



EMERGING TRENDS & INVESTMENT IN ASEAN

EXECUTIVE SUMMARY

In a world of slow growth and jittery markets, ASEAN economies have continued to outperform global norms. The region's performance is underpinned by strong fundamentals – including a growing middle class and a young workforce. ASEAN also benefits from the increasing integration of regional and global supply chains and relative political stability. Investor interest is further bolstered by China's relative slowdown, prompting more to look to ASEAN as an attractive alternative in their Asia strategies. Major powers are stepping up their political and economic engagement with ASEAN and foreign direct investments (FDIs) into ASEAN are increasing, not only from leading businesses in the West but also from within Asia.

Investors have previously been sceptical to ASEAN, claiming that that the diversity across the different states and lack of harmonisation of rules increase the cost of doing business. However, the current ASEAN leaders are committing to deeper economic reforms, and streamlining rules and regulations across the region. Trade agreements such as the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP) offer further momentum for the formation of regional production and trade networks. ASEAN's diverse and yet complementary economies will allow companies to draw on the different competitive advantages of the various economies.

This Report offers a number of insights into ASEAN and its key economies: global trends and decisions made by major powers, such as the Sino-Japanese rivalry and the upcoming US presidential election, are surveyed to understand how they can influence trade and investment relations in the region.

Finally, this Report will consider changes at the domestic level within ASEAN countries. ASEAN leaders are emphasising good governance, moving against corruption, and integrating into the wider ASEAN Economic Community (AEC). These commitments enhance the sustainability of investments and signal the region's desire to join the global marketplace, altering the region's business climate that companies have grown accustomed to.

More than ever, the political will to transform ASEAN into a competitive economic bloc is on the rise. ASEAN is entering a new chapter in history. Taken together, the 10 economies are significant in size with very strong predictions for their future growth. Coming changes can alter the business and investment climate so that competitiveness grows exponentially for ASEAN. While the implementation of these reforms may take time, the process is already happening and investors who enter ASEAN earlier rather than later can pre-emptively establish themselves across the region, thereby gaining a first-mover advantage.

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SEPTEMBER 2016

INTRODUCTION: ASEAN OUTPERFORMS

At a time where the global economy faces slow growth, ASEAN economies have continued to outperform. The Asian Development Bank (ADB) forecasts aggregate growth in ASEAN economies to accelerate steadily from 4.4 percent in 2015 to 4.5 percent in 2016.¹ This is not a ‘flash-in-the pan’. The region’s economic growth has exceeded the global growth average for the past decade, and is second in Asia only to China.² ASEAN economies have grown since the 2008 global financial crisis, with GDP growth averaging around 5 percent (see

Figure 1), even as advanced countries struggle to gain their footing.³

Looking ahead, prospects are positive for ASEAN. Whereas land and labour costs continue to rise in China, the region continues to offer lower cost labour. A Chinese factory worker earns an average of US\$28 per day but wages in Indonesia and Vietnam are, respectively, around US\$9 and US\$7.⁴ Multinational corporations (MNCs) are trimming reliance on China and scaling up their production in ASEAN countries in what has been dubbed a ‘China+1 strategy.’

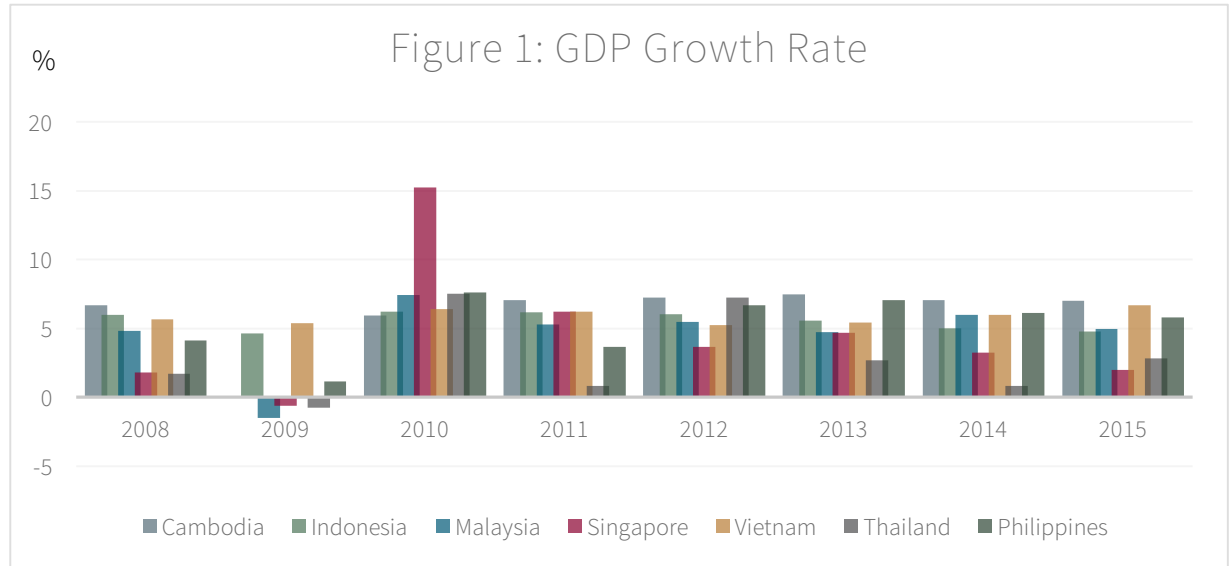


Figure 1 Source: World Bank

¹ Asian Development Bank (2016) Asian Development Outlook 2016 Asia’s Potential Growth, Available: <http://www.adb.org/sites/default/files/publication/182221/ado2016.pdf>, Retrieved: 19 August 2016

² Vinayak HV, Fraser Thompson & Oliver Tonby (2015) Understanding ASEAN: Seven Things You Need to Know, *Mckinsey & Company*, Available: <http://www.mckinsey.com/industries/public-sector/our-insights/understanding-asean-seven-things-you-need-to-know>, Retrieved: 2 September 2016

³Kyung-Hoon, Kim (2013) The Potential of ASEAN Revisited, *SERI Quarterly*, Available: <http://www.asia.udp.cl/informes/2013/the-potential-of-asean-seri.pdf>, Retrieved: 2 August 2016

⁴International Enterprise Singapore (2015) ASEAN Economic Community: Opportunities through Economic Integrations in Southeast Asia, *IE Insights*, Available: http://www.iesingapore.gov.sg/~media/IE%20Singapore/Files/Publications/IE%20Insights/Vol22_ASEAN_Economic_Community_Opportunities_through_Economic_Integration_in_Southeast_Asia.pdf, Retrieved: 4 August 2016

Although the difference in wages is a significant push factor it is important to note that ASEAN has more to offer; three macro factors require special mention.

