UOB HONG KONG

23/F, Three Garden Road, Central, Hong Kong SAR

Tel: (852) 2910 8888 | Fax: (852) 2910 8899 | www.uobgroup.com/hk/

HONG KONG UNIVERSITY OF SCIENCE AND TECHNOLOGY
INSTITUTE FOR EMERGING MARKET STUDIES

IAS2018-2020, Lo Ka Chung Building, Lee Shau Kee Campus
Hong Kong University of Science and Technology, Clear Water Bay, Kowloon, Hong Kong SAR

Tel: (852) 3469 2215 | Email: iems@ust.hk | iems.ust.hk

The Belt and Road Initiative in ASEAN

Overview

December 2020

Contents

Highlights

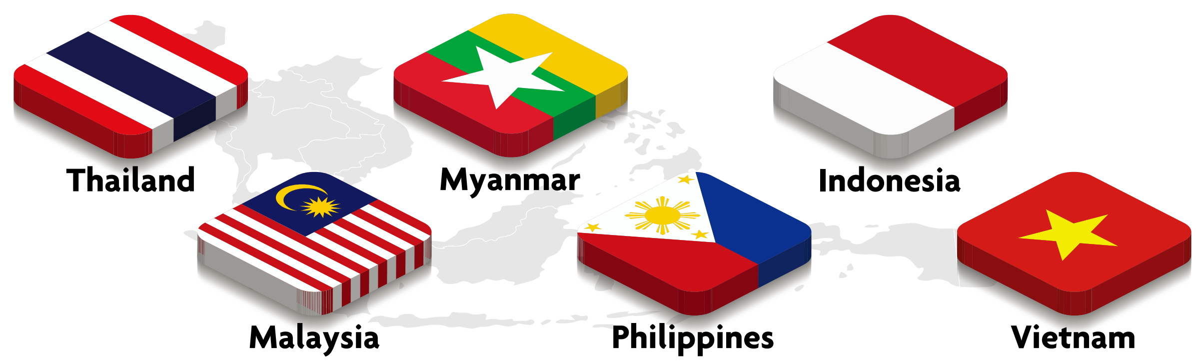
- Mainland Chinese foreign direct investment (FDI) and construction projects in countries in the Association of Southeast Asia Nations (ASEAN) have increased by 85% and 33%, respectively, since the start of the Belt and Road Initiative (BRI), with growth concentrated in Indonesia, Malaysia, the Philippines, and Vietnam.

- Although most countries have effectively controlled the spread of COVID-19, the pandemic has led to recessions in most countries, leading to delays but not cancellation of the Belt and Road Initiative (BRI) projects.
- Countries in Southeast Asia are part of a large and increasing number of multilateral and bilateral trade and investment agreements that enhance their attractiveness as global value chains are adjusted in response to the US-China trade war and the pandemic.
- The majority of mainland Chinese greenfield FDI in ASEAN is in the resource sector. In some countries, Chinese companies are increasing both greenfield and brownfield investments in renewable energy projects.
- In most countries in Southeast Asia, state-owned enterprises (SOEs) play a leading role in large mainland Chinese FDI projects. At the same time, the role of private enterprises is also significant and increasing faster than SOEs in most of the countries studied.
- Some mainland Chinese projects have been criticised for not complying with local regulations, treating local workers unfairly, or polluting the environment. Mainland Chinese firms can avoid such unwanted outcomes by doing due diligence in evaluating the economic, social and environmental impacts of proposed projects ahead of time, and by improving their engagement with affected groups.

The Belt and Road Initiative in ASEAN

China's Belt and Road Initiative (BRI) is enhancing development prospects and creating new business opportunities in ASEAN, one of the world's most dynamic regions. Announced in 2013, the BRI is an ambitious plan to promote economic cooperation with countries around the world that has increasingly defined mainland China's global engagement. The BRI's official goals are to promote five connectivities: policy coordination, facilities connectivity, unimpeded trade, financial integration, and people-to-people bonds. Under the Initiative China has helped to finance large infrastructure projects with the support of its state-owned banks and sovereign wealth funds and encouraged mainland Chinese firms to undertake FDI projects in participating countries. These projects are establishing a network of transnational economic corridors, multimodal land and maritime routes, oil and gas pipelines, and electrical grids that assist mainland China and participating countries to hedge against the inherent geopolitical risks of single trade routes. The ambitious scale and scope of the Initiative means that multinational and domestic firms alike should have a keen interest in monitoring new business opportunities created by BRI projects. At the same time, they should recognise the challenges of making investments in specific Belt and Road countries.

Although the BRI has a global reach and a wide scope, ASEAN has been a high priority region of the Initiative since the start. *Belt and Road* is short for the Silk Road Economic *Belt*, which includes multiple overland routes to Asia and Europe, and the Maritime Silk Road, which refers to overseas trading routes that connect mainland China to Southeast Asia, South Asia, East Africa, and Europe. President Xi Jinping announced the Maritime Silk *Road* during an address to the Indonesian parliament in October 2013. The development of overland rail and road links to ASEAN countries that are part of the China-Indochina Economic Corridor is also an essential part of the BRI. All of the countries in ASEAN were included in the initial list of 68 BRI countries, which later expanded to all countries willing to participate in the Initiative. By 2020, over 130 countries have signed MOUs or agreements signifying their participation in the Initiative.



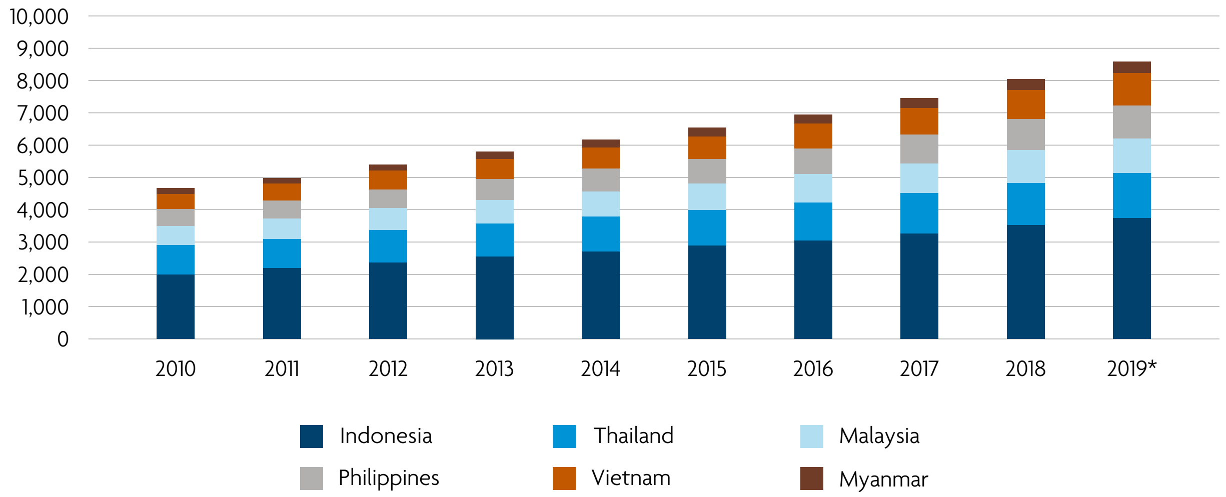


Figure 1. GDP of Six ASEAN Countries, 2010-2019

Southeast Asia is a priority region for the BRI because of its economic potential as one of the world's fastest-growing regions. From 2010 to 2019, the region's GDP grew at an average annual rate of 6.9%. Among countries on the initial list of BRI countries, in recent years ASEAN has accounted for nearly half of all trade with mainland China and 44% of FDI from mainland Chinese in the BRI countries (from 2010-2018, see Figure 2).

This report aims to provide guidance to businesses considering or undertaking investment projects in ASEAN attracted by the opportunities created by the BRI. We focus our attention on the six emerging markets where investment opportunities are the greatest, namely Indonesia, Malaysia, Myanmar, the Philippines, Thailand, and Vietnam. As seen in Figure 1, these countries are growing fast. Among them, Indonesia is by far the largest market as measured by GDP, followed by Thailand, Malaysia, the Philippines, Vietnam, and Myanmar. This overview report is complemented by detailed reports on each of these six countries.

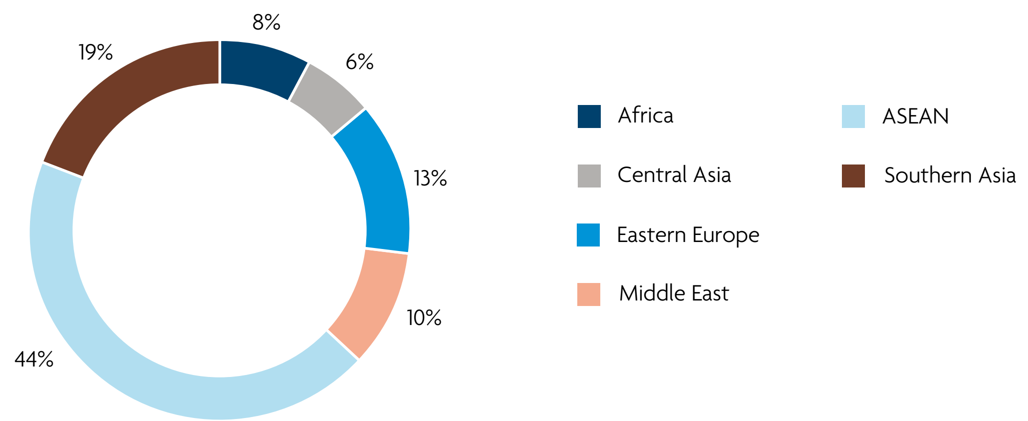


Figure 2. FDI from Mainland China (BRI Regions). Economic Importance of Southeast Asia to the BRI.

