

RESEARCHERS AT SINGAPORE'S INSTITUTE OF SOUTHEAST ASIAN STUDIES SHARE THEIR UNDERSTANDING OF CURRENT EVENTS

---

## Singapore | 31 Jan 2013

---

### **China's FDI into Southeast Asia**

*By Zhao Hong (Guest Writer)*

#### INTRODUCTION

In the early 1990s when China started increasing its OFDI (outward foreign direct investment), ASEAN countries were receiving only around 3% of their northern neighbour's total investments. That has changed dramatically since then.

According to statistics made available by China's Ministry of Commerce, Chinese investments in ASEAN jumped from US\$0.12 billion to \$5.9 billion between 2003 and 2011, with total accumulation reaching \$22.1 billion by the end of 2011. ASEAN's share in China's total investments overseas almost doubled, rising from 4.1% to 7.9%. This has been a recent development though. Compared to the previous year, China's OFDI in ASEAN for 2011 increased by 34.1%. This can be relevantly compared to increment levels for that same year for other major trading partners—EU (\$7.6 billion) increased by 26.8%, the US (\$1.8 billion) by 38.5%, and Russia (\$7.2 billion) by 26.1%.

Of ASEAN's 10 recipient countries, Singapore receives as much as 55% of Chinese OFDI (in 2011). Chinese investments in the four new ASEAN members also witnessed a rapid expansion. Between 2003 and 2011, Chinese OFDI in Cambodia increased from \$2.2 million to \$566 million; in Laos from \$0.8 million to \$458.5 million; in Myanmar from \$4.1 million (in 2004) to \$217.8 million; and in Vietnam from \$12.8 million to \$189.2 million.

## MOTIVATIONS

One of the most commonly recounted motivations for Chinese investments overseas appearing in the international media and in some academic writings is China's hunger and need to secure natural resources to fuel its rapid economic growth. Yet, Chinese OFDI in Southeast Asia shows that the importance of seeking market opportunities and labour-division is greater than the wish to obtain overseas resources.

The latest figures, published by the Chinese Ministry of Commerce in August 2012, show that of China's total OFDI in Southeast Asia, the share of mining (including oil & natural gas, ferrous metal & non-ferrous metal mining) fell from 17.3% in 2009 to 7.6% (in China's total OFDI accounting for 14.1%) in 2011, while the share of financial and non-financial services rose from 68% to 79.5% over the same period. The predominance of non-financial services (including wholesale and retail, transportation and storage, leasing and business servifinancial) is a direct reflection of China's export boom and its efforts to expand market opportunities in Southeast Asia and beyond.

Chinese OFDI in individual ASEAN countries also suggests that a main motivation is to seek market opportunities. For example, Singapore is its largest destination in Southeast Asia. From 2004 to 2011, China's FDI in Singapore rose from \$38 million to \$3,269 million, which is an astounding increase of nearly nine times. By the end of 2011, Chinese FDI accumulation in Singapore reached \$10.9 billion, accounting for nearly 50% of China's total accumulation in Southeast Asia. Singapore, as we know, is both an entrepot centre for intra-ASEAN trade and as a hub for FDI. The footprint we note in Singapore can be read as only a prelude to the expansion of Chinese transnational corporations into the entire ASEAN region, and beyond.

In Cambodia, China's FDI increased from US\$2.2 million in 2003 to US\$566 million in 2011, with total accumulation reaching US\$1.76 billion by the end of 2011. Since most of this goes into Cambodia's garment industry, one could say that Chinese investments there are by its nature export-oriented and efficiency-seeking. The motivation for Chinese companies to move their factories there has apparently been to gain preferential access to the US and EU markets since the Multi Fiber Agreement (MFA), which imposed quota restriction on textile products, especially from China, was in effect until 2004.