First, regional integration is creating a market of approximately 600 million people with a young demographic and increasing purchasing power. Urbanisation across ASEAN is also accelerating with a demand for infrastructure, goods and services.⁵ This has encouraged ASEAN leaders to reduce their reliance on the resource and agro-forestry sectors that have traditionally been growth engines for ASEAN.

Second, the region's resilience to the effects of the 2008 global financial crisis has been due in part to stable macro-economic management. After recovering from the earlier 1997 Asian currency crisis, most ASEAN economies have built up foreign currency reserves. They have also concluded multilateral currency swap arrangements amongst themselves and with the larger Asian economies of China, Japan and South Korea to strengthen readiness for future crises.

Third and more importantly, ASEAN leaders are responding to the hard realities of slow global growth by rethinking their strategies to reform to be more competitive and to attract more quality foreign investments. A number of key ASEAN economies are shifting their economic strategy to promote industrialisation and innovation as new growth engines.

As ASEAN states aim to move up the value chain, the region offers diverse and yet complementary economies that allow companies to draw on the different competitive advantages of various ASEAN economies.⁶ A wide range of businesses stand to benefit from distributing their production nodes according to cost, skill and competitiveness across the region. Foreign investors can and will play a part in the continuing growth of ASEAN.

EUROPEAN BUSINESSES IN ASEAN

The European Union (EU) is a major economic partner for ASEAN. The EU remains the second largest trading partner for ASEAN, behind only China.⁷ It is moreover the region's largest foreign investor with more than 10,000 European companies operating in Southeast Asia.⁸ Further growth is possible and indeed, deepening the economic engagement is a desirable and vital strategy for European businesses.

It is not to be taken for granted however that this relationship is secured for the future. Amidst ongoing challenges in Europe, there is a question of whether Europeans have the capacity to focus on ASEAN.

ASEAN has been at the center of a web of free trade agreements (FTAs) with its major partners in Asia. Negotiations are ongoing to bring together Australia, China, India, Japan, New Zealand and South Korea in a Regional Comprehensive Economic Partnership (RCEP).

⁵ KPMG & SIIA (2016) Southeast Asia in Transition: Geopolitical Dynamics and Implications for Investment, Available: <https://assets.kpmg.com/content/dam/kpmg/pdf/2016/06/sg-southeast-asia-in-transition.pdf>, Retrieved: 3 August 2016

⁶Ibid

⁷ Ji Xianbai (2015) Time to Revisit an ASEAN-EU FTA?, *The Diplomat*, 3 June 2015, Available: <http://thediplomat.com/2015/06/time-to-revisit-an-asean-eu-fta/>, Retrieved: 5 September 2016

⁸ Ibid

There is also the Trans-Pacific Partnership (TPP) led by the USA in which four ASEAN economies – Brunei, Malaysia, Singapore and Vietnam are involved. Others including Indonesia, the Philippines and Thailand are showing interest to join the TPP too.

Combining these FTAs with continuing economic growth, the trend is that production and trade networks are increasingly shifting towards the Asia Pacific, making ASEAN a central player in the region. As these trends take shape, businesses and investors from the EU should look at ways to continue and indeed deepen their engagement with the region.

It is in this context an inter-regional EU-ASEAN FTA is notably absent, despite years of efforts and discussions. Potentially such an FTA could help open up ASEAN markets further and boost inter-regional commerce to promote growth and job creation in both regions. The ratification of the FTA will enable European businesses investing in ASEAN to enjoy higher levels of protection, including their intellectual property rights.⁹

If negotiations are not possible between the EU and ASEAN as a whole, bilateral or minilateral arrangements may be useful. Already, the EU is negotiating a Comprehensive Economic Partnership Agreement (CEPA) with Indonesia and also recently concluded a FTA with Singapore, which is now still pending ratification.

Even without such FTAs, European businesses can and should equip themselves for

business with ASEAN. Efforts are already being made with the EU's recent launch of an EU Business Avenues in Southeast Asia program that aims to bring up to 1,000 European small and medium-sized enterprises (SMEs) through 20 targeted business missions across a range of sectors in Southeast Asia over the next five years.¹⁰ This aims to lay the groundwork to deepen private sector engagement from the European companies in ASEAN markets by exploring new business opportunities and identifying potential local business partners.

Against this backdrop, the Report aims to offer insights at three, inter-linked levels.

First, this Report will survey the global factors that are influencing the region, directly and indirectly. For example, changes in global leadership such as the upcoming leadership change in the USA which can have spillover effects onto the wider region. The US-China tensions over issues such as the South China Sea also hold implications for security balance across the region.

Secondly, we will survey economic and geopolitical trends in ASEAN and Asia that have an impact on regional economic integration. Some initiatives are being taken by ASEAN itself, like the AEC and RCEP. Other trends like China's infrastructure expansion in Southeast Asia will also be discussed.

Thirdly, the Report will share some key analyses of trends that are developing in the ASEAN states of Thailand, Indonesia and Myanmar. Economic and political transitions occurring within these states will have a

⁹Magkilat Bernie (2016) Survey: EU Businesses Planning to Expand in ASEAN, *Manila Bulletin*, 1 September 2016, Available: <http://www.mb.com.ph/survey-eu-businesses-planning-to-expand-in-asean/>, Retrieved: 3 September 2016

¹⁰Hui, Calvin (2016) EU Launches Programme for SMEs Seeking to Enter Southeast Asia, *Channel News Asia*, 15 June 2016, Available: <http://www.channelnewsasia.com/news/business/eu-launches-programme-for/2873766.html>, Retrieved: 5 September 2016

direct impact not only on the citizens of these countries but on the investment climate for businesses interested in investing or expanding across the region.