Regional Economic Integration

For those undertaking investments in ASEAN, it is important to be aware of the multilateral and bilateral arrangements that influence economic integration of countries in the region both with each other and with mainland China and other key countries. These arrangements have been changing rapidly in recent years, and are influencing the relative attractiveness of investing in different countries in depending on the investment source country, sector, and global value chain linkages to other countries.

The six countries which are the focus of this report are all members of ASEAN which was established in 1967. ASEAN's role in promoting regional integration has grown significantly over time. Major milestones were the establishment of the ASEAN Free Trade Area (FTA) in 1992 and the establishment of the ASEAN Economic Community (AEC) in 2015, which codified significant progress and established an agenda to create a common market with US$2.6 trillion in annual GDP and a population of 622 million people. ASEAN serves as a platform for member states to negotiate free trade and investment agreements with other countries in order to reduce trade barriers with partner economies and ensure better protections to foreign investors. Since the late 2000s, ASEAN has negotiated FTAs governing trade in goods, services, and investment with Japan, South Korea, Australia and New Zealand, and India. FTAs between ASEAN and mainland China took effect in 2005 for trade in goods, 2008 for trade services, and 2010 for investment. In 2017, ASEAN countries and Hong Kong SAR signed an FTA and Investment Agreement that has gradually entered in force. The investment agreement protects the rights of Hong Kong SAR-based investors, including protection against expropriation and the right to fair compensation, physical security and security of the investment, fair and equitable treatment, and free transfer of investments and returns. Hong Kong SAR-based investors have the right to settle claims using investor-state arbitration mechanisms.

The Regional Comprehensive Economic Partnership (RCEP) is an ASEAN-led FTA between the ASEAN member states and Australia, China, Japan, South Korea and New Zealand. The negotiations for the RCEP began in 2013 with the objective of broadening and deepening ASEAN's economic engagements with its FTA partners. The agreement was signed in November 2020.

ASEAN member states remain free to pursue other trade or investment agreements to increase their competitiveness. Malaysia, Vietnam, Singapore, and Brunei were set to join the Trans-Pacific Partnership Agreement with Australia, Canada, Chile, Japan, Mexico, New Zealand, Peru, and the United States. However, the Trump administration withdrew from the agreement, leading the remaining 11 countries to renegotiate the agreement and rename it the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). The CPTPP is a comprehensive and complex trade and investment agreement that affects global value chains by eliminating tariffs, and providing greater market access in specific sectors such as telecommunications, professional services, and public procurement. The CPTPP offers stronger intellectual property rights protections and improves regulation of trade and investment in the digital economy. It also requires some signatory countries to implement reforms to meet treaty requirements in the areas of SOEs, IP rights, and competition. Thailand, the Philippines, Indonesia, and mainland China have at different times expressed an interest in joining the agreement.

Combinations of agreements can give specific advantages to signatory countries. For example, Vietnam is the only country among those considered in this report that has signed a bilateral agreement with the European Union as well as with Israel and the Eurasian Economic Union, giving it an advantage in attracting investors intending to export to those regions.

Six Key Emerging Markets in Southeast Asia

Many of the countries of ASEAN share geographic and cultural similarities. At the same time, the countries have unique political, social, and cultural institutions as well as recent histories and leadership changes that shape their development trajectories. The region has high-, middle-, and low-income countries, all growing at different rates and with different success rates in attracting foreign investment. Here, we highlight some of the key economic, governance, and cultural differences in the six key emerging markets in the region that are likely to influence the location choices of investors.

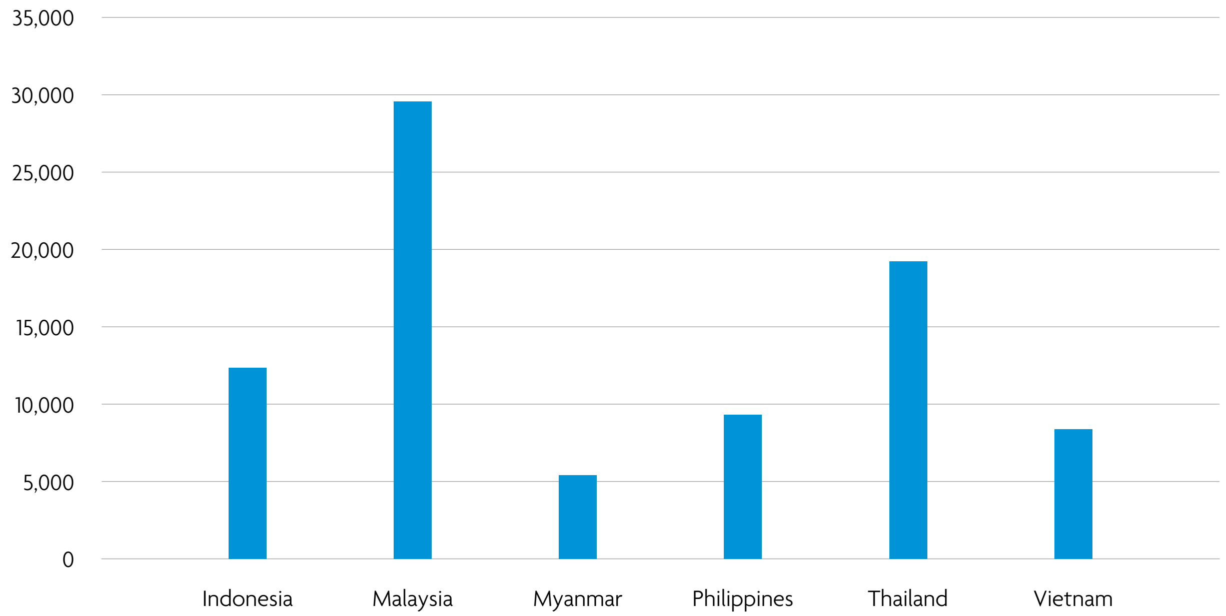


Figure 3. GDP Per Capita in Six Southeast Asian Countries, 2019. Source: World Bank, in US$ Using Purchasing Power Parity Exchange Rates

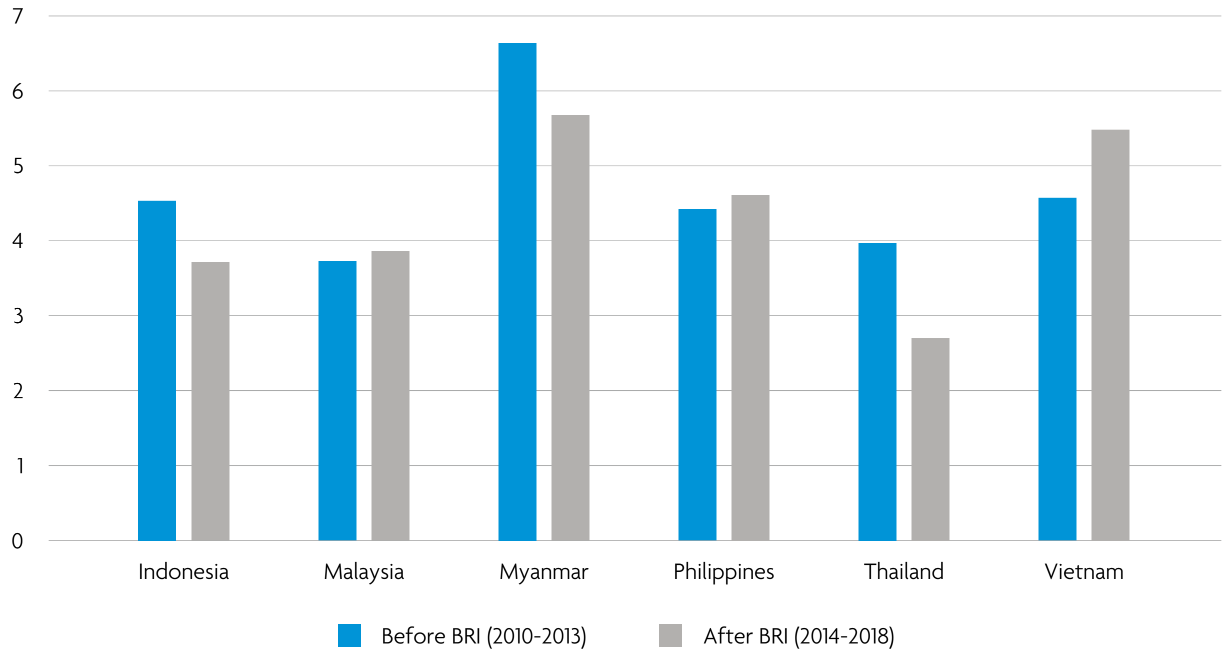


Figure 4. Growth Rates of Real GDP Per Capita in Six Southeast Asian Countries
Note: The Real GDP Per Capita Growth (%) for Each Country is the Average Value in Each Period.

