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FOREIGN DIRECT INVESTMENT AND ECONOMIC ZONES IN ASEAN

This special issue of the *Global Investment Trends Monitor* is based on the annual ASEAN Investment Report, a joint report prepared by the UNCTAD and ASEAN Secretariat. The Report was launched during the ASEAN Business and Investment Summit on 13 November 2017 in Manila.

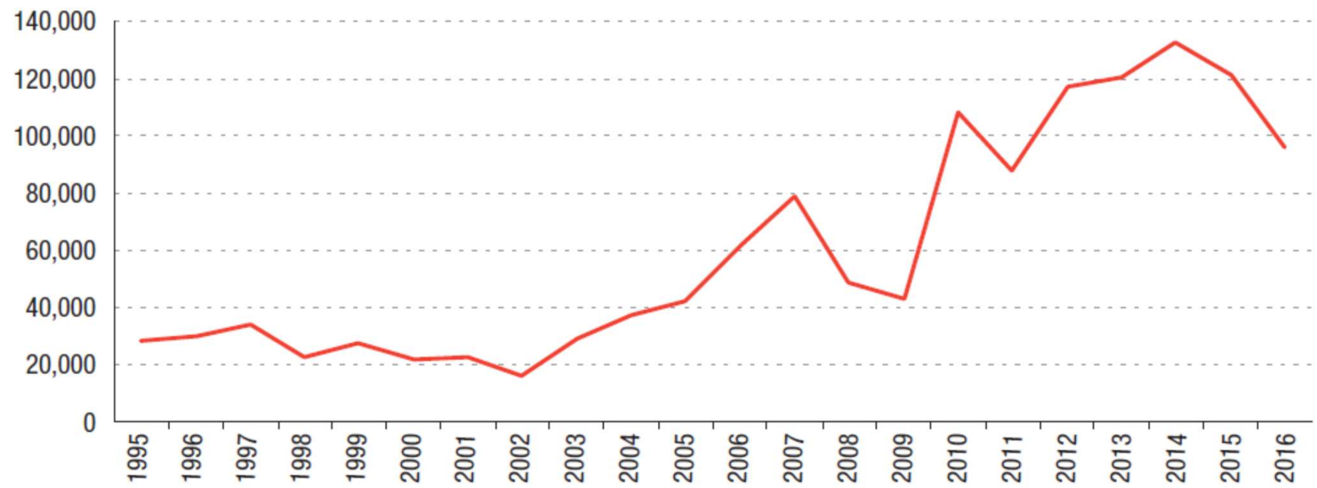
HIGHLIGHTS

- *FDI flows in ASEAN fell by 20 per cent in 2016, to $96.7 billion (figure 1).* The decline reflected the general fall in global FDI flows and in flows to developing economies. A significant drop in FDI in two Member States, caused mostly by one-off factors, dragged down total inflows to the region.

- *Intra-ASEAN FDI rose to a record level ($24 billion) in 2016 and accounted – for the first time – for a quarter of total FDI flows in the region*. Intraregional investment flows continued the upward trend since 2003 (except for a blip in 2013).

Figure 1. FDI flows in ASEAN, 1995–2016

(Millions of dollars)



Source: ASEAN Investment Report 2017.

- *The EU is the largest investor group in ASEAN.* It accounted for over 22 per cent of all FDI flows in the region from 2000 to 2016. While in preceding years (2005–2010), most investment was in manufacturing, more recently EU FDI into finance and other services has increased substantially.

- *ASEAN is a major destination for outward FDI from India.* More than 20 per cent of Indian FDI stock is in ASEAN and at least 1,950 Indian companies are present in the region. Indian FDI in ASEAN is also dominated by services activities, primarily in finance and insurance.

- *The ASEAN region has more than 1,600 economic zones of various types.* These economic zones have generally made a significant contribution to industrial development in ASEAN Member States. They have helped improve the investment environment, generated employment (including for women), increased foreign exchange earnings, generated government revenues, often brought spillover effects in local economies, helped develop domestic contract manufacturers and played a significant role in linking countries in global value chains.