1. GLOBAL FACTORS IMPACTING ASEAN

1.1. American leadership

Since the end of World War II (WWII), the USA has been the guarantor for regional peace and stability in Asia. It is also a major trading and investment partner for ASEAN. These roles have been re-emphasised by the Obama administration with its pivot towards Asia.

The competition and nervousness associated with overlapping claims in the South China Sea have led some to re-focus their alliances and security relations with the USA.

These are clear signs that the upcoming leadership change in USA could have knock-on effects on ASEAN. How the new President views and deals with China will be a key factor, as will American relations with its erstwhile allies in Asia, most notably Japan.

In the economic sphere, the TPP led by the USA can potentially shift production networks and it will make a key difference whether the TPP comes to pass in the USA, and if so, when.

The TPP, characterised as a 21st century trade deal, is expected to facilitate greater economic activity across the Asia Pacific. It provides a framework and creates institutional networks for the world's largest economies such as USA and Japan to gain access to some of the world's fastest growing

economies such as Vietnam.¹¹ This will result in a win-win trade situation where businesses are able to easily source inputs from across the region, allowing TPP economies to leverage on the region's growth synergies.

However, the rhetoric of the frontrunner candidates in the lead up to the 2016 US Presidential Elections have raised concerns among those in Asia on whether its next leader will be able to maintain America's pivot towards Asia. The anti-TPP stance adopted by presidential candidates of the Republican and Democrat Parties is worrying.

Against this backdrop, during Singapore's Prime Minister Lee Hsien Loong's recent state visit to Washington, he called the ratification of the TPP a "litmus test of credibility" for the USA in the eyes of its friends and partners. Strategically, Prime Minister Lee added that the "TPP is vital to the US engagement in Asia Pacific as it will add heft to the Asia rebalance, which cannot just be about the Seventh Fleet."¹²

While the TPP is pending ratification by the USA, ASEAN economies are already using the trade pact to anchor domestic reforms. These efforts are seen even for countries who remain outside the agreement.

For example, Indonesia, Thailand and the Philippines have adopted progressive measures to liberalise and restructure their economies along the lines of TPP's high

¹¹ Interview with Steven Okun, Vice Chairman, Asia Pacific Council of American Chambers of Commerce (APCAC)

¹² Fang, Nicholas (2016) TPP Ratification a 'Litmus Test of Credibility' for US, PM Lee Says, *Channel News Asia*, 2 August 2016, Available:

<http://www.channelnewsasia.com/news/business/tpp-ratification-a-litmus/3005752.html>, Retrieved: 10 August 2016

standards and requirements.¹³ In this sense, even before ratification, the TPP has already set in motion economic reforms that can change the context for investors.

1.2. Future of Sino-US Relations

Another global trend that impacts ASEAN is the US-China relationship. While the two are highly interdependent, most believe that competition and rivalry between the current and emerging powers cannot be avoided and occasional sparks may fly in parallel with efforts to cooperate on global issues.

This is already visible even as both sides have expressed support towards building a new model of major power relationship, with the aim of reaching a consensus on key international and regional issues of mutual concern. At present, the standing Chinese rhetoric is that it will continue on its path of peaceful development, while striving to realise the Chinese Dream.¹⁴ The Obama administration in response has said it welcomes the rise of a China that is peaceful, stable, prosperous, and a responsible player in global affairs.

The stakes are high, not only for the two major powers but also for those in Asia. The underlying attitude in US-China relations is therefore important in seeking a balance between cooperation and competition. In this context, the upcoming leadership change in the US could severely alter the current *modus vivendi*.

The next President will preside at a time where it is likely that Chinese growth may overtake America's economy in absolute terms. Managing US-China relations will grow increasingly important and much will depend on the domestic politics of each country, as well the personality of both leaders. With signs suggesting that Xi is firmly in charge of China, it is the change in the American presidency and the Asia policy he or she adopts that is perhaps the most important variable today.

2. IMPACTS ON ASEAN INTEGRATION

ASEAN is a group of 10 small and medium-sized countries in a region among rising powers. The region remains diverse in political and economic systems, as well as in social and historical make-up.

In an attempt to come together as a region, the grouping inaugurated the ASEAN Community at the end of 2015 to strengthen political and security cooperation, economic integration and deeper socio-cultural exchanges. Although ASEAN unity and centrality are emphasised for the group, it is often challenged. The following section takes into account several current and emerging regional trends that impact ASEAN's cohesiveness.

2.1. The South China Sea and Fear of China's Domination

Brunei, Malaysia, the Philippines and Vietnam have claims to parts of the South China Sea that overlap with China, with its controversial 'nine-dash line'. These differences are long-standing but have flared up in recent months after the Permanent Court of Arbitration's (PCA) ruling. The PCA's ruling in favour of the Philippines has not decided who owns what

¹³ KPMG & SIIA (2016) Southeast Asia in Transition: Geopolitical Dynamics and Implications for Investment, Available: <https://assets.kpmg.com/content/dam/kpmg/pdf/2016/06/sg-southeast-asia-in-transition.pdf>, Retrieved: 3 August 2016

¹⁴ (2014) Build a New Model of Major-Country Relationship between China and the United States, 7 June 2013, *Xi Jinping: The Governance of China*, pp.306-311, Beijing: Foreign Languages Press Co.

but has questioned the extensive nature of the “nine-dash line” put forward by China.

Beijing chose not to be present at the ruling and its initial reaction has been to deny the legitimacy of the PCA’s decision. Observers including the USA have urged that ASEAN uphold decision made by the PCA.

During the 2016 ASEAN Foreign Ministers’ Meeting in August, Cambodia chose to block any mention of the PCA’s ruling in ASEAN’s joint communiqué; a move widely seen to be made at the behest of China.¹⁵ Laos as the ASEAN chair this year, has also maintained that, “it has no opinions on the matter and have no plans to issue any statement.”¹⁶

ASEAN statements issued in 2016 have instead emphasised the rule of law and peaceful conduct in the resolution of differences. ASEAN also relies on a non-binding 2002 declaration with China.