In addition to overall market size, the level of development as measured by GDP per capita and the growth rate of GDP per capita are positive predictors of future market demand, which make those markets attractive to investors interested in selling goods or services locally. At the same time, one advantage of less developed countries is that wages are lower, which can in turn reduce the cost of export-oriented, labour-intensive production. Figures 3 and 4 show that the levels and growth rates of GDP vary considerably across the six countries. Malaysia was the most developed with GDP per capita in 2019 of nearly US$30,000 measured using purchasing power parity (PPP) exchange rates. Thailand and Indonesia were next richest with GDP per capita between US$10,000 and US$20,000, and the remaining countries had GDP per capita of less than US$10,000--in order, the Philippines, Vietnam, and Myanmar. In general countries with lower GDP per capita tend to grow faster than countries with higher GDP per capita, consistent with having greater catch-up potential. For instance, Myanmar and Vietnam have the highest annual growth rates, both above 5% in recent years. However, the correspondence is not perfect. Malaysia, the country with the highest GDP per capita by PPP, grew slightly faster than Indonesia and Thailand in recent years.

Measurements of the quality of institutions in different countries are highly correlated with the level of economic development. Figure 5 presents an overall governance indicator for each country compiled by the World Bank over the period 2010 to 2018. The governance indicator combines scores for voice and accountability, political stability and absence of violence/terrorism, government effectiveness, regulatory quality, rule of law, and control of corruption. Among the six countries, Malaysia's governance quality was significantly better than any of the others. Indonesia and Thailand had the next highest governance scores, but were just slightly better than the Philippines and Vietnam. Myanmar had

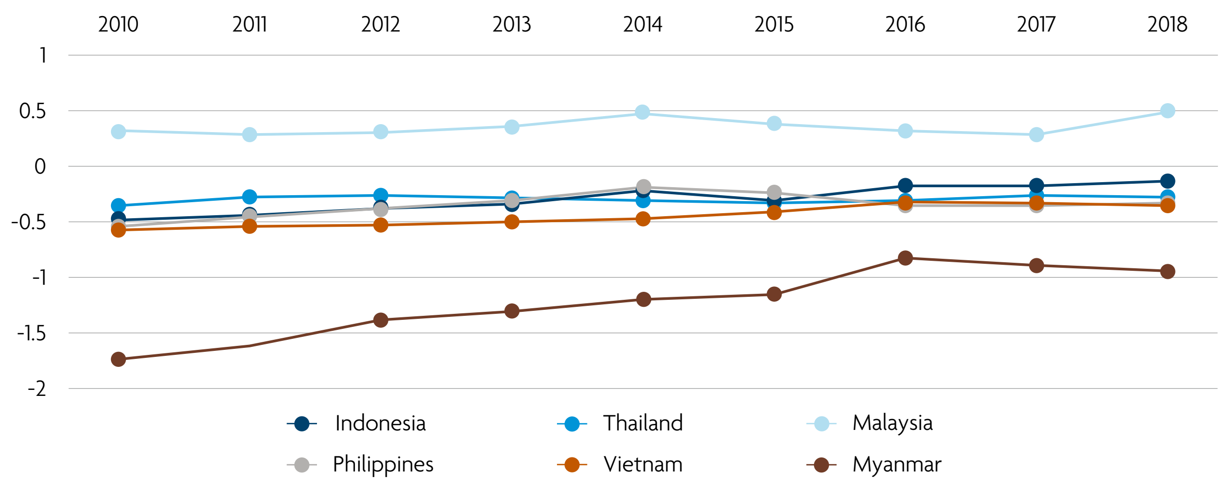


Figure 5. Governance Indicator for Six Southeast Asian Countries, 2010-2018

the lowest governance scores, but the country's governance has improved rapidly over time. Indonesia also made steady progress relative to other countries, passing the Philippines and Thailand compared to when the BRI began in 2013.

With respect to the well-known Ease of Doing Business rankings also calculated by the World Bank (Figure 6), again more developed countries tend to score higher. The top scores were for Malaysia and Thailand, which were very close to each other. A bit behind were Indonesia and Vietnam, followed by the Philippines and Myanmar.

Cultural factors also play a role in determining the attractiveness of different investment locations. Mainland Chinese firms may find it easier to operate in countries with larger Chinese-speaking populations. Among the Southeast Asian countries, only Malaysia (24%) and Thailand (14%) have Chinese-speaking populations greater than 5%. Myanmar has 3% Chinese speakers, and the remaining countries have about 1% Chinese speakers. Religious beliefs also vary across countries with Indonesia and Malaysia having Muslim population shares of 87% and 61%, respectively, and the Philippines having a 93% Christian population share.

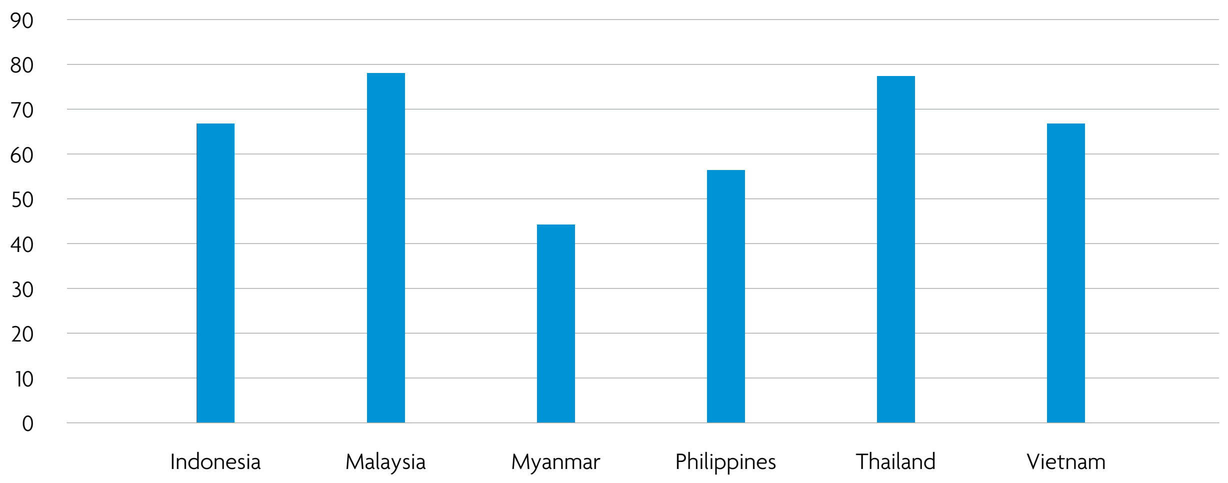


Figure 6. Ease of Doing Business in Six Southeast Asian Countries, 2018

COVID-19

Most of the countries we study have done an outstanding job controlling the spread of COVID-19 in their countries. However, two countries — Indonesia and the Philippines — have struggled somewhat, with thousands of new cases still being reported daily in October 2020. As of 20 October 2020, total COVID-19 cases and deaths were over 350,000 in both Indonesia and the Philippines. Still, to put these numbers in perspective, it is worth noting that deaths per capita in these countries are only one tenth of the United States (US) and other hard-hit countries in Europe and Latin America. Each of the other countries had fewer than 40,000 total cases, with less than 4,000 cases in Thailand and Vietnam.

Successful control of COVID-19 does not mean countries in the region were able to avoid significant negative shocks to their economies. Lockdown policies created severe contractions in both supply (business closures) and demand (due to unemployment and lower incomes). The pandemic's impact on countries throughout the world sharply reduced demand for many goods exported by countries in ASEAN. Travel restrictions have crippled international tourism. Overall, the Asian Development Bank projects that growth in ASEAN will be -3.8% in 2020, compared to 4.4% in 2019, with growth in the region expected to rebound to 5.5% in 2021. Unemployment rates in many countries reached levels not seen in decades. The pandemic had the most negative impact on economies of countries such as Thailand that rely more on exports and tourism, even though the country had relatively few COVID-19 cases. Thailand's GDP is expected to contract the most (by 8% in 2020) among all Southeast Asian countries. The next worse performing economy is the Philippines (projected -7.3% growth in 2020), which had the most COVID-19 deaths per capita among countries in the region. Only two countries — Vietnam and Myanmar — are expected to enjoy positive growth in 2020, thanks to their low COVID-19 exposure, lower reliance on exports, and for Vietnam the greater resilience of the demand for the country's labour-intensive export products.

	Cases	Deaths	Cases/1M pop	Deaths/ 1 million population
Philippines	362243	6747	3292	61
Indonesia	373109	12857	1360	47
Myanmar	39696	972	728	18
Malaysia	22957	199	707	6
Thailand	3719	59	53	0.8
Vietnam	1144	35	12	0.4

Table 1. COVID-19 Cases and Deaths in Six Southeast Asian Countries, 20 October 20, 2020

	2019	2020	2021
Indonesia	5.0	-1.0	5.3
Malaysia	4.3	-5.0	6.5
Myanmar	6.8	1.8	6.0
Philippines	6.0	-7.3	6.5
Thailand	2.4	-8.0	4.5
Vietnam	3.4	1.8	6.3

Table 2. GDP Growth Rates in Six Southeast Asian Countries. Source: Asian Development Bank, Asian Development Outlook, September 2020

Governments in the region responded aggressively to the COVID-19 challenge by passing fiscal stimulus packages that provided assistance to vulnerable households and businesses, and by making credit more widely available, often by lowering policy interest rates. Sound macroeconomic management prior to the crisis in most countries provided sufficient policy space for governments to respond to the pandemic challenge proactively without creating excessive imbalances. The policy responses varied across countries in terms of magnitude and the specific programmes depending on local economic conditions, budgetary resources, and the choices of leaders.