- *Actors involved in zone development include public and private owners and developers, service providers and foreign MNEs active in economic zone development.* While local development companies are the main contributors to economic zone build-up in ASEAN, foreign developers have also played an important role in the growth of economic zones in ASEAN – often in JVs with local partners.

FDI flows in ASEAN remained at a relatively high level in 2016 despite a decline to $96.7 billion. Flows to the region fell by 20 per cent, reflecting the general decline in global FDI flows and in flows to developing economies. Flows from most ASEAN Dialogue Partners rose, but a single significant divestment, acquisitions of foreign assets by ASEAN companies in their home countries and large repayments of intracompany loans in one Member State contributed to the decline. Cross-border M&A sales in ASEAN fell by 25 per cent, from $10.3 billion in 2015 to $7.7 billion in 2016, which also contributed to the fall in FDI inflows.

There were some bright spots. Inflows from a number of major source countries rose, but not enough to overcome the decline. FDI flows from the European Union (EU) rose by 46 per cent to $30.5 billion, those from China rose by 44 per cent to $9.2 billion, those from the Republic of Korea rose by 3 per cent to $6.0 billion and those from Australia rose by 77 per cent to $3.4 billion. Significant FDI from the Netherlands, Ireland, Luxembourg, Denmark, Spain and France pushed up investment in ASEAN from the EU economies.

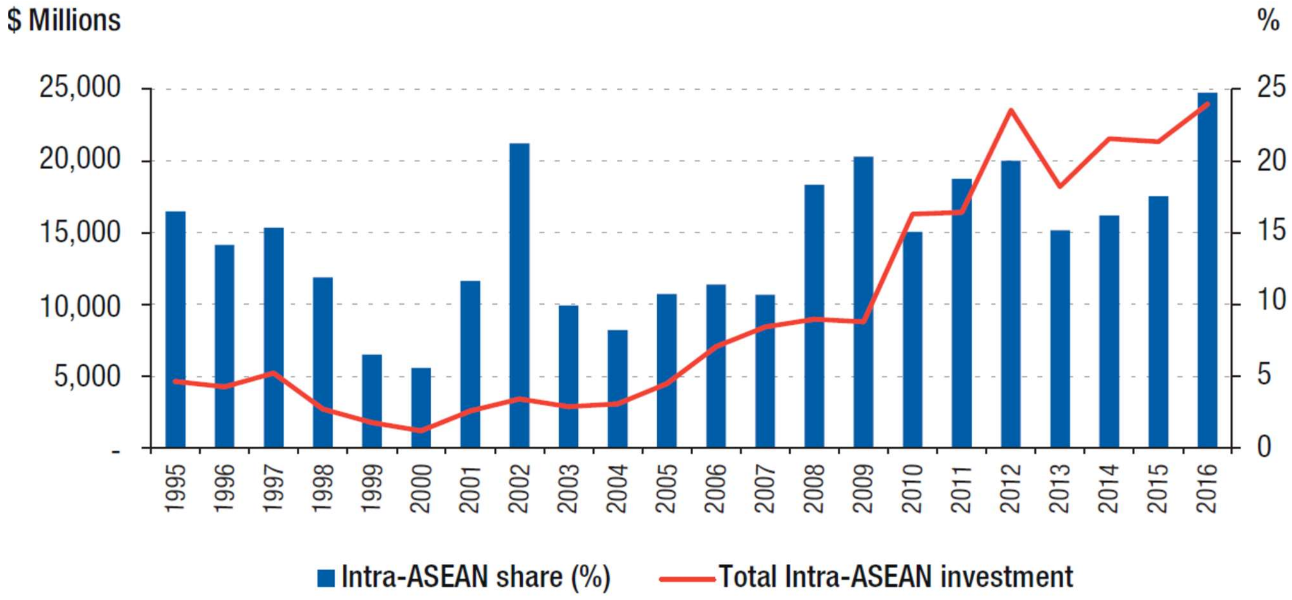
Intra-ASEAN investment rose to a record level ($24 billion) in 2016 and accounted – for the first time – for a quarter of total FDI flows in the region (figure 2). Intraregional investment flows continued the uptrend they have been on since 2003.