The Declaration on the Conduct of Parties in the South China Sea (DOC) aims to maintain peace and stability in the region, even as efforts are being made to finish a binding Code of Conduct (COC) for management of the issue by mid-2017.

These statements may be considered to imply the PCA’s decision indirectly, prompting China to be aware of the group’s stance without feeling confronted. Moving ahead on the COC is also seen to be an essential and practical step in managing the situation.

Critics suggest that the issue shows the limits of ASEAN, especially in relation to the group’s ability to present a united front in the face of China’s growing influence. ASEAN’s principle of consensus in decision-making processes has also surfaced as an issue of concern. If ASEAN cannot remain both united and relevant to strategic issues such as the South China Sea, some predict that the group will be splintered and then dominated by China.

Although this fear of China’s domination is not without some basis, it is important to note that China is not the only superpower that has influence.¹⁷

In terms of security and military concerns, especially at sea, the USA remains the strongest and most visible presence. Indeed, with the pivot, the Obama administration has increased American naval presence in the region.

There are others with economic influence too so that ASEAN is well-balanced between different investors.¹⁸ Top investors include the EU with 16.4 percent of the total FDI inflows followed by Japan and US. China ranks fourth, with just 6.8 percent (see Table 1).

For ASEAN leaders, there is no doubt that while China is important to the region, there is a recognised value in seeking to engage other powers and in maintaining the unity of

¹⁵ (2016) China Gives Cambodia \$600M in Exchange for International Support, *Voice of America*, 16 July 2016, Available: <http://www.voanews.com/a/china-gives-cambodia-millions-exchange-international-support/3421648.html>, Retrieved: 3 September 2016

¹⁶ (2016) South China Sea Ruling to Test ASEAN Unity, *Nikkei Asia Review*, 14 July 2016, Available: <http://asia.nikkei.com/Politics-Economy/International-Relations/South-China-Sea-ruling-to-test-ASEAN-unity>, Retrieved: 3 September 2016

¹⁷ Tay, Simon (2016), Steer ASEAN-China Talks Towards Quiet Diplomacy, Flexibility, *Today Online*, 7 July 2016, Available: <http://www.todayonline.com/commentary/steer-asean-china-talks-towards-quiet-diplomacy-flexibility>, Retrieved: 3 September 2016

¹⁸ (2016) The South China Sea Doesn’t Have to Hurt Businesses, *The Jakarta Post*, 18 August 2016, Available: <http://www.thejakartapost.com/news/2016/08/18/the-south-china-sea-doesn-t-have-hurt-business.html>, Retrieved: 3 September 2016

Table 1: Foreign Direct Investment (FDI) Net Inflows in ASEAN

Partner Country/Region	Share of Total Net Inflows (%)			Year-on- Year Change (%)	
	2013	2014	2015	2013-2014	2014-2015
ASEAN	15.7	17.0	18.5	13.1	0.1
China	5.1	5.4	6.8	8.8	16.7
EU 28	19.6	19.2	16.4	2.0	-21.3
Japan	19.8	12.1	14.5	-36.5	10.8
USA	5.7	11.3	10.2	106.1	-17.3

Source: ASEAN Foreign Direct Investment Statistics Database, 30 June 2016

the group. ASEAN members know they will gain the most if they continue to engage as a partner with a range of major and middle-sized powers, rather than be a mere puppet to anyone.

2.2. ASEAN Integration and Beyond

The AEC blueprint is aimed at increasing the group's competitiveness and integration, and to create stronger resilience amidst global and regional economic turbulence.

ASEAN's economic integration offers companies a chance to benefit from economies of scale, gain access to an expanded single market and production base that allows businesses in the region to gain from the different comparative advantages of various ASEAN economies.¹⁹ The formation of

supply chains across borders and the lowering of trade barriers point to the possibility of intra-ASEAN trade increasing in future; currently estimated at some 23 percent.

Yet while ASEAN seeks economic integration among its 10 members, the group will remain open to others, especially its largest trade and investment partners. Intra-regional agreements are therefore as important as the AEC, and efforts are proceeding in sequence.

Amongst intra-Asian arrangements, RCEP holds the greatest potential. RCEP which consolidates ASEAN's existing FTAs with key economies into one mega trade agreement

¹⁹ Tay, Simon and Kiruppallini, Sivashangari (2015) Moving Ahead with the ASEAN Economic Community: Business Initiatives Across Borders, *SIIA Special Report*, October 2015, Available:

<http://www.siiainline.org/page/PublicationDetails/id/129/ArticleCategoryId/3/#.VyyDN3qHjf0>, Retrieved: 6 September 2016

will bring large income gains of US\$260–644 billion to the world economy in a decade.²⁰

Some commentators suggest that RCEP is an effort led by China, in response to the US-led TPP, discussed earlier. However, it is in fact ASEAN that initiated the negotiations and the group remains at the center of this effort to support the spread of intra-Asian networks.

Looking at the middle term, the AEC and RCEP are building blocks that can work to reinforce one another. Taken together, they have the potential to open up many pockets of untapped markets in ASEAN and the wider Asian region, unlocking potential for even greater investment and consumption-led growth.

2.3. China, Japan and ASEAN Infrastructure

While ASEAN engages all major powers, China and Japan are especially prominent. Sino-Japanese differences relate not only to historic WWII issues and emerge in ongoing economic and commercial rivalry. Infrastructure is the most recent manifestation of Sino-Japanese competition.

Considerable infrastructure gaps remain not only between ASEAN members but within each country. Infrastructural development is therefore vital for ASEAN to give substance to their ambitions for integration and strong reasons for ASEAN to court investments in infrastructure.

On their part, China and Japan are providing these investments not merely for abstract reasons of friendship and prestige. Potentially, the new infrastructural linkages

will allow them to tap on ASEAN resources and production networks, as well as to connect more easily with their new markets.

Yet while there are elements of competition and rivalry, these can be managed and need not always be negative. Consider Myanmar in the lens of China and Japan's interests in infrastructure.