In Vietnam, market-seeking has also been one of the main motives for Chinese investments. The value of these increased from US\$12.8 million in 2003 to US\$189.2 million in 2011, with total accumulation in Vietnam reaching US\$1.3 billion by the end of 2011. China's OFDI in Vietnam is concentrated on low-skill, labour-intensive manufacturing and tends to be relatively small-scale. They are oriented both towards local distribution, and for export to the US and the EU. Chinese production activities are often vertically fragmented, with the final production stage being located in Vietnam to avoid high import tariffs and to exploit labour-cost differentials in low-skill assembly activities.

To be sure, it cannot be denied that the fast growth of China's OFDI in Southeast Asia reflects its growing demand for energy (primary coal and liquefied natural gas) and raw materials. Resource-rich countries like Myanmar and Indonesia have attracted Chinese investments in the primary sector. In Myanmar, China's largest state-owned oil companies – China National Petroleum Company (CNPC), Sinopec and China National Offshore Oil Corporation (CNOOC), have all started exploration projects there. In November 2008, CNPC and Myanmar's Ministry of Energy signed an agreement to build a US\$2.3 billion crude oil pipeline and a US\$2 billion natural gas pipeline. After the Myanmar-China gas pipeline goes into operation in 2013, Myanmar will be supplying 10 billion cubic metres of gas to China annually.

Indonesia is also one of China's top suppliers of materials such as coal, nickel ore, bauxite, and iron ore. It is the world's largest exporter of thermal coal, possessing in 2010 proven coal reserves of 5 529 million tons, achieving coal production of 188.1 million tons of oil equivalent (toe), and consuming 39.4 million toe. Figures from the same year show that it has proven gas reserves of 3.1 trillion cubic metres (tcm), production of 82 billion cubic metres (bcm), and consumption of 40.3 bcm. Indonesia is currently the world's third-largest exporter of liquefied natural gas after Qatar and Malaysia, and supplies 12% of the world's LNG from two production centres at Arun in Aceh and Bontang in East Kalimantan.

## REASONS

The expansion of China's OFDI in Southeast Asia may also be attributed to the rapid economic growth and deepening economic integration in this region.

In recent years, despite the global financial crisis, most ASEAN countries achieved some of the world's highest GDP growth rates (7.2% in 2010 and 5.4% in 2011). Regional governments are also trying to generate domestic demand through their loose economic policies and large public infrastructure spending. This strengthening of regional trade and investment ties has boosted ASEAN's economic prowess. While about 26% of the region's total trade in 2011 was internal, trade with China grew significantly that year to more than 10%, up from less than 4% in 2000. At the same time, ASEAN trade with industrialized economies declined to 36% from 54%.

As ASEAN developed in 2000-2011, the region's bilateral trade with China rose from less than \$5 billion to \$36.0 billion, with imports from China rising from \$17.3 billion to \$138.1 billion. Chinese OFDI in ASEAN has increased as a result, as have China's contracted projects in ASEAN, covering diverse areas such as transportation, construction, electricity, geological exploration, and port facilities.

More significantly, this development also shows that ASEAN economies can compete effectively for FDI and industrial migration, even against China. Rising wages in China have

been encouraging Chinese enterprises to transfer their factories to Southeast Asia. During 2000-2009, wages in China grew impressively by an average of 10-15% annually while in ASEAN countries, wage increments have been much more modestly.

Overall, with China and other East Asian countries experiencing higher wages and production costs, the competitiveness of ASEAN has been enhanced. Thus, as wage rate increases in China outpace those found elsewhere, orders are being outsourced to economies such as Cambodia and Vietnam.

Deepening regional integration is also encouraging Chinese investors to favour Southeast Asia. In November 2002, ASEAN Heads of Government meeting in Phnom Penh proposed that the region create an “ASEAN Economic Community” by 2020 (later brought forward to 2015). To be sure, over time, ASEAN has been making important strides in the area of investment cooperation; in the form of ASEAN “one-stop investment centers” and the ASEAN Investment Area (AIA) which seeks to ensure national treatment for ASEAN investors by 2010 and for all investors by 2020. Since the implementation of AIA in 1998, ASEAN has been strengthening its investment regime, and this commitment was further reinforced with the signing of the ASEAN Comprehensive Investment Agreement (ACIA) in 2009.