The rise in intra-ASEAN investment in 2016 was driven by a two-thirds increase in investment in manufacturing, to $8.3 billion, and a doubling of investment in finance, to $5 billion. Intraregional investment from seven Member States rose. Singapore, Malaysia and Thailand dominated intra-ASEAN investment.

Major factors behind the rise in intraregional investment are the growing financial strength and significant cash holdings of ASEAN firms and their increasing drive to internationalize to build competitiveness and to access markets, natural resources and strategic assets. Review of a selection of 100 major ASEAN companies with operations in the region shows their presence in multiple ASEAN Member States and expansion of their regional footprint.

Figure 2. Intra-ASEAN investment, 1995−2016

(Millions of dollars and per cent)



Source: ASEAN Investment Report 2017.

The CLMV countries continued to receive increasing attention from investors in 2016. FDI flows to this group of ASEAN Member States (Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam) rose by 8 per cent, from $17.4 billion in 2015 to $18.9 billion in 2016. As a result, their share in total ASEAN FDI inflows rose from 10 per cent in 2015 to 13 per cent in 2016. FDI from developing Asian economies, including intra-ASEAN investment, remained the major source of investment in these Member States. China and ASEAN are major investors in Cambodia and the Lao People's Democratic Republic, ASEAN is a lead investor in Myanmar, and the Republic of Korea is the largest investor in Viet Nam. Activities of foreign companies in Cambodia concentrated in finance, light manufacturing and infrastructure activities, while the Lao People's Democratic Republic attracted strong infrastructure investment, particularly in power projects. FDI into Myanmar rose, with growing investor interest across all sectors. FDI flows in Viet Nam were dominated by strong manufacturing investments from the Republic of Korea.

FDI flows from major source economies concentrated in the manufacturing and services sectors. For instance, Japanese companies invested strongly in manufacturing, where flows rose significantly, from $7.9 billion in 2015 to $23.8 billion in 2016. More than 50 per cent of the $6.0 billion in FDI from the Republic of Korea in 2016 went to manufacturing; a majority of the investments were made in Viet Nam. FDI from Hong Kong (China) rose, concentrating in finance, electricity, manufacturing and real estate activities. Chinese FDI went mainly to finance, wholesale and retail trade, transportation and real estate. Australian FDI in ASEAN concentrated in finance, with flows into that industry increasing from $568 million in 2015 to $5.3 billion in 2016. FDI from both the EU and the United States went predominately to services, particularly in finance. Intra-ASEAN investment remained the largest source of investment in agriculture and mining. ASEAN companies were the largest investors in real estate activities, reflecting the growing demand for real estate and growth in the region, in particular in the CLMV Member States. In manufacturing, ASEAN was the second largest source of investment after Japan, with $8.0 billion in FDI in 2016.

Significant investment in finance contributed to the dominance of FDI in services. A majority of the investment in finance went to Singapore. These flows include intra-firm financial activities of non-financial MNEs, regional headquarters functions and holding company operations.

Many of the Fortune Global 500 companies continued to invest in the region. In 2016, they expanded their operations with multiple facilities both in the same ASEAN host country and across a number of Member States. They established or added plants or business functions (e.g. from manufacturing to research and development (R&D) activities) or upgraded their operations. MNEs that opened R&D facilities in the region include Nestle (Switzerland), Panasonic (Japan), Osram Opto Semiconductor (Germany), Honda (Japan), Nissan (Japan), Apple (United States) and Samsung Electronics (Republic of Korea). In 2016–2017, some MNEs also increased their investment in regional headquarters operations to coordinate their expanding networks and affiliates in the region.

Investments by major global automotive MNEs were concentrated in a few Member States such as in Indonesia, Malaysia and Thailand. Some have also expanded with activities in Viet Nam, the Philippines and Singapore. In addition to the global automotive manufacturers, parts and components manufacturers are also expanding in the region, with new investment and factories starting operations in 2016–2017. New factories are dominated by Japanese companies, with a large share of these factories set up in Thailand and in Indonesia.