Investments by the China International Trust and Investment Corporation (CITIC) focus on the Kyaukphyu Special Economic Zone (SEZ). Plans for a deep-sea port, an industrial park, and a housing project²¹ add up to a commitment of about US\$ 10 billion by 2025.²² These investments are not only focused on the natural gas resources of the area and other investments intend to achieve strategic goals to link China's western provinces to the coast.

Japanese investments in Myanmar are also considerable, but focused on the Dawei SEZ. Here, the Japanese aim to construct a deep-sea port, petrochemical and heavy industry hub.

This example from Myanmar shows that the presence of China and Japan does not necessarily lead to direct and negative competition. Instead, the injection of fresh capital into infrastructure projects by both China and Japan will potentially allow Myanmar to move ahead more quickly to improve its infrastructure.

²⁰ Wignaraja, Ganeshan (2013) Why the RCEP Matters for Asia and the World, *East Asia Forum*, 15 May 2013, Available: <http://www.eastasiaforum.org/2013/05/15/why-the-rcep-matters-for-asia-and-the-world/>, Retrieved: 3 August 2016

²¹ (2015) CITIC-led Consortium Wins Bid for Implementing SEZ in Myanmar, *China Daily*, 12 December 2015, Available: http://www.chinadaily.com.cn/business/2015-12/31/content_22882073.htm, Retrieved: 4 September 2016

²² Paul, Joshy (2016) Myanmar in China's Push into the Indian Ocean, *Institute for Defence Studies and Analyses*, 14 March 2016, Available: http://www.idsa.in/backgrounder/myanmar-in-chinas-push-into-the-indian-ocean_jmpaul_120316, Retrieved: 22 August 2016

But ASEAN governments must be adroit in handling the attentions from China and Japan which cannot always be guaranteed. China's promotion of its One Belt One Road (OBOR) Initiative²³ emphasises infrastructure to the benefit of all, but the way it has been pursued may in some cases, be felt to be too aggressive or be proposed on terms that are unacceptable, leading to misunderstandings.

The proposed high speed railway for Thailand to the border of Laos and then onwards into China is one example of this. On the surface both governments maintain that Sino-Thai relations continue to be friendly, but a reason for the two year protracted process to reach a consensus on the railway has been the result of misalignments between the two governments as China wanted concessions to the land along the proposed railway.

Presently, Thailand has undertaken to self-finance the railway and therefore will retain full ownership, while the Chinese would be responsible for surveying the project design. The project is moving forward but there are signs that tensions remain on this issue.

Similarly, in Indonesia, China is the chosen partner to build a modern, fast railway between the capital of Jakarta and Bandung, controversially winning preference over a Japanese bid for the project. China had offered better terms for financing and also promised a shorter time to get the project running. Yet the project has been mired in problems.

After the groundbreaking ceremony in January 2016, the landmark scheme came to

²³ This project aims to connect China with Africa and Europe via ports along Southeast Asia and South Asian countries to connect more than 60 emerging markets and a population of over four billion, for a total worth of about US\$21 trillion

a halt after the Chinese²⁴ failed to submit files detailing the development design, technical illustrations, field data and specifications for approval.²⁵ This prolonged the consortium's ability to secure necessary construction permits and skepticism are mounting over its 2019 completion date.²⁶

Controversy also bedevils the China-led Myitsone dam project in Myanmar. Construction of the mega-dam was suspended in 2013 as the dam is expected to bring severe economic and social costs to the Myanmar people living in the area, including displacement, damage to the environment and ecology.²⁷ These complaints are coupled with the one-sided terms of the original agreement, under which at least 90 percent of the generated electricity would go to China.

China has been pushing for the construction of the dam to be restarted and the government has formed a new commission to examine the risks and opportunities.

In addition to the merits of the project itself, there are also geopolitical considerations. The suspension of the dam was seen as a sign that the Myanmar government was turning away from China to seek a closer relationship with the West and popular opinion among the Myanmar people continues to show concerns about ties with China. However, with a long

²⁴ A consortium was formed, PT Kereta Cepat Indonesia China (KCIC), consisting of four Indonesian state-owned enterprises and the China Railway Corporation

²⁵ Zhou, Laura (2016) Xi Urges Widodo to Help Keep Sino-Indonesian Rail Project Rolling, *South China Morning Post*, 3 September 2016, Available:

<http://www.scmp.com/news/china/diplomacy-defence/article/2013190/xi-urges-widodo-help-keep-sino-indonesian-rail-project>, Retrieved: 5 September 2016

²⁶ Ibid

²⁷ Ramachandran, Sudha (2016) Will Myanmar's New Govt Scrap Myitsone Project?, *Asia Times*, 16 March 2016, Available: <http://atimes.com/2016/03/will-myanmars-new-govt-scrap-myitsone-project/>, Retrieved: 4 September 2016

shared border, both governments have a vested interest to get along on various issues, both economically and politically.

Sino-ASEAN relations have many layers of intersecting interests and are necessarily complex. The OBOR initiative from China to assist with and fund infrastructure and connectivity with ASEAN adds further complexity and concerns that Beijing will dominate and dictate terms to its neighbours.

Today, different ASEAN countries are reacting to such concerns in different ways and degrees. Looking ahead, what will then determine the stability of the region and bolster ASEAN will be the group's ability to find a more cohesive and coordinated way to work with China. This can help ensure that assistance for infrastructure fits well with plans made by ASEAN for itself, rather than being dictated by China or other donors.

3. OPPORTUNITIES AND REFORMS

In addition to the global and regional trends that influence ASEAN, there are more bottom-up factors that bear examination. Notwithstanding the diversity among the 10 members of the group, there are similar patterns that can be seen across the region. This next section of the Report will briefly survey reforms in economic policies and systems of governance as well as the rise of populist politics and protectionist-nationalist sentiments.

3.1. Reforms and Opportunities

There is a wave of reforms happening on the national level in ASEAN as countries compete to attract quality FDIs and sustain their economic growth amidst poor global conditions. Reforms seek to make the countries more efficient, transparent and competitive to attract FDIs. At the same time,

in attracting high-quality FDIs, ASEAN governments are emphasizing higher calibre and responsible investors who will help create more and better-paying jobs for their citizens, while avoiding adverse human and environmental abuses.