As most MNCs in ASEAN are from non-member countries and ASEAN countries are actively courting FDI, legislation is emerging or is already in place in a number of member countries, which accords national treatment for all investors. This has been verified by the fact that total FDI inflows to ASEAN reached a record \$116.6 billion in 2011, up from \$92.8 billion the year before.

Moreover, the China-ASEAN FTA was established on 1 January 2010 with the signing of the Merchandise Trade Agreement, the Service Trade Agreement and the Investment Agreement. China also offered an “early harvest program” in 2004, which favoured Cambodia, Laos, Myanmar and Vietnam (CLMV) and has greatly promoted trade in agriculture and marine products. Under the Investment Agreement reached in August 2008, China and ASEAN will establish a free, convenient, transparent and competitive investment regime. Obviously, the institutionalized China-ASEAN integration process has not only fueled bilateral trade, but also led to the jump in China’s FDI to ASEAN.

## REGIONAL CONCERNS

While once considered an economic threat, the opportunities that Chinese investments offer are increasingly being acknowledged. Without exception, ASEAN member countries foresee a further increase in such inflows. As yet, FDI to Singapore and other more advanced ASEAN countries is dominated by Japan and the US, and Singapore alone accounted in 2010 for nearly 60% of all FDI to ASEAN countries. For ASEAN as a whole, the

share of FDI from China to total inward FDI is still low (3.8% in 2010), and EU-27 (22.4%), intra-ASEAN (16%), the US (11.3%) and Japan (11%) remain the top investors.

Yet, despite the proportionately low level of Chinese investments in the region, some ASEAN countries still express reservations and hesitations about their expansion. This may be largely caused by a misperception of China's rise and its investments. For example, in Indonesia, there is worry that Chinese technology, though cheap, may not be environmentally friendly. The issue of sovereignty is also often raised due to the fact that many projects involve the use of Chinese workforce. The local media also claim that many Chinese companies lacked "prudent attitude and due diligence". These concerns are probably inhibiting the Indonesian government from relaxing restrictions on Chinese capital inflow.

In the Philippines, distrust and uneasiness about Chinese investments have slowed its willingness to jump completely onto the Chinese economic bandwagon. According to Renato Cruz De Castro, "Beijing's main motive for developing economic relations with the Philippines is to wean it away from Washington, while isolating the US politically and diplomatically to the maximum possible extent". Without a doubt, a degree of wariness towards China is still evident among leaders and policy makers.

Hence, for this and other reasons, China's investment commitment in these two countries remains relatively small. In 2011, Chinese FDI in the Philippines was US\$294 million, accounting for only 4.5% of China's total FDI in ASEAN. By the end of 2011, China's accumulative investment in Indonesia and the Philippines were \$1,688 million and \$494.3 million respectively, accounting for 7.6% and 2.2% respectively of its total accumulative amount in ASEAN.

In contrast to this, Chinese OFDI in CLMV (Cambodia, Lao, Myanmar and Vietnam) is more appreciated since the export-orientation of these investments generates employment and facilitates better access to the global economy via export spillovers. China (including Hong Kong) has in recent years been the largest investor in Cambodia and Myanmar

Most Chinese investments in Cambodia go to the garments industry where large and labour-intensive factories are typical, and many job opportunities are created. According to a recent survey done by Chinese scholars on four Chinese garment factories in Phnom Penh, two of these factories were found to provide jobs for over 1000 local workers; the third for over 2000 workers, and the last for over 3000 Workers. Most of these workers are from the countryside and their earnings are the main source of income for their families. Chinese investments thus play a very important role in Cambodia in providing capital, employment and income, and in enhancing productivity and competitive edge.