Financial services MNEs are also expanding in ASEAN. Many American and European finance MNEs have been in the region for a long time. However, 2016 brought a few first-time investors, in particular Chinese companies in infrastructural finance. Chinese banks are also increasingly active in other financial services in the region. MNEs continue to participate in infrastructure development in the region in various segments of the value chain. They participate as owners and operators of power plants, as providers of engineering, procurement and construction (EPC) services and as equipment suppliers to infrastructure projects.

As in past reports, AIR 2017 continues the tradition of examining in detail the trends in FDI development and corporate investment from two selected ASEAN Dialogue Partners. The report this year focuses on FDI and enterprises from the EU and India.

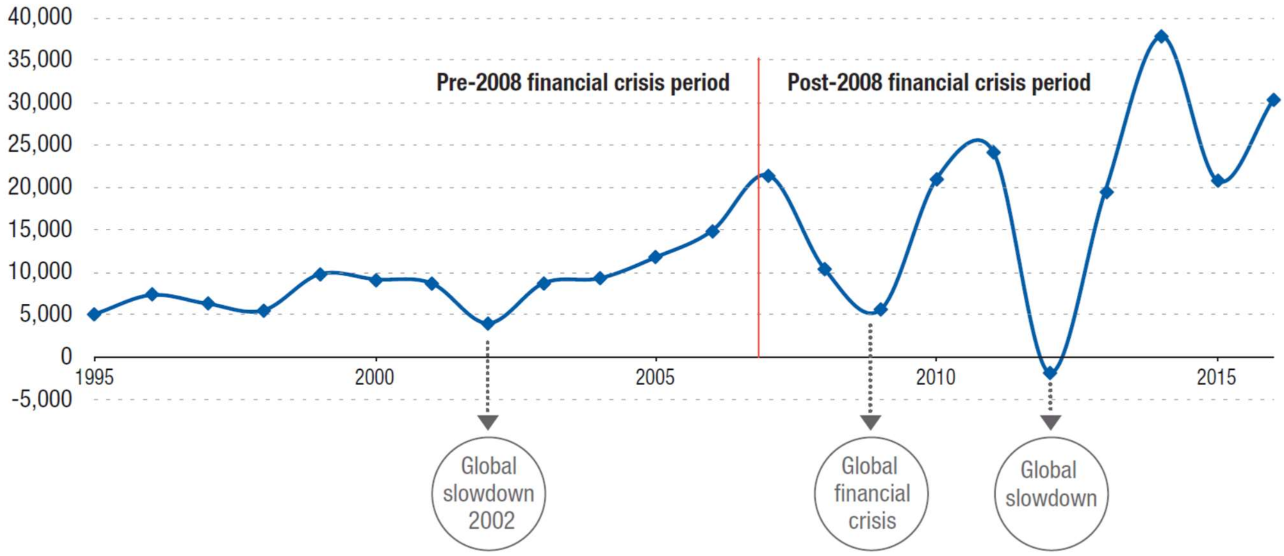
European Union FDI and MNEs in ASEAN

The EU is the largest investor group in ASEAN in value terms. It accounted for over 22 per cent of all FDI flows in the region from 2000 to 2016. These flows have been volatile, particularly since 2007, because of the impact of global economic factors and EU-specific events that affected EU MNEs' investment patterns. EU FDI flows into ASEAN have more than doubled in the past decade, registering in 2014 an all-time high of $37.9 billion. After a decline in 2015, they rose by 46 per cent in 2016, to $30.5 billion. However, less than 2 per cent of the EU's global outward FDI stocks are in ASEAN, as compared with 13 per cent for Japan.

EU FDI flows in the region can be divided into two periods: before and after the 2008 global financial crisis (figure 3). Flows between 1995 and 2007 were on a generally upward trend despite minor fluctuations and dips in 1998 and 2002, which were the effects of the 1997– 1998 Asian financial crisis and the 2002 downturn in the stock markets in many economies. The fall in EU FDI flows in ASEAN mirrored the decline in global FDI in 2002. However, these flows increased more than fivefold between 2002 and 2007, from just $4 billion to $21 billion. In the period after the financial crisis, EU FDI flows in ASEAN were more volatile, with steeper increases and declines over shorter periods.

