market, and Asian sites that supply the regional or global market ("China +1" strategy).[12]

10 Also known as the "Belt and Road Initiative" (BRI).
11 "*TikTok expands its reach in Southeast Asia*", *China Daily*, March 2022.
12 Foreign companies tend to split activities between operations in China that serve the local market and operations in Asia that serve the rest of the world.

⁂

Given the region's economic vitality, with growth expected to overtake that of China in 2022 – a remarkable performance that could well continue into the future – **the ASEAN region should continue to attract global foreign direct investment, due to the size of its market (population of 620 million**[13]**)** and its increasing importance in international value chains.

The United States-China trade conflict represents both an opportunity and a risk for the countries of the region. While the situation is encouraging production chains to leave China for ASEAN countries (China +1 scenario), the possible bifurcation of value chains and relocation of activities as close as possible to Western countries ("nearshoring") could also hurt the region.

As such, if **the Regional Comprehensive Economic Partnership (RCEP)** is effectively implemented, especially across the services sector, **this would be a major factor in boosting intra-regional ASEAN trade**. Once again, Singapore seems particularly well placed to take advantage of its role as an economic and financial hub for South-East Asia.

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13 The middle class population in ASEAN countries was estimated at 190 million in 2020 and could exceed 330 million by 2030.