How were major Belt and Road infrastructure and investment projects affected by the pandemic? Undoubtedly, most ongoing projects were delayed by at least three to six months due simply to the disruptions caused by lockdowns, travel bans, and the preoccupation of government leaders and firm managers with responding to urgent concerns caused by the pandemic. Governments that prioritise increased spending of available resources on direct assistance and healthcare programmes may decide to postpone infrastructure spending, which could further delay some projects. On the other hand, some governments with sufficient resources, such as the Philippines, plan to increase infrastructure spending as a way to stimulate their economies. Generally speaking, both mainland Chinese and country leaders have reaffirmed their commitment to completing major Belt and Road projects even if they are delayed.

Mainland Chinese FDI and Construction Projects in Southeast Asia

How has the BRI affected the amount of mainland Chinese FDI and construction projects in Southeast Asia? To address this question we analyse a dataset of all mainland Chinese outbound FDI (OFDI) and infrastructure projects globally from 2010 to 2018. The project-level data comes from two independent sources that verify information on mainland Chinese projects at final destination from government, company, and media websites: the Financial Times' fDi Market (6FM) dataset on greenfield FDI projects, and the mainland China Global Investment Tracker (CGIT) of the American Enterprise Institute, which records large (above US$ 100 million) construction and FDI projects (including greenfield and brownfield investments, and mergers and acquisitions). Information on final destinations enable us to overcome a major limitation of official FDI statistics, which show that most of mainland China's outbound FDI go to Hong Kong SAR or tax haven countries which are intermediate destinations.

As seen in Figure 7, comparing the four-year period before the BRI (from 2010 to 2013) with the five-year period after the BRI, we find that the value of annual FDI investments by mainland Chinese companies in Southeast Asian countries increased by 85% after the BRI, and the value of construction projects increased by 33%. Most of the FDI is in the form of greenfield, or new factory, investments. The value of other types of FDI (brownfield, mergers and acquisitions) was comparatively less at the beginning but increased by nearly four times after the BRI.

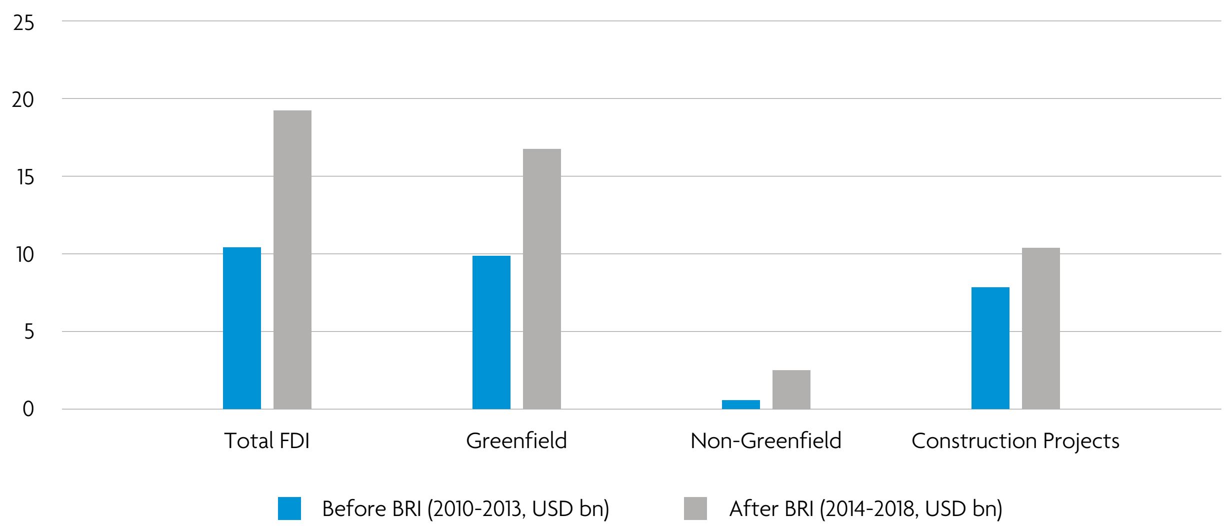


Figure 7. Mainland Chinese FDI and Construction Projects in Southeast Asia Before and After the BRI
Note: The Numbers are Average Annual Values for Each Period.

Since most investors are interested in greenfield investments, we next present the amount of mainland Chinese greenfield FDI that has flowed to the six countries of interest (Figure 8). Indonesia received the most mainland Chinese FDI both before and after the start of the BRI, which perhaps is not surprising given the size of its economy. The next largest recipient of mainland Chinese FDI is Malaysia, which is the most developed country and has the highest governance quality and ease of doing business scores. The Philippines and Vietnam are the next largest recipients under the BRI, while Thailand and Myanmar lag behind. The Philippines and Vietnam are relatively large markets that are growing quickly with decent governance.

The most surprising result is the relatively low level of FDI in Thailand, which is the region's second largest market and second most developed country. This could be a result of the large flows of FDI into Thailand from Japan and South Korea to support the country's shift to higher technology production, which may have in turn crowded out the demand for FDI from mainland China.

Also worth noting from Figure 8 is that among the six countries the increase of FDI after the BRI began is greater in the larger economies (with the exception of Thailand), especially Indonesia which accounts for the lion's share of increased investment. In terms of the amount of increased investment, the countries receiving the next largest increases are Malaysia, the Philippines, and Vietnam, which corresponds to their GDP rankings. Thailand and Myanmar have seen no significant change in greenfield FDI under the BRI. Worth noting is that in terms of the rate of increase in FDI, Vietnam stands out with a tripling of greenfield FDI after the BRI began, compared to a doubling of FDI in Indonesia and the Philippines, and a 62% increase in Malaysia.

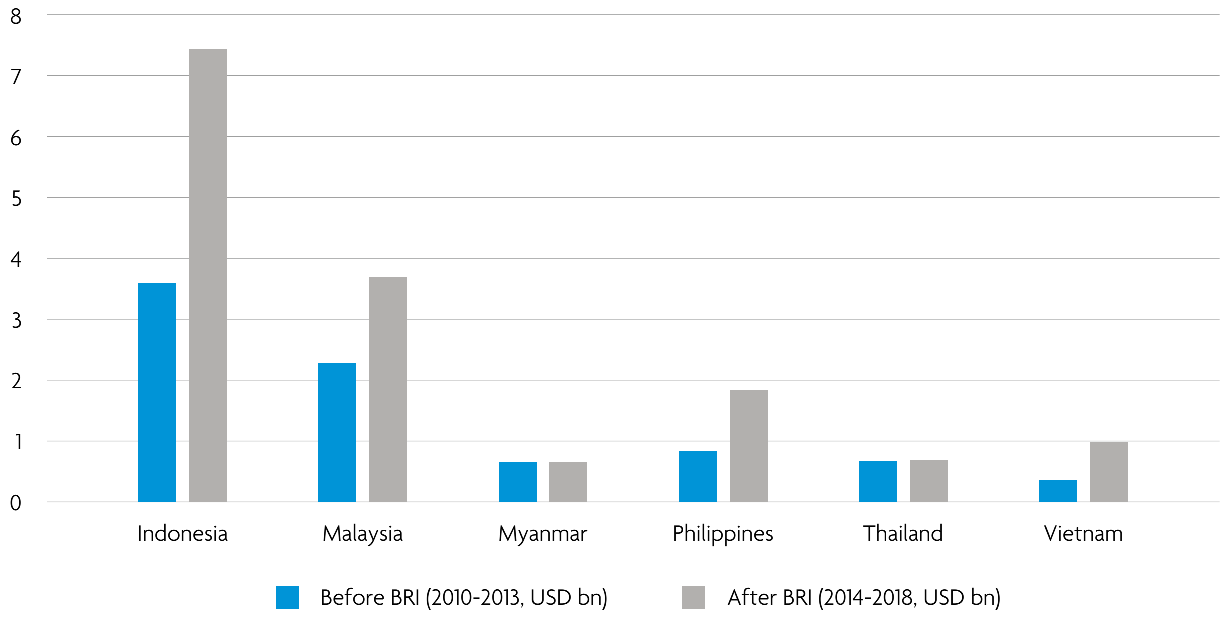


Figure 8. Mainland Chinese Greenfield FDI in Six Southeast Asian Countries Before and After BRI
Note: The FDI for Each Country is the Average Annual Value During Each Period.

Next, we examine the distribution of large mainland Chinese construction projects in Southeast Asian countries (Figure 9). Again, we see the largest amounts in Indonesia and Malaysia, where construction projects more than doubled. However, among the other countries the patterns are not the same as for FDI. Notable are large increases in construction projects but from smaller bases in Thailand (10 times increase), the Philippines (doubling), and Myanmar (150% increase), and a considerable drop in construction projects in Vietnam from a high base. Because infrastructure projects entail large capital disbursements, there is greater year-to-year variability in construction projects compared to FDI.