Figure 3. EU FDI flows in ASEAN, 1995–2016

(Millions of dollars)



Source: ASEAN Investment Report 2017.

The sectoral distribution of EU FDI in ASEAN has changed in the last five years (2011–2016). In the preceding period (2005–2010), manufacturing investment dominated. In the more recent period, EU FDI into finance and other services has increased substantially, to at least 85 per cent of all EU FDI in ASEAN (figure 4). Flows to finance and insurance activities rose 93 per cent, despite annual fluctuations between the two periods. In the primary sector, investment in mining and quarrying rose by 71 per cent.

Figure 4. EU services FDI in ASEAN, 2000–2016

(Millions of dollars)

Source: ASEAN Investment Report 2017.

More than 9,000 EU companies operate in ASEAN. The association of EU MNEs with ASEAN has a long history, dating back to the 1800s. Many of the activities of early EU MNEs were concentrated in plantations, finance and extractive industries in the region. Over time, more became involved in a wide range of industries. Many continue to be involved with development in the region through the expansion of operations and the incorporation of more business functions, such as regional headquarters and R&D activities. Although the services sector dominates their investment focus, significant numbers of EU MNEs invest in manufacturing as well.

Two thirds of the 100 largest EU MNEs have subsidiaries in ASEAN. This share highlights the significance of ASEAN as an investment destination for EU MNEs. More than half of the 75 largest EU MNEs in ASEAN have a presence in four or more Member States.

Indian FDI and companies in ASEAN

ASEAN is a major destination for outward FDI (OFDI) from India. About 22 per cent of Indian global OFDI stock was in ASEAN in 2015, and at least 1,950 Indian companies are present in the region. This proportion is much larger than the shares of global OFDI stocks of Japan, the United States, China and the EU in the region (i.e. 13 per cent, 5 per cent, 6 per cent and 2 per cent, respectively).

Indian OFDI flows to ASEAN fluctuated widely between 2005 and 2016, with a peak in 2012. Since the peak, flows have declined – until 2016, which saw inflows exceeded $1 billion (table 1) − about 1 per cent of total ASEAN inflows. Indian FDI in ASEAN is dominated by services activities, primarily in finance and insurance, repair of motor vehicles and motorcycles, and real estate activities. These three groups of services industries received the bulk of cumulative Indian FDI in ASEAN during 2012–2016. About 60 per cent of Indian FDI flows in ASEAN went to finance and insurance, with another 9 per cent in wholesale and retail trade in repair of motor vehicles and 8 per cent in real estate activities. Indian companies are increasingly establishing operations in higher technology content activities, in e-commerce and technology start-ups in the region.

Table 1. Indian FDI flows in ASEAN, by industry, 2012–2016
(Millions of dollars)

Industry	2012	2013	2014	2015	2016	2012–2016
Agriculture, forestry and fishing	8.7	4.6	4.7	3.5	4.4	25.8
Mining and quarrying	(0.7)	0.4	(0.1)	0.2	2.9	2.7
Manufacturing	109.4	66.2	34.2	(131.4)	20.2	98.6
Services	7,193.7	2,036.9	1,177.4	1,089.3	1,021.1	12,518.4
Of which:						
Wholesale and retail trade; repair of motor vehicles and motorcycles	633.9	192.1	25.1	131.5	199.0	1,181.6
Transportation and storage	(451.5)	(17.0)	36.6	0.4	41.0	(390.5)
Finance and insurance	5,619.6	1,067.6	771.5	525.7	(578.4)	7,405.9
Real estate	9.1	1.3	428.7	296.0	276.2	1,011.4
Total	**7,311.1**	**2,108.1**	**1,216.2**	**961.6**	**1,048.6**	**12,645.5**

Source: ASEAN Investment Report 2017.

Economic Zone Development in ASEAN

The ASEAN region has more than 1,600 economic zones of various types (table 2). In this report economic zones refer to all types of industrial and non-industrial zones, estates or parks that facilitate investments, especially FDI.

Economic zones can be regarded as investment in industrial infrastructure to attract investments in productive assets. These zones have played an important role as industrialization tools for Member States in the ASEAN region.