As they move to implement reforms and become more open to foreign investments and trade, ASEAN governments also have to manage a balancing act with domestic industries and key stakeholder interests which have been historically protected. Other key factors to note will be the transparency, legitimacy, capability of governance, as well as the introduction of more credible legal systems.

ASEAN is moving ahead with reforms on a tide of renewed interest and confidence. In recent years, overall FDIs into key ASEAN economies like Singapore, Indonesia, Malaysia, the Philippines, Thailand and Vietnam – have been increasing. The 2014 figure of US\$128 billion surpassed the US\$119.56 billion which flowed into China.²⁸

Although key ASEAN economies have piqued investor confidence, ASEAN leaders are also aware that they cannot afford to be complacent. In an attempt to retain investor confidence amid the recent commodity slump, Indonesia is “transforming its economy from a commodity-based economy to a more manufacturing and services based economy.”²⁹

²⁸ Owen, Nicholas (2016) Southeast Asia Attracts More Foreign Investment than China for Second Year, *Reuter*, 16 March 2016, Available: <http://www.reuters.com/article/southeast-asia-investment-idUSL4N0WE1Q620150316>, Retrieved: 4 September 2016

²⁹ Interview with Dr. Bambang Permadi Soemantri Brodjonegoro, Minister for National Development Planning (Bappenas), Republic of Indonesia

As the country restructures its economy, it presents new opportunities in a variety of sectors for potential investors. Last year, President Joko Widodo (popularly known as Jokowi) rolled out 12 economic reform packages aimed at stimulating economic growth and attracting fresh investments into Indonesia. This was followed by an announcement of his 'big bang' plan earlier this year to reduce restrictions on foreign investment in 49 sectors – ranging from fishery, healthcare, transport and retail, representing the country's largest opening to international investment in 10 years.³⁰

The announcement was also targeted at encouraging competition in an economy dominated by powerful vested interests.³¹ Such efforts towards economic deregulation signals Indonesia's commitment towards market friendly reforms, encouraging foreign ownership in key sectors earmarked for development.

Jakarta based officials have also highlighted that the Jokowi administration will maintain this momentum and continue to introduce progressive economic reforms aimed at driving Indonesia's industrialisation and innovation agenda forward.

After the July cabinet reshuffle, President Jokowi now has the majority support in Parliament for the first time since taking office in 2014. His political position is now stronger than ever, allowing him to move ahead with his reform agenda aimed at job

creation and a more inclusive Indonesian society.

Thailand is another key ASEAN state which is introducing forward-looking reforms aimed at transforming the country's economy into a value-based economy. Under Prime Minister Prayut Chan-o-cha, Thailand has introduced a new economic model for Thailand known as Thailand 4.0. It will focus more on research and development, and innovation-led growth with the primary aim to move the country out from the middle-income trap.

Previously, Thailand 1.0 was used to describe the period when agriculture was the major economic driver while 2.0 focused on light industries and Thailand 3.0 relied on heavy industries and exports.³² A key focus of Thailand 4.0 will be on reforming the country's vast agricultural sector by embarking on 'smart farming' to empower farmers to be 'entrepreneurs' instead of being subjected to the volatility of the weather and often unfair terms dictated by the middleman. In the long run, farmers will be able to move up the value chain and receive a larger portion of the overall market share.

In implementing this new economic model, the Thai government nonetheless faces the risk that farmers who are unable to quickly and successfully adapt to Thailand's economic restructuring might find themselves being squeezed out of the industry. About a third of Thailand's 70 million people are linked to the agricultural sector, a powerful voter base, which explains why successive governments have been

³⁰ (2016) Indonesia Plans 'Big Bang' to Woo Foreign Investments, *The Straits Times*, 11 February 2016, Available: <http://www.straitstimes.com/asia/seasia/indonesia-plans-big-bang-to-woo-foreigninvestments>, Retrieved: 15 August 2016.

³¹ Ibid

³² Yoon, Suthichai (2016) Thailand 4.0: Will it Move the Country Out of its 'Lost Decade,' *The Nation*, 26 May 2016, Available: <http://www.nationmultimedia.com/opinion/Thailand-4-0-Will-it-move-the-country-out-of-its-l-30286689.html>, Retrieved: 4 September 2016

reluctant to push ahead with radical changes on agriculture.³³ As such, Prayut Chan-o-cha's attempt to reform the agriculture sector signals the political will to introduce painful reforms that will ensure different segments of society to benefit from Thailand moving up the value chain.

3.2. Cleaning Up Governance

More governments are seeking to improve transparency and increase competitiveness to attract high quality FDIs through better governance and transparency. They are also making efforts to improve the rule of law by tackling corruption.

Corruption remains a problem in the region. Transparency International's 2015 Corruption Perceptions Index shows Southeast Asia countries to score only an average of 38 out of 100 (where 100 is very clean and 0 is highly corrupt). A survey conducted by the EU-ASEAN Business Council further reveals that 44 percent of European businesses in the region report "facing unfair competition from local and regional incumbents, including state-owned and government-linked enterprises."³⁴

Overall perception of corruption in the region is improving but remains a concern for foreign investors looking to do business in ASEAN.³⁵ The prevalence of corruption leads

to the impression of the region as a complex and costly location to invest and set up business in and hurts the region's investment prospects. There is also a sense that corruption partly exists because there remain investors who use it as a tool to complete business processes faster.³⁶

Only Singapore is an exception, ranking as the 8th least corrupt nation in the world in the latest Corruption Perceptions Index.³⁷ The efforts Singapore has made nationally are reinforced by laws that make it punishable if a Singaporean person or corporate entity were to engage in corrupt practices even abroad.