Research that analyses the determinants of mainland Chinese outbound FDI flows to different countries using the global project-level dataset finds that after the start of the BRI, the importance of economic fundamentals such as economic growth rates in determining the destination of mainland Chinese FDI declined, while the importance of good governance increased.[1] These results suggest that the large increase in BRI investments may have been partly driven by non-economic or at least long-term objectives. However, mainland Chinese investors were clearly not seeking to exploit weak, poorly governed states but rather put more emphasis on governance quality when making new investments.

The map of key BRI Projects in ASEAN provides a more granular picture of the major BRI projects in the region. Many of the largest projects are transport infrastructure (rail, roads, ports, airports), energy projects, or economic cooperation zones or industrial parks. The industrial parks are all joint ventures between mainland Chinese and local partners, which help to increase the confidence of mainland Chinese firms that are considering establishing operations in the parks.

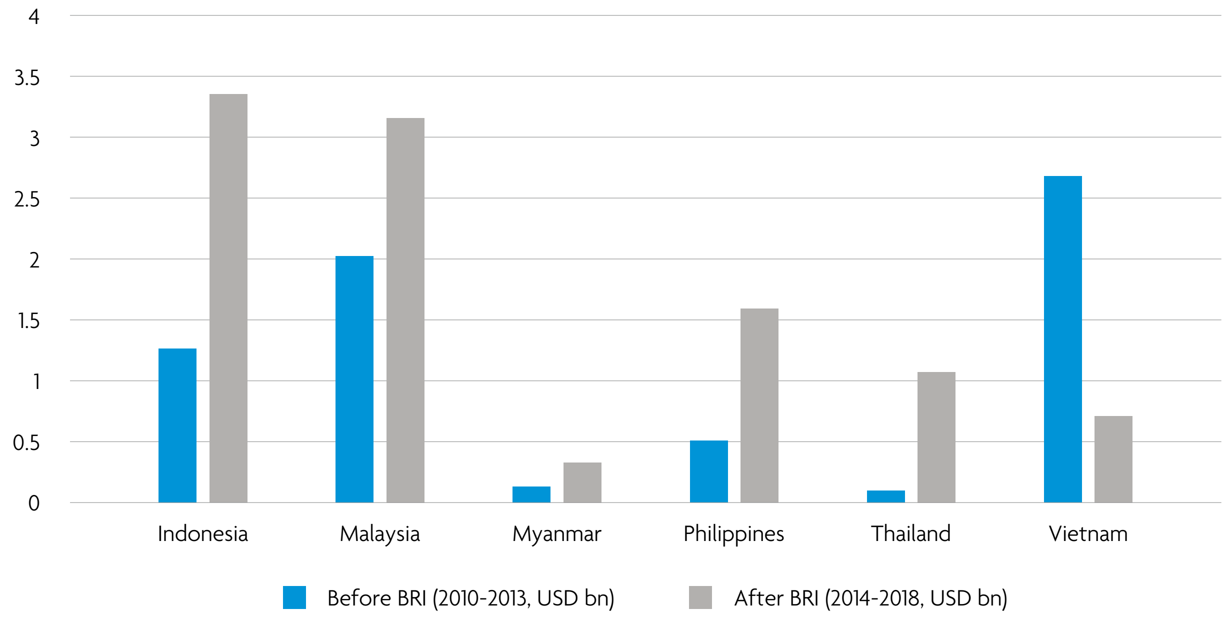
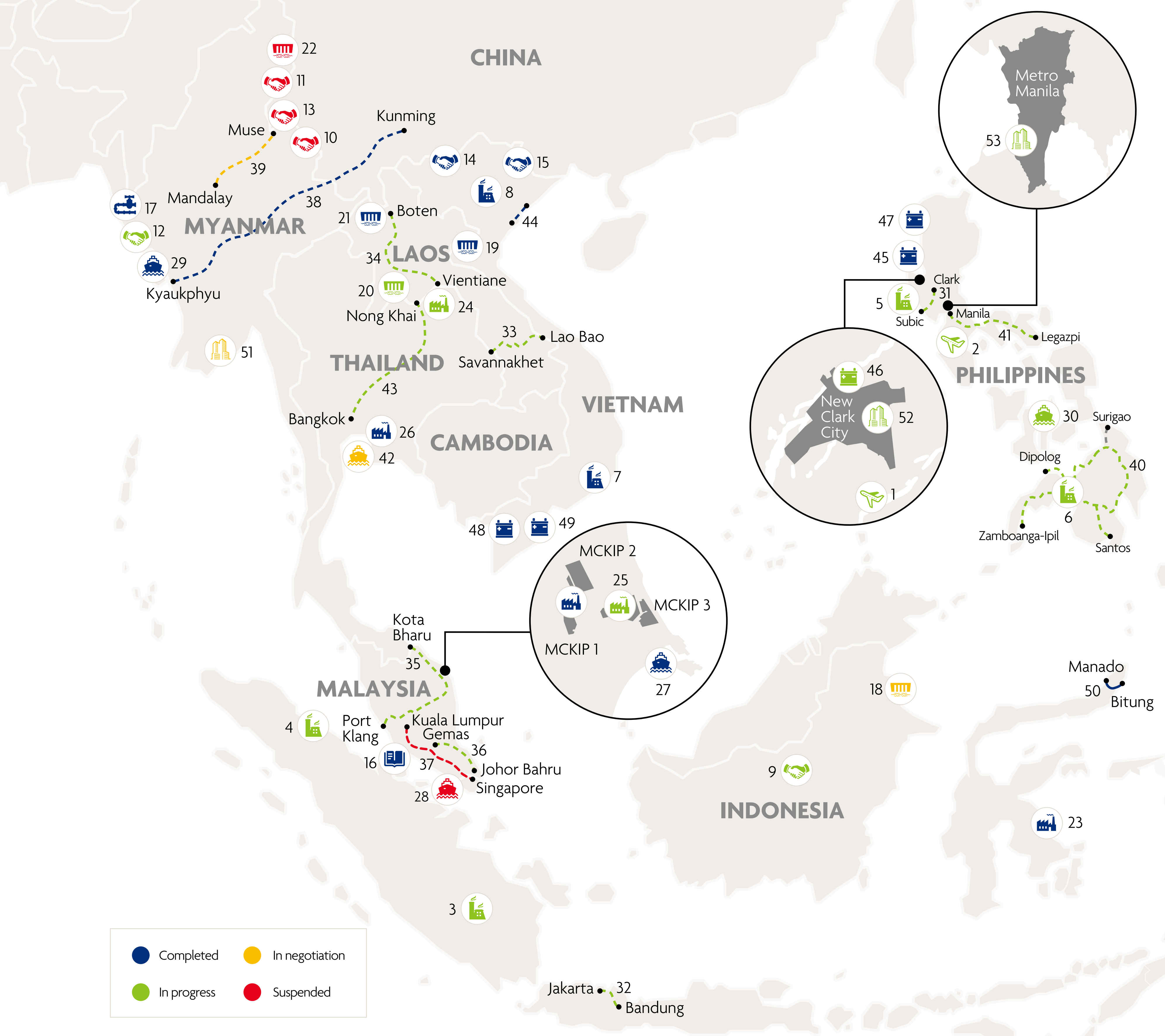


Figure 9. Mainland Chinese Construction Projects in Six Southeast Asian Countries Before and After BRI
Note: The Numbers are the Average Annual Value During Each Period.

[1] *Albert Park, Which Countries Have Benefited the Most from mainland China's Belt and Road Initiative?, HKUST IEMS Thought Leadership Brief No. 32, 2019. (http://iems.ust.hk/tlb32)*