The development of economic zones in ASEAN varies by country depending on institutional set-up, stage of industrial development and demand. The development of economic zones in some Member States involves government authorities at state or provincial levels owning and operating such zones (e.g. Malaysia and Viet Nam). In some Member States, all economic zones are regulated or coordinated through a central authority (e.g. the Industrial Estate Authority of Thailand and the Philippine Economic Zone Authority). In most Member States, the private sector is actively involved in the development and operation of economic zones. This report offers 10 country case studies of economic zone development and the role of such zones as investment facilitation tools.

Economic zones in ASEAN continue to evolve. Some economic zones are developed for a general purpose by attracting investors that operate in a wide range of manufacturing and services industries. Some Member States have developed specific types of economic zones earlier in their industrialization (e.g. FTZs in Malaysia or EPZs in Indonesia and Thailand). Some are developing new generations of economic zones with strong integrated elements and industrial-residential-commercial township features such as large-scale SEZs (e.g. the CLMV Member States and Indonesia) or regional economic corridors (e.g. Malaysia). Some ASEAN Member States are cooperating in developing border economic zones. Furthermore, some are developing dedicated or specialized economic zones reflecting the economic strengths of the locations or the zones (e.g. zones for IT and business process outsourcing (BPO) in the Philippines, tourism-linked SEZs in Indonesia and the Lao People’s Democratic Republic, technology parks in various ASEAN Member States, aerospace parks in Singapore and the Rubber City Industrial Estate in Thailand).

Economic zones have made significant contribution to industrial development in ASEAN Member States. They have helped improve the general investment environment, generated employment (including for women), increased foreign exchange earnings, generated government revenues, caused spillover effects in the local economy, developed domestic contract manufacturers and linked the host country in global value chains controlled by MNEs. Evidence suggests that economic zones have helped Member States in the region achieve industrial development, develop export-oriented industries and, in some cases, develop strong industrial clusters. With increasing demand in the region, more economic zones are being planned and developed.

Table 2. Economic zones in ASEAN, as of December 2016

	Type of economic zone											
Country	FIZ	FCZ	EPZ	IE	EZ	SEZ	BEZ	CEZ	TP	REC	ITC	Other
Brunei Darussalam	..	..	..	>25	..	..	..	..	..	..	..	..
Cambodia	..	.	..	<10	..	16	..	..	..	..	..	..
Indonesia	3[a]	..	..	75	..	11	..	..	..	..	..	14[b]
Lao People's Democratic Republic	..	..	..	..	..	12	..	..	..	..	.	..
Malaysia	22	18	..	>500	..	..	..	..	..	5	..	..
Myanmar	..	..	..	<20	..	3	..	..	..	..	..	..
Philippines[c]	..	..	..	74	21[d]	19[e]	..	..	49[f]	..	200	2
Singapore	10	..	..	>75[g]	..	..	..	..	..	..	..	..
Thailand	..	..	10	58	..	10	..	..	..	..	..	.
Viet Nam[h]	..	..	3	325	..	..	28	16	3	..	..	..

Source: ASEAN Investment Report 2017.

Note: BEZ = border economic zone and border-gate economic zone; CEZ = coastal economic zone; EPZ = export processing zone; EZ = economic zone; FCZ = free commercial zone; FIZ = free industrial zone; IE = industrial estate or park; ITC = information technology centre; LMW = licenced manufacturing warehouse or bonded warehouse; REC = regional economic corridor; SEZ = special economic zone; TP = technology park.

[a] FTZs in Bintan, Batam and Karimum in Riau Province.

[b] 14 KAPETs, a type of integrated economic development zone introduced in 1998.

[c] Refers to economic zones registered with the Philippine Economic Zone Authority only.

[d] Refers to agro-industrial economic zones.

[e] Refers to tourism SEZs.

[f] IT parks.

[g] An estimate that covers industrial parks and business hubs developed by JTC, the Housing Development Board and Ascendas-Singbridge, as well as a few privately owned business parks that house light manufacturing activities.

[h] BEZs and CEZs are considered economic zones in Viet Nam.