Other countries lag considerably behind but are making efforts that seem to be improving matters. Take Thailand for example; while corruption remains a problem, steps are being taken and in 2016, anti-graft organizations have found that Thailand's transparency standing to be at its best in a decade.³⁸

One area of concern for foreign companies emerges from the lack of transparency when submitting government tenders. This was addressed by new provisions when the Public Sector Anti-Corruption Commission in Thailand set up a 24-hour hotline for foreign investors to seek recourse in the event they

³³ Lopez, Leslie (2016) Thai military plans three-pronged economic overhaul, *The Strait Times*, 9 September 2016, Available: <http://www.straitstimes.com/asia/se-asia/thai-military-plans-three-pronged-economic-overhaul>, Retrieved: 14 September 2016

³⁴ (2016) Survey: EU Businesses Planning to Expand in ASEAN, *Manila Bulletin*, 1 September 2016, Available: <http://www.mb.com.ph/survey-eu-businesses-planning-to-expand-in-asean/>, Retrieved: 3 September 2016

³⁵ Interview with Emil Akander, Swedish Trade Commissioner to Singapore

³⁶ SIIA 9th ASEAN Asia Forum (2016) Panel 2: Indonesia, ASEAN and other Opportunities, Panelist: Dr. Lili Yan Ing, Economist, Economic Research Institute for ASEAN and East Asia (ERIA); and Senior Advisor on Trade and Investment, Executive Office of the President, Republic of Indonesia

³⁷ Tham, Raymond Mark (2016) Singapore is 8th Least Corrupt Nation in the World: Index, *Today Online*, 28 January 2016, Available: <http://www.todayonline.com/singapore/singapore-8th-least-corrupt-nation-world-index>, Retrieved: 13 September 2016

³⁸ (2016) Corruption Still a Big Issue for the Government in Thailand: Survey, *The Nation*, 2 July 2016, Available: <http://www.asianews.network/content/corruption-still-big-issue-government-thailand-survey-21492>, Retrieved: 2 September 2016

encounter corrupt officials accepting bribes. In the past, it could last up to two years without going to the criminal process, but with the establishment of the Commission, the process is expected to be reduced to a maximum of 180 days.³⁹

Indonesia too is making efforts to improve efforts in anti-corruption. The Corruption Eradication Commission (KPK) has emerged as a legitimate and independent force in the complex politics of Indonesia, gaining popular support for efforts to root out corrupt officials and elites.

The KPK's success in seizing more than Rp 250 billion (US\$19.23 million) worth of assets from graft convict Fuad Amin, a politician from the Great Indonesia Movement Party (Gerindra) who served as regent of Bangkalan⁴⁰ between 2003 and 2013, shows its seriousness and commitment in tackling corruption.

In Myanmar, the anti-corruption effort is being led by the new National League for Democracy (NLD) government. Reports are that the newly appointed Members of Parliament and political office holders have been closely screened for any corruption concerns and have been warned by the party's senior leadership to avoid overly close contact with corrupt business elites.

Yet, another area that ASEAN countries will require improvement is the process to protect foreign investors when they have disputes with government agencies. Clearer dispute-

settlement mechanisms can lead to more transparent investor-state relations.

For example, foreign investors have been hesitant to invest or expand in Indonesia due to a lack of confidence in the country's legal system. Many feel that seeking arbitration in Indonesia is a very complicated, tedious and time-consuming process. Yet recourse to other forms of dispute settlement are neither easy nor accepted by all.

As of 2012, foreign investors have been limited to use the International Convention on the Settlement of Investment Disputes (ICSID), an international dispute mechanism only when the central government is at fault, not the local governments. This leaves investors without legal recourse whenever there are disputes concerning local governments who may be more directly and proximately be involved, given the decentralisation across the archipelago.

Recognising this problem, President Jokowi has instructed the newly-appointed Coordinating Minister for Political, Legal, and Security Affairs, Wiranto, to carry out legal reform of national and local legislation. These are however early days and any progress of this reform will need to be monitored.

As ASEAN countries work towards a cleaner system of governance to attract quality foreign investments, businesses should also play a supporting role to extract higher standards of transparency and accountability from the local governments. New technologies aided by the rising internet penetration rates and the government's drive for digitalisation of services will further allow businesses to play a supporting role in driving transparency and challenging traditional practices such as in submission of

³⁹ Thamnukasetchai, Piyanuch (2016) Bribery Hotline for Foreign Investors, *The Nation*, 22 November 2015, Available: <http://www.nationmultimedia.com/national/Bribery-hotline-for-foreign-investors-30273474.html>, Retrieved: 14 September 2016

⁴⁰ A regency of the East Java province in Indonesia

government tenders to create more transparent systems and processes.⁴¹ This will go a long way to strengthen national institutions within respective countries to provide for fair competition and increase ease for doing business.

3.3. Populism and Protectionism

The growing wealth disparity between the rich and the poor in ASEAN is ushering in a new generation of populist pressures in almost all countries. Systems with democratic, mass voting are visibly leaning in this direction as seen in Myanmar, Indonesia and the Philippines. Yet similar popular pressures are felt even in more autocratic systems.

New demands are placed on ASEAN governments not only to continue growth but to ensure that benefits are more widely shared. Creating more and better paying jobs is one of the highest priorities for governments across ASEAN.

The popular mandate is a double-edged sword in respect of reforms and economic opening. On one hand, this can facilitate new efforts to push against the privileges and protectionist measures that have benefited established elites. The mandate also means that the governments are held to higher standards of transparency and accountability and must address inefficiencies and corrupt, rent-seeking behaviour among bureaucrats. But populist pressures also mean that reforms and FDIs must be seen as benefiting the masses. The scrutiny on FDIs will be increased to consider the quality and quantity of jobs created, profits retained

within the country as well as corporate social responsibility especially for environmental and community concerns.

For example, President Jokowi has set the ambitious goal to achieve a seven percent growth rate for Indonesia, and to create 2.5 million jobs by the end of his first term in 2019. Such emphasis stems from his electoral campaign and background as the 'people's president' and the first from outside the Jakarta elite to hold the highest office in the land.

After initial concerns, President Jokowi's political base and credibility have visibly strengthened over the last year, both among the public and in Parliament. However, there remain challenges to push through with economic reforms towards a more open economy. Powerful elites from the old system are trying to retain preferential and protectionist measures that favour them.⁴² Frequently, they use 'nationalism' as an excuse against reform.⁴³ This is not helped by problems of inefficiency, ineffectiveness and corruption within a bloated bureaucracy.

