Headline: Beijing May See Itself As Stakeholder In Asean's Boom
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Beijing may see itself as stakeholder in Asean's boom

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WHEN the financial crisis caused global foreign direct investments (FDI) to drop by 20 per cent in 2008, China's own direct investments overseas more than doubled, reaching US$55.9 billion (S$78.5 billion). Preliminary data for last year shows that the trend is continuing.

Still, China's direct investments overseas are quite small: It was ranked 13th in the world as a source of FDI in 2008. And that too was largely driven by the Chinese government and giant state-owned or controlled enterprises, which were responsible for nearly 70 per cent of all of China's investments overseas.

These Chinese firms have shown a strong appetite for well-established foreign brands, proprietary technologies and natural resource assets. Acquisition of the first two has been viewed as a short-cut for Chinese companies to bridge the technology gap with the developed world. And securing natural resource assets has more to do with geopolitical than economic considerations.

What does the future hold for China's direct investments overseas? There are reasons to believe that the recent surge in such investments is likely to increase in the coming years.

China's huge stock of external assets has hitherto been skewed towards US Treasuries and other US dollar-denominated assets. Over time, an increasing proportion of these assets will find their way into direct investments overseas. The need to diversify its investment portfolio will lead to more Chinese investments in the rest of the world.

The Chinese government has already started to loosen regulations so as to encourage more Chinese firms to invest overseas. Chinese companies trying to acquire strategic assets with the implicit backing of Beijing have been met with strong political resistance in Western countries. By contrast, private Chinese firms have recently successfully acquired mining assets in Brazil and Australia.

Two major constraints on the overseas investments of Chinese firms and individuals are China's inflexible exchange rate system and restrictions on capital accounts. In a 2008 Cato Journal article, American-trained economist Yi Gang, who has since become a deputy governor of China's central bank, wrote: "Over the long run, China is bound to have a free flow of capital and a floating exchange rate regime." When that prospect materialises, a stronger yuan and the free flow of capital in and out of China will fuel further Chinese overseas investment.

While developed countries will remain attractive to Chinese investors, given their technological sophistication and mature markets, Asean countries will also see increasing Chinese investments. In the near term, China will be attracted primarily to Asean countries rich in natural resources such as Indonesia, Malaysia and Myanmar.

Over time, however, as more and more Chinese companies acquire intangible assets such as proprietary technology, manufacturing know-how and internationally recognised brands, Chinese investments in the region will rise in order to tap into a market of nearly 600 million people. The recently signed Asean-China investment agreement is expected to smooth investment flows.

China's labour cost will continue to rise, particularly in the coastal region. Interior China is already seeing an inflow of investment from the coastal region. At the same time, labour cost in various parts of Asean, including Cambodia, Laos and Vietnam, will become increasingly competitive and is likely to attract Chinese manufacturers.

Singapore has been a major beneficiary of previous waves of FDI in the region – from Europe, the United States, Japan and more recently Taiwan and South Korea – by modelling itself as a gateway to the region, with superb infrastructure and well-functioning institutions. These fundamentals will continue to serve Singapore well in reaping the benefits from a growing presence of Chinese investors in the region.

By the end of 2008, Singapore accounted for 52 per cent of the stock of China's investments in Asean. Singapore will remain popular with Chinese investors.

However, Chinese investment in Asean is likely to be different from earlier investment in the region from the US, Europe and Japan. Part of the reason is that China is in close geographical and cultural proximity with Asean countries.

China may also be aiming at a more fundamental engagement with the region and may even see itself as a stakeholder in the region's prosperity. This may help to assuage Asean countries' unease with China's growing clout in their backyard.

Singapore will gain, directly and indirectly, from increasing Chinese investment in Asean, but its traditional role as a gateway to the region may not be as prominent as before.

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