The experience of ASEAN Member States with economic zones in attracting investment has been encouraging for various reasons. They facilitate quick set-up of operations for foreign investors, lower the transaction costs of investing and operating in the host country, ensure factories are more secure, induce agglomeration of firms and generate cluster benefits. To the extent that economic zones are able to reduce transaction costs, they increase their attractiveness to potential economic zone tenants. The need to provide good services in and to economic zones is important. The key issue is how to make them more effective in attracting FDI and in achieving the economic objectives of the host country. Not all economic zones are successful. Some are more successful than others at attracting investments and developing clusters. Some zones have not been successful in attracting investment because of their lack of competitiveness and lack of good facilities. Some are located far from major road networks, ports or airports, or face other logistical challenges as well as issues such as a lack of housing facilities for workers or an inadequate pool of low-cost workers in the vicinity. Economic zones are not without challenges. The challenges in economic zone development include whether demand exists to justify more such zones, as well as financing aspects and sustainability issues. There are also risks to consider. They include concern about the footloose industries that some of these economic zones were established to attract, possible "enclave" consequences that can limit spillover effects to the local economy, possible fiscal losses associated with the provision of incentives, and social and environment risks. These challenges and risks need to be carefully addressed. In addition, countries need to develop or upgrade economic zones to be competitive or build next-generation zones to attract targeted industries, to support the stage of the country's economic development. Furthermore, regional cooperation in economic zone development, to facilitate regional value chains and production networks, can be considered or pursued to improve the competitiveness and connectivity of economic zones in ASEAN.

Key players in Economic Zone Development in ASEAN

Actors involved in zone development include public and private owners and developers, service providers, foreign MNEs associated with economic zone development and zone tenants. For policy design, it is important to understand the roles of these different actors and how they contribute to economic zone development, industrial agglomeration and improvement in the competitiveness of the overall FDI environment. The roles and involvement of players depend on factors such as the role of the government, institutional support, investment opportunities in industrial estates, stage of industrial development, the external environment and the demand for economic zones. For economic zones to be successful and for a country to be competitive, all players need to play their roles by providing suitable industrial facilities to facilitate investment to designated areas and by operating in them. Local players (public and private sector) are the main contributors to economic zone development in ASEAN. They have contributed to shaping the landscape of industrial facilities through the zones they have built, owned and managed. The public sector regulates, encourages and develops economic zones, providing investors (tenants) with facilities across the country depending on their needs (e.g. near main customers, ports, airports, neighbouring countries, specialized industrial estates) and types of investment (e.g. energy-intensive operations, export-oriented, IT service). In most cases, the private sector is the largest developer and owner of economic zones in the region. However, the public sector provides the crucial enabling environment through policy, institutional support and public–private partnerships. Private sector players include major industrial estate developers, real estate companies and infrastructure corporations. Governments have actively encouraged them to play a significant role. In some cases, the public sector works closely with the private sector through public–private partnerships, concession arrangements and joint ventures (JV) in economic zone development. The public sector includes provincial authorities, State government, port authorities, municipalities and government agencies.

Foreign companies have also played an important role in the development of economic zones in ASEAN – often in JVs with local partners. MNEs from Japan, China and other countries are involved in economic zone development in the region. Companies from ASEAN Member States are increasingly participating in the development of economic zones in other ASEAN Member States.

Companies involved in economic zone development operate abroad for a combination of reasons. In general, the drivers and motives of FDI in economic zone development are similar to those for real estate and infrastructure investments. There are also strategic reasons, such as bilateral cooperation in developing economic zones as tools to support industrialization. Such cooperation often takes the form of JVs between two State-owned enterprises or government-linked companies, such as the development of the various Vietnam–Singapore Industrial Parks in Viet Nam.

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The preparation of the ASEAN Investment Report by UNCTAD’s Investment Division is part of its wider programme of collaboration on investment research and policy analysis with regional organisations. UNCTAD has also contributed to the Investment Report of the CEFTA (Central European Free Trade Agreement) region, which will be launched on 21 November 2017, in parallel with the launch of UNCTAD’s Investment Policy Review of the region.

The next issue of UNCTAD’s Global Investment Trends Monitor will be released in January 2018.

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