Key BRI Projects in ASEAN



	No.	Project	Country
Airport	1	Clark International Airport	Philippines
	2	Sangley Point International Airport	Philippines
Coal Power Plant	3	Muara Enim Bukit Asam coal-fired pithead power plant	Indonesia
	4	Pangkalan Susu Power Plant phase II unit II	Indonesia
	5	Dinginin 2x660 MW	Philippines
	6	Kauswagan 4x135 MW	Philippines
	7	Binh Thuan Power Plant	Vietnam
	8	Hai Duong Power Plant	Vietnam
Economic Cooperation Zone	9	China-Indonesia JuLong Agricultural Industry Cooperation Zone	Indonesia
	10	Chinshwehaw Border Economic Zone	Myanmar
	11	Kanpiketi Border Economic Zone	Myanmar
	12	Kyaukphyu Special Economic Zone	Myanmar
	13	Muse Border Economic Zone	Myanmar
	14	Cross Border Economic Zone in Hekou-Lao Kai	Vietnam
	15	Cross Border Economic Zone in Pingxiang - Dong Dang	Vietnam
Education and Cultural Collaboration	16	Xiamen University Malaysia Campus	Malaysia
Energy Transmission	17	Oil and Gas Pipeline	Myanmar
Hydropower Plant	18	Kayan River Hydropower Plant	Indonesia
	19	Nam Chiane Hydropower Station	Laos
	20	Nam Ngum 3 Hydropower Station	Laos
	21	Nam Tha 1 Hydropower Station	Laos
	22	Myitsone Dam and Hydropower Plant	Myanmar
Industrial Park	23	China-Indonesia Morowali Industrial Park	Indonesia
	24	Vientiane Saysettha Development Zone (SCDZ)	Laos
	25	Malaysia – China Kuantan Industrial Parks (MCKIP 1, 2, 3)	Malaysia
	26	Thai-Chinese Rayong Industrial Zone	Thailand
Port	27	Kuantan Port Expansion	Malaysia
	28	Melaka Gateway - Port and Real Estate	Malaysia
	29	Kyaukphyu Deep Sea Port	Myanmar
	30	Cebu International Container and Bulk Terminal	Philippines
	31	Laem Chabang Port Development Project Phase 3	Thailand
Railway	32	Jakarta – Bandung High-Speed Railway	Indonesia
	33	Savannakhet – Lao Bao Railway	Laos
	34	Vientiane – Boten Railway	Laos
	35	East Coast Rail Link	Malaysia
	36	Gemas Johor Bharu Double Tracking	Malaysia
	37	KL – Singapore High-Speed Rail	Malaysia
	38	Kyaukphyu – Kunming	Myanmar
	39	Muse – Mandalay	Myanmar
	40	Mindanao Railway	Philippines
	41	Philippine National Railways (PNR Bicol)	Philippines
	42	Subic – Clark	Philippines
	43	Bangkok – Nong Khai High-Speed Rail	Thailand
	44	Cat Linh – Ha Dong Urban Railway	Vietnam
Renewable Energy	45	Burgo 132 MW Wind-Solar Plant	Philippines
	46	Clark 100 MW Wind-Solar Plant	Philippines
	47	Pasuquin 100 MW Wind-Solar Plant	Philippines
	48	Can Tho Waste-to-Energy Plant	Vietnam
	49	Hau Giang 40MW Wind-Solar Plant	Vietnam
Road	50	Manado-Bitung Tollway	Indonesia
Smart city	51	New Yangon City Development	Myanmar
	52	New Clark City	Philippines
	53	New Manila Bay - City of Pearl	Philippines

Sectors

The resource sector (including energy and minerals) accounts for a significant share of mainland China's large FDI projects in Southeast Asia, and in all Belt and Road countries. According to the project-level dataset, 55% of mainland China's greenfield FDI projects in Southeast Asia were in the resource sector before the BRI (2010-2013), increasing to 60% under the BRI (2014-2018). Indonesia, Myanmar, and the Philippines, have over 80% of greenfield projects in the resource sector, while Vietnam has nearly 50%. The shares are much lower for Malaysia and Thailand. As can be seen from the map, some major BRI projects are coal power plants in Indonesia, the Philippines, and Vietnam. Many donor countries no longer invest in such plants because of their impact on climate change, but coal remains the cheapest energy resource for many countries. Mainland China has also supported the construction of a number of hydropower plants, some of which have been criticised for their negative environmental impact. In recent years, in response to international criticism, mainland China has put greater emphasis on green projects, and the map shows that mainland Chinese companies have invested in a number of large renewable energy projects in the Philippines and Vietnam, while Malaysia and Thailand also have received investments in the manufacturing of solar panels.

The US-China trade tensions and the ongoing pandemic are leading many manufacturers to seek greater diversification of their supply chains. In recent years, mainland China also has experienced rapidly rising wages that make producing labour-intensive goods domestically less competitive.

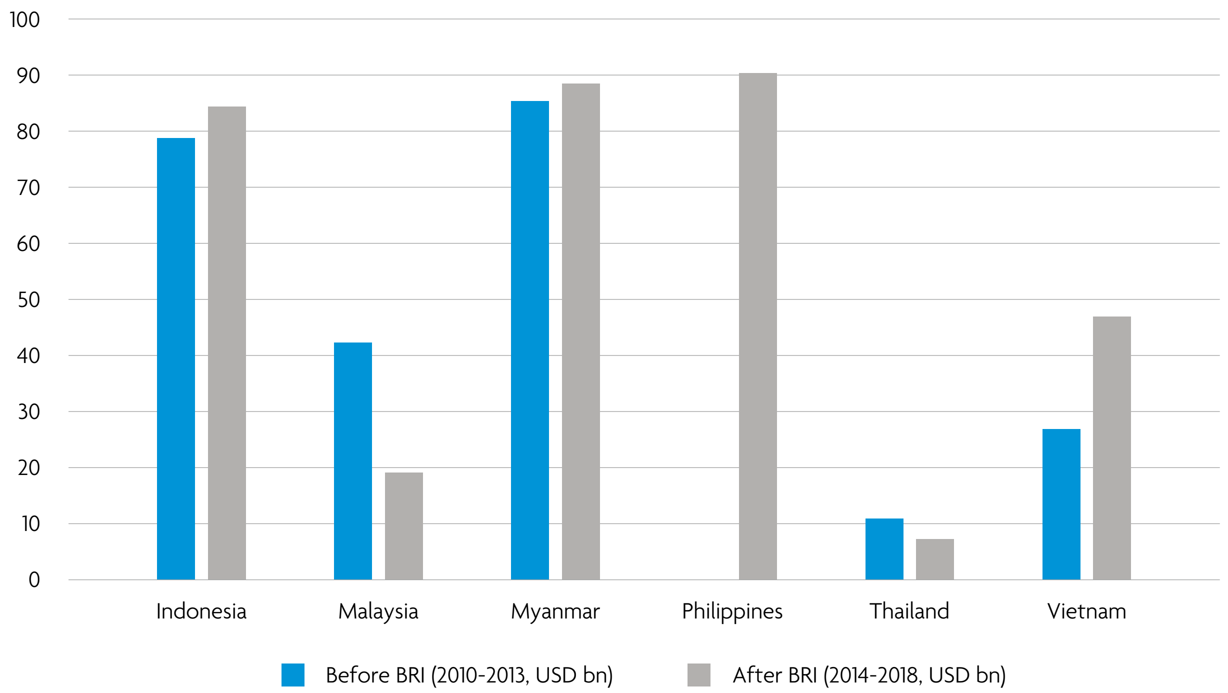


Figure 10. Resource Sector Share of Mainland Chinese Greenfield FDI in Six Southeast Asian Countries

As a result of these trends, more manufacturing activities are relocating from mainland China to other countries, providing an opportunity for countries in Southeast Asia to attract these businesses. Vietnam's low wages, disciplined labour force, and hospitable investment environment have proven to be an attractive location for labour-intensive manufacturing. However, low wages are not always indicative of the overall costs of production, which also depend on differences in labour productivity, supply chain costs, and the reliability and price of energy. Yet even if overall costs are not lower, there still may be an incentive to shift production to other countries just to avoid high tariffs imposed on mainland Chinese exports to the US. Manufacturers of higher value added goods may care less about the wages of unskilled workers and more about the availability of skilled workers and high quality inputs as well as the presence of other high-tech firms and business services.

The services sector accounts for a significant share of FDI flowing into ASEAN countries.[2] FDI in services are concentrated in financial services, wholesale and retail trade, and real estate. The overall amount of FDI in different service industries in different countries depends on local demand and supply as well as government policies towards foreign investment in specific industries.

Emerging markets in Southeast Asia have considerable demand for high tech products and services. Governments view investments in telecommunications infrastructure and development of smart cities as important for supporting rapid development, and consumers and businesses have great demand for smartphones, online services and entertainment, and other high-tech products. Leading mainland Chinese telecommunications and technology companies like Huawei and Alibaba as well as smaller, more specialised companies, are active in many countries in Southeast Asia, selling smartphones, building 4G and 5G infrastructure, providing e-commerce and other online services, and supporting other smart city technologies. As reflected on the map, several key BRI projects are smart cities in Myanmar and the Philippines. Alibaba acquired Lazada, the leading e-commerce company in the region, in 2016. In the same year, Jack Ma was appointed as an advisor to the Malaysian government to advise the country on its digital economy strategy, and later Alibaba supported the launch of a Digital Free Trade Zone to promote e-commerce for SMEs, and also helped develop a smart city solution for Kuala Lumpur that collected data on traffic to reduce congestion. In Indonesia, many online P2P lenders from mainland China entered the local market, catching regulators off guard. Eventually, their activities were restricted in order to protect Indonesian consumers. In the digital services space, government regulations are not very well developed in most countries in the region, including how to address privacy issues. Thus, investors in such services should be aware that regulations could evolve rapidly as new services are introduced and become better understood by regulators.

[2] *The ASEAN Secretariat and UNCTAD, ASEAN Investment Report 2019 (Jakarta: ASEAN Secretariat), 2019.*

The Role of State-Owned and Private Enterprises

Some observers have expressed concerns about the leading role played by mainland Chinese SOEs in the BRI and have wondered whether the Initiative is attracting much investment from private mainland Chinese firms. The Chinese government has made significant progress in providing stronger incentives to SOE managers to maximise profits. However, the advice of government leaders and preferential access to credit and other government subsidies affects the investment and other decisions of SOEs. As a consequence, SOEs often are more willing to bear risks and be patient in waiting for returns to materialise when pursuing projects endorsed by mainland China's central or local governments. Some SOE managers report that they are expected to participate in the BRI and make new outbound investments. In the short term, such incentives may undermine the expected profitability of BRI projects, but could deliver longer term benefits by encouraging firms to undertake investments and gain experience that may eventually pay off. The ability of the BRI to attract private firms is a better market test of whether the Initiative is creating profitable business opportunities.