In Vietnam, Chinese accumulative FDI was \$1.3 billion at the end of 2011. In 2011 alone, actual Chinese investment reached \$0.2 billion, a large proportion of which came from Hong Kong and the British Virgin Islands. Chinese investments in Vietnam cover a range of industries, from garment and electronics to motorcycle manufacture.

Compared to the Philippines and Indonesia, Vietnam seems to hold a more positive attitude to Chinese OFDI. The country's rapid industrialization process and general optimism have largely restrained its domestic economic nationalism from protesting against the expansion of Chinese investment. Apparently, Hanoi's strategy is not to restrict investments from China but to develop new and expand existing export markets (including the Chinese market). The ideal scenario for leaders in Hanoi and Beijing will be for surging economic growth to create division of labour, shared prosperity, and a win-win outcome in the region.

## IMPACTS

China's OFDI has long-term significance for Southeast Asian economies. Firstly, it affects regional production networks. As analyzed above, in Cambodia, Vietnam and Laos, China started with labour-intensive manufacturing industries, which largely targeted the global export market. This drastically changed these countries' competitiveness in manufacturing. Obviously, CLMV have a comparative advantage in labour forces, mineral and agricultural sources, while China has a substantial comparative advantage in industrial production, capital and technology. These economic complementarities are being exploited. There is substantial intra-industry trade, and both sides are closely linked in the international production chain.

Hence, business relations here appear to follow the "flying geese" pattern similar to that between Japan and the "Four Little Dragons of Asia" that became obvious in the mid-1960s. Doubtless, Chinese FDI in ASEAN (especially in CLMV) will strengthen the "flying geese" development pattern there, and reinforce production fragmentation involving China and its neighbours. China exports capital goods and key industrial intermediate products to Cambodia, Vietnam and Laos to exploit cheap labour and raw materials there, and these countries in turn export finished products to the US and EU. This situation suggests that Chinese OFDI has actually helped these countries by enhancing the regional division of labour, strengthening their competitiveness, and expanding their export markets.

Secondly, China's FDI will undoubtedly enhance energy cooperation between China and ASEAN countries. While Southeast Asia has large reserves of oil and gas and was for a long time an important exporter of oil and gas, things have changed radically. The region as a whole is currently a net oil importer, and the individual countries' net-oil import dependence has been steadily rising.

Thus the region has a great need to enhance energy cooperation and to attract more foreign investment into energy sectors. In 2002, ASEAN member states adopted the ASEAN MoU on the Trans-ASEAN Gas Pipeline (TAGP). Once realized, this TAGP will have the potential of linking almost 80% of the ASEAN region's total gas reserves, and will dramatically express the region's steadily increased energy interdependence.

The first cross-border gas pipeline in the ASEAN region was the one exporting gas from Malaysia to Singapore. This was commissioned in 1991. Since then, several regional gas pipelines have been completed and several more are being designed and constructed.

Doubtless, China's expanding FDI can enhance full interconnection of these pipelines, and increase gas trade throughout ASEAN and beyond. For example, given the ambitious magnitude of TAGP and China-Myanmar pipelines, it is possible that the network will extend into China and beyond. Advocates of the TAGP already argued in the 1990s that the network would eventually connect with gas markets in China, Japan, and India, making it the largest pipeline grid in the world.

\* \* \* \* \*

**Zhao Hong** is visiting senior research fellow at the East Asian Institute, National University of Singapore.

---

**ISEAS Perspective** is published electronically by the Institute of Southeast Asian Studies, Singapore.

© Copyright is held by the author or authors of each article.

ISEAS accepts no responsibility for facts presented and views expressed. Responsibility rests exclusively with the individual author or authors. No part of this publication may be reproduced in any form without permission.

Comments are welcomed and may be sent to the author(s).

Editor: Ooi Kee Beng

Institute of Southeast Asian Studies  
30, Heng Mui Keng Terrace  
Pasir Panjang,  
Singapore 119614  
Main Tel: (65) 6778 0955  
Main Fax: (65) 6778 1735

Homepage: [www.iseas.edu.sg](http://www.iseas.edu.sg)