By linking our project-level data to Chinese firm registration data, we are able to identify which FDI projects are undertaken by SOEs versus private enterprises, and thus can present unique micro-based estimates of the shares of FDI coming from the two ownership types. We report these shares for greenfield FDI in the six countries in Figure 11. We find that since the BRI began, in five of the six countries the majority of FDI funds are invested by SOEs. The SOE shares are over 90% in Myanmar; between 50% and 60% in Indonesia, Malaysia, Vietnam, and the Philippines; and about 10% in Thailand. While these findings confirm the important role played by SOEs in most countries in the region, they also reveal that private firm activity also is significant, accounting for at least 40% to 50% of FDI in all countries other than Myanmar. Since private firms usually make smaller investments than SOEs, the share of FDI projects undertaken by private firms is likely much higher. Moreover, the data reveal that the SOE share of FDI decreased after the BRI in four of the six countries, including very large decreases in Thailand and the Philippines. Overall, both SOEs and private enterprises are playing important roles in the BRI.

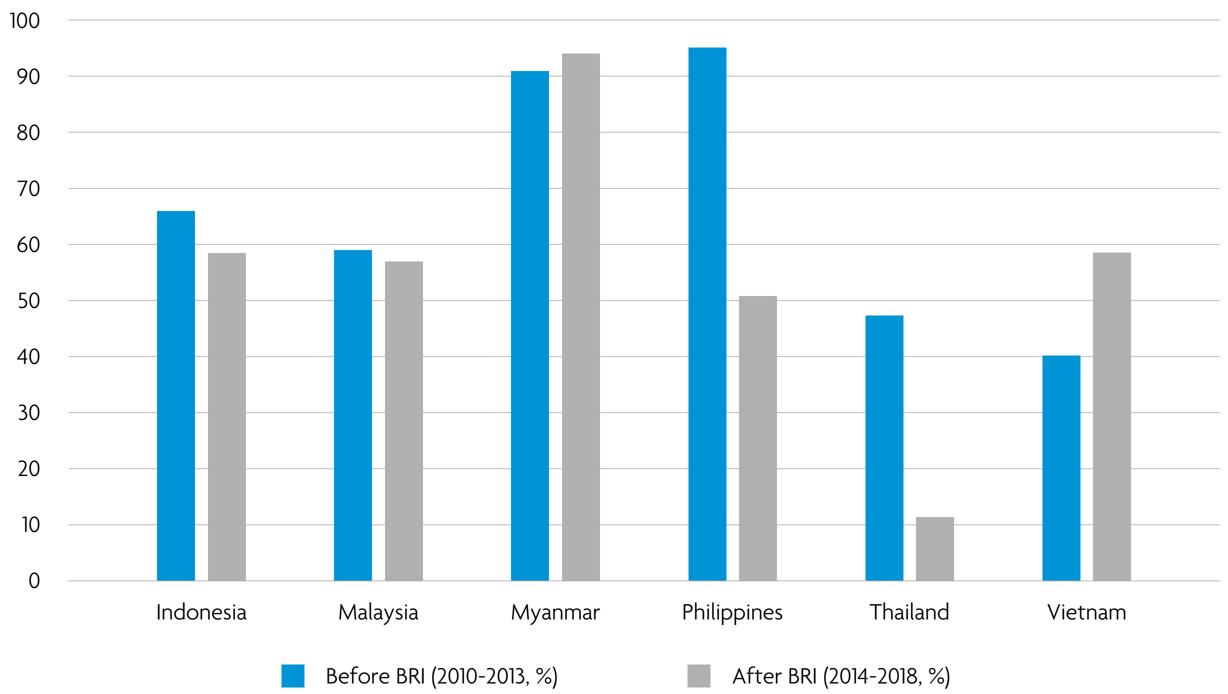


Figure 11. State-Owned Enterprise Share of Mainland Chinese Greenfield FDI in Six Southeast Asian Countries

Competing with Japan and Korea

ASEAN countries' fast development pace and dynamism attracts substantial amounts of FDI from countries other than mainland China. In 2018, the top sources of foreign investment in ASEAN countries were other ASEAN countries (16%), Japan (14%), mainland China (14%, including 7% from Hong Kong SAR), the United States (5%), Netherlands (5%), and Korea (4%).[3] Other than Singapore, the favourite destination of Japanese investors is Thailand, where they have established a supply chain for auto manufacturing and other manufacturing sectors. Japanese firms also invest heavily in Thailand's finance and insurance sectors. Other than Thailand, Japanese firms also invest significant but smaller amounts in Indonesia and Vietnam. Korean investors have concentrated investments in Vietnam, where they are also investing in the auto sector and other manufacturing sectors. In the countries where they are active (especially Thailand, Indonesia, and Vietnam), Japan (and to a lesser extent Korea) also has been supporting the implementation of large infrastructure and FDI projects for many years. Japanese and Korean entities have established a strong reputation for complying strictly with local government regulations and using advanced technologies to produce high quality products. Mainland Chinese firms typically are highly competitive on price, but are relative newcomers with less established reputations in compliance and quality compared to Japanese and Korean firms.

[3] *The ASEAN Secretariat and UNCTAD, ASEAN Investment Report 2019 (Jakarta: ASEAN Secretariat), 2019.*

The Role of Hong Kong

Hong Kong SAR is the economic gateway to mainland China, an increasingly important economic partner for ASEAN countries, and a global financial centre with strong market-based institutions and professional services. Hong Kong SAR's gateway role is being enhanced by the Greater Bay Area initiative that will more closely integrate Hong Kong SAR with Shenzhen, Guangzhou, and other cities in Guangdong Province. Given these unique attributes, Hong Kong SAR is well positioned to both lead and support investment projects in BRI countries.

More than two thirds of mainland China's inbound and outbound FDI go through Hong Kong, and Hong Kong is the second largest destination for mainland Chinese exports after the US, much of which is re-exported. As noted earlier, in 2018 Hong Kong also was the fourth largest investor in ASEAN accounting for 7% of FDI in the region, nearly identical to the 7% coming directly from mainland China. Notably, Hong Kong FDI in ASEAN countries increased by 83% from 2017 to 2018.[4] Among the six countries studied in this report, Thailand and Malaysia are the main destinations of Hong Kong FDI. ASEAN also accounts for 16% of Hong Kong's imports, 16.9% of domestic exports, and 7.7% of re-exports, making ASEAN Hong Kong's most important trading partner after mainland China.[5]

The Hong Kong SAR government has been proactive in supporting the BRI and engaging with companies interested in pursuing projects in Belt and Road countries. In 2016, it established an Infrastructure Financing Facilitation Office (IFFO) under the Hong Kong Monetary Authority and a Belt and Road Office. It joined the Asia Infrastructure Investment Bank in 2017. Since 2016, the Hong Kong Trade and Development Council (HKTDC) has hosted an annual Belt and Road Summit which focuses on connecting businesses interested in pursuing projects in BRI countries, with many participants from ASEAN countries, and also organized trade missions to many countries in ASEAN. The Hong Kong-ASEAN FTA signed in 2018 has accelerated efforts to promote greater economic engagement between Hong Kong SAR and ASEAN countries.

Hong Kong is clearly well placed to help finance BRI projects, with its large number of foreign banks providing a large asset pool of hard currency as well as its being the largest offshore RMB centre in the world. Although mainland Chinese policy banks have provided most financing for large infrastructure and investment projects in the past, it is not clear whether such funding will be sufficient in the future to meet growing demand. Hong Kong also has a transparent legal framework, respected dispute arbitration services, and high quality professional services, making it a preferred location for concluding FDI contracts. Although Singapore also is a leading financial centre for Southeast Asia, Hong Kong's close proximity to mainland China and the Greater Bay Area and close linkages to mainland companies gives it clear advantages for financing BRI projects.[6] Recent progress in developing green financing products in Hong Kong could support efforts to make BRI projects more environmentally sustainable. Hong Kong firms generally have very positive reputations in terms of management, professionalism, and quality, and so are viewed as attractive business partners. Hong Kong companies in a wide range of business areas may benefit from pursuing projects in Belt and Road countries. For example, some Hong Kong garment manufacturers that previously moved production to mainland China are now investing in Vietnam where wages are lower. Most Hong Kong investment in Myanmar is also in manufacturing. In November 2020 the Federation of Hong Kong Industries signed a Memorandum of Understanding with the Eastern Economic Corridor Office of Thailand to promote industrial investment and business exchanges by Hong Kong and Thai companies, especially in advanced industries. Hong Kong also has globally leading expertise in logistics that is in high demand for building and managing new infrastructure. For example, Hong Kong's CK Hutchison operates major ports in many Southeast Asian countries, Hong Kong's Mass Transit Railway (MTR) has provided training and advisory services to Indonesia's Mass Rail Transit through its MTR academy, and many other Hong Kong logistics firms handle various components of building or managing large infrastructure projects. Hong Kong also has leading real estate developers, food and beverage companies, and retail companies that are undertaking investments in ASEAN to meet the growing demands of rising middle classes in the region.

Hong Kong SAR is striving to become an innovation leader in the areas of fintech, biotechnology, artificial intelligence and robotics, and smart city development. Hong Kong companies in these fields may be attractive partners for emerging markets in ASEAN desiring to upgrade their industrial or service technologies. For example, a Hong Kong architecture firm is designing the smart city development Manila City of Pearls in the Philippines, and Thailand's Ministry of Industry is working with Hong Kong's Cyberport to develop a start-up ecosystem.

[4] *The ASEAN Secretariat and UNCTAD, ASEAN Investment Report 2019 (Jakarta: ASEAN Secretariat), 2019.*

[5] *Source: Hong Kong SAR Trade and Industry Department (https://www.tid.gov.hk/english/trade_relations/mainland/trade.html)*

[6] *Alicia Garcia-Herrero , Hanrui Li and Gary Ng, Hong Kong SAR's Intermediary Role on Funding the BRI: How does it fare against Singapore?, HKUST IEMS Thought Leadership Brief No. 44, 2020. (http://iems.ust.hk/tlb44)*

Implementation of BRI Projects

Role of Host Country Governments

Officials and commentators from the US and some other Western countries have strongly criticised the BRI as an attempt by the Chinese government to exert control over other countries. Mainland Chinese leaders have consistently emphasised their desire to support economic development in other countries. Overlooked in these debates is the essential and critical role played by local government leaders in each country in designing their own development strategies and deciding on what is the proper role, if any, for mainland Chinese or other foreign investment. In fact, all of the governments in Southeast Asia can be considered developmental states in which leaders at least to some extent put high priority on achieving high rates of economic growth and promoting the development of their countries. As such, they have agency in determining what infrastructure or FDI projects are approved, how the contracts are awarded, and what regulations must be observed by investors given the country's strategic direction. Local governments also make decisions on whether or not to reform institutions or policies to encourage or discourage different types of investments. Thus, the strategies and policies of local governments critically determine the opportunities and constraints faced by both domestic and foreign investors. The country reports go into great detail on these strategies and policies in each country and what they mean for investors. Here, we highlight in a general way some of the key ways in which local governments affect the actual implementation of BRI projects, drawing on examples from the six country reports.

Government-to-government agreements between China and the host country are usually the starting point for many of the ambitious projects undertaken under the BRI. These can take the form of joint statements (or communiques) or memorandums of understanding that express the government's willingness to participate in the BRI in general terms and may also indicate agreement between the two countries to work together on specific major projects.

All of the countries in ASEAN have signed such agreements with China. The agreements provide a clear signal to investors that the two governments are committed to the goals of the BRI and to successfully completing specific major projects. Given the inherently high risks attached to most greenfield FDI projects, such agreements provide some assurance (but no guarantees) to mainland Chinese investors that host governments will work in good faith to resolve unanticipated problems that might arise, and that the Chinese government will support them in undertaking the project, including by providing necessary financing. Thus, potential investors should be fully aware of the contents of all existing government-to-government agreements. However, joint statements (or communiques) or memorandums of understanding do not create legal obligations for the parties involved and so do not provide direct protections to investing companies.

As discussed earlier, governance quality plays an increasingly important role in attracting FDI. Although host governments face constraints in terms of the capabilities of public bureaucrats, they also have the ability to reform institutions and policies to improve governance and reduce the costs of doing business in their countries. Many of the governments in the six countries studied responded to the opportunity to attract mainland Chinese FDI under the BRI by making organised efforts to attract mainland Chinese investors and reduce the red tape involved in making investments. Indonesia and Malaysia set up dedicated China desks in their investment promotion agencies, and Myanmar established a BRI Committee chaired by Daw Aung Sang Suu Kyi herself. In order to improve the ease of doing business, Indonesia upgraded its Online Single Submission for business license applications after consulting with mainland Chinese companies. Thailand set up One-Stop Service Centres for foreign investors to streamline administrative procedures in industrial parks and special economic zones, and also recently introducing a new Smart Visa to facilitate mobility of highly-skilled professionals.

Governments also may provide incentives and/or restrictions for different types of foreign investments based on the country's development priorities. For example, in Thailand, investments may qualify for tax reductions or other subsidies if they are in designated high-tech or high value-added sectors. Vietnam shifted in 2014 to a "negative list" approach that allows foreign businesses to operate in all business areas except for in a few explicitly prohibited sectors.

Moving Up the Learning Curve

Compliance with local laws, regulations, but also with cultural norms is paramount to achieve positive investment outcomes and develop a good reputation. Some Belt and Road projects, especially hydropower and coal power plant projects, have been criticised both internationally and locally for not adequately considering environmental impacts. Public opposition to such projects can delay or prevent the projects' implementation and damage the reputation of the companies involved and mainland Chinese investors as a group.

The Chinese government has recognised the need to put greater priority on promoting green Belt and Road projects. During the Belt and Road Forum in 2019 President Xi emphasised the greater attention toward the pursuit of sustainable investment projects through compliance with strict environmental standards. Even when local environmental or labor regulations are not strictly enforced, mainland Chinese investors should conduct their own assessments and anticipate and avoid projects that are likely to be unpopular among local citizens.

Prompted by both China's aspiration for a greener BRI and increased demands from local governments and citizens for more sustainable development, in some countries Chinese companies are responding with increased investments in renewable energy projects.

There are some positive examples of mainland Chinese companies improving their Corporate Social Responsibility (CSR). Many potential problems can be avoided if firms reach out to local consultants and community-based organisations that understand local dynamics. Some civil society organisations have successfully established a meaningful dialogue with investors to discuss ways to further environmental and social goals. Ideally, affected communities should be consulted beforehand regarding planned projects and adequately compensated based on how the project affects their land and resources.

In Kyaukphyu, Myanmar, CITIC established a fund for local villagers in Rakhine state to develop small businesses and has established a center for vocational training. The company has committed to disbursing US$1 million in CSR funds over the first five years of the project, and US$500,000 afterwards to alleviate poverty improve the living conditions of the nearby communities. A mainland Chinese real estate company involved in land reclamation to develop Forest City in Johor, Malaysia drew criticism for harming the local ecosystem. In response, the company stepped up efforts to address the concerns and now supports local villages, educational programs, and local civil society groups.

Conclusions: Opportunities and Challenges

The BRI is supporting large scale infrastructure projects and promoting other dimensions of connectivity between mainland China and ASEAN countries, although it is too early to tell how BRI projects will shape the development trajectories of host countries. However, the scale and scope of BRI projects commands the attention of anyone who is on the lookout for profitable investment opportunities in one of the world's most dynamic and fast growing regions.

As they consider these possibilities, investors should be mindful of many factors, including the following:

To maximise the likelihood that BRI projects are successful, investors are advised to consider all of these factors carefully when deciding whether to move forward with a project and while implementing green-lighted projects. Managers should ensure that the firm conducts its own independent assessment of the economic, social, and environmental impacts of the project. Companies should move as rapidly as they can up the learning curve by being attentive to local cultural, social, and labour norms. Collaborating with local partners and engaging with local community members can facilitate the understanding of the new market. Investors are advised to focus on building a long-term reputation rather than minimising short-term costs.

About UOB

United Overseas Bank (UOB) is a leading bank in Asia with a global network of more than 500 offices in 19 countries and territories in Asia Pacific, Europe and North America. Since its incorporation in 1935, UOB has grown organically and through a series of strategic acquisitions. UOB is rated among the world's top banks: Aa1 by Moody's Investors Service and AA- by both S&P Global Ratings and Fitch Ratings. In Asia, UOB operates through its head office in Singapore and banking subsidiaries in China, Indonesia, Malaysia, Thailand and Vietnam, as well as branches and representative offices across the region.

Over more than eight decades, generations of UOB employees have carried through the entrepreneurial spirit, the focus on long-term value creation and an unwavering commitment to do what is right for our customers and our colleagues.

We believe in being a responsible financial services provider and we are committed to making a difference in the lives of our stakeholders and in the communities in which we operate. Just as we are dedicated to helping our customers manage their finances wisely and grow their businesses, UOB is steadfast in our support of social development, particularly in the areas of art, children and education.

About the Authors and HKUST IEMS

Angela Tritto is an Adjunct Assistant Professor at the Division of Public Policy and a Postdoctoral Fellow jointly appointed by the Institute of Emerging Market Studies and by the Division of Social Science at Hong Kong University of Science and Technology.

Dini Sejko is a Research Associate at the Centre for Comparative and Transnational Law, Faculty of Law, at the Chinese University of Hong Kong and a research affiliate at The Fletcher Network for Sovereign Wealth and Global Capital. Dini Sejko was a Post-Doctoral Fellow at the HKUST Institute for Emerging Market Studies (IEMS) during the period October 2018 to July 2020.

Albert Park is the Head and Chair Professor of the Department of Economics, Chair Professor of Social Science, and Professor of Public Policy, HKUST. He is also the Founding Director and currently Special Advisor to the Director at HKUST IEMS.

HKUST Institute for Emerging Market Studies (IEMS) provides thought leadership on issues facing businesses and policymakers in emerging markets. Building on the research strengths of the faculty at the Hong Kong University of Science and Technology, the Institute focuses its research and activities on the themes of human capital, employment, and structural change; innovation and entrepreneurship; global economic integration; financial development; strategy, firms, and markets; and organisational and consumer behaviour. Find out more at *http://iems.ust.hk*

The authors would like to acknowledge the generous support from UOB for the project. This research project is also supported by the Strategic Public Policy Research Funding Scheme from the Central Policy Unit of the HKSAR Government.