Similar efforts and obstacles can be seen in Myanmar in the wake of the NLD's sweeping victory in the 2015 elections. Winning an overwhelming majority of almost 80 percent of the votes has led to sky-high expectations. Concerns and criticisms from local and foreign investors alike are growing that the new government has been too slow in coming up with a detailed economic plan.

⁴² The Jakarta Post-PECC Conference "Global Challenges and Regional Solutions" The Next Phase of Regional Cooperation: Engaging Stakeholders", 25 April 2016, Jakarta.

⁴³ Castle, James (2016) A Foreign Investor's View: Will Indonesia's Economy Recover?, *Australian-Indonesia Centre*, 10 January 2016, Available: <http://australiaindonesiacentre.org/a-foreign-investors-view-will-indonesias-economy-recover/> Retrieved: 3 September 2016

⁴¹ Interview with Sam Saba, Head of South East Asia and Oceania, Ericsson

In part, this is due to a shift in focus by the new government. The NLD and Daw Aung San Suu Kyi have clearly given priority to the difficult task of national reconciliation with the different ethnic groups. In this sense, it would be premature to assess the new government's economic agenda when the administration's priority is to ensure the continuity of the peace process.

After decades under a succession of military and military-backed governments, a balance between change and continuity, between new leaders and old elites will need to be negotiated. But the trend is towards more populist policies given the strong mandate from the masses. With regard to FDIs, the early signals suggest that policy makers will prefer responsible foreign investors who have a good record in creating more jobs while minimising environmental and social concerns.⁴⁴

3.4. Making Economic Nationalism Work

Governments in ASEAN are faced with the challenge to reform at a pace that is fast enough to ensure economic growth, while allowing domestic businesses a chance to adapt and compete. From the perspective of established elites, some may choose to try to defend their privileges and stymie reform.

There is an internal debate or even 'war' against reforms and Indonesia's state owned enterprises (SOEs) exemplify this. These SOEs represent one-fifth of the country's economy and hold assets amounting to more than US\$250 billion. While some are competitive globally and regionally, others are inefficient

and often perceived as fiefdoms to serve the interests of elites and high-ranking bureaucrats. Considerable resistance to reforms proposed by the Jokowi administration has therefore come from the SOEs.

They argue for the need for 'national champions' and the national control and planning of the economy rather than a more open, market-based system. Even if their interests are personal and corrupt, they dress their cause in the words of nationalism and the colours of the flag.

SOEs are not the only industry players resisting economic reforms. SMEs in ASEAN tend to be localised and depend more on domestic demand than exports. SMEs therefore fear that as ASEAN leaders reform and open up their borders, they might be unable to compete and be squeezed out of the industry.

In ASEAN, SMEs make up a significant proportion of all enterprises at 96 per cent and employ 52–97 per cent of all workers.⁴⁵ As such, they are the backbone of the ASEAN economy and ASEAN leaders need to find a balance between economic deregulation and protecting their local industries.

Resistance is also voiced in the name of the ordinary citizens and community groups. In Thailand, a large number of rural farmers are growing discontented with the lack of economic progress in the country and this has pressured the military-led government to implement more populist economic policies.

⁴⁴ Tay, Simon and Au, Melody (2016) Myanmar's Missteps or New Directions, *The Jakarta Post*, 27 July 2016, Available: <http://www.thejakartapost.com/academia/2016/07/27/myanmar-s-missteps-or-new-directions.html>, Retrieved: 3 September 2016

⁴⁵ Ong, Keng Yong and Gonzales Vineles (2016) What ASEAN's enterprises need to succeed, *East Asia Forum*, 19 August 2016, Available: <http://www.eastasiaforum.org/2016/08/19/what-aseans-enterprises-need-to-succeed/>, Retrieved: 4 September 2016

These include a promise to raise minimum daily for workers to tackle rising costs of living. Such a move would increase costs for producers and employers. Moreover, as government social safety nets may increase, this will in effect shift a considerable part of the social burden from the state to the private sector.⁴⁶

Such protectionist-nationalist sentiments cause frustrations, delays, and higher costs for foreign investors. The perception is that governments across ASEAN are tilting towards such protectionist tendencies.

Less visible are the reforms that ASEAN governments are making to bring in the right quality investors. It is often the case in the present climate that reforms are undertaken and the underlying openness to FDIs is tacit, and in parallel with more visible and noisy 'flag waving'. The tensions between the two tendencies has led to a preference for higher-quality FDIs that is demonstrably able to help the country and generate value in the domestic economy to citizens as workers, local partners and include local SMEs in their production processes and networks.

Looking at Myanmar for instance, the new government has been criticised for their slow opening of the economy. But as a frontier market, Myanmar has many hurdles to cross before it is ready to receive and compete alongside foreign companies. As U Aung Naing Oo, Secretary from the Myanmar Investment Commission (MIC), a government entity which approves foreign investments entering Myanmar, succinctly summarizes his

country's stance on protectionism. He explains, "Many are speculating about the future...since we still have yet to allow foreigners to export directly, they claim we are still protectionist but it is not like that. We've just opened the doors to the country so we have to proceed phase by phase while balancing between protecting SMEs and allowing international investment for the growth of the nation."⁴⁷

Given the political climate then, investors should not expect governments in ASEAN to start implementing policies that privilege FDIs above local economic players in all sectors. Instead, foreign investors would be advised to better understand the government strategies and identify areas where they can add value visibly beyond what local entities can provide. In some cases, the government will have earmarked specific sectors for FDI participation and will push through reforms to open up these specific sectors to foreign participation, ahead of other parts of the economy.

CONCLUSION: COLLABORATING TOWARDS A MORE PROMISING ASEAN

At the recent ASEAN Summit, Laotian Prime Minister Thongloun Sisoulith highlighted that ASEAN should "continue improving its regulatory frameworks, mechanisms and procedures in order to enhance the business environment and turn ASEAN into a preferred global investment destination."⁴⁸

⁴⁶Leeahtam, Pisit (2011) Thailand's Economy Vulnerable to Populist Politics, *East Asia Forum*, 8 August 2011, Available: <http://www.eastasiaforum.org/2011/08/08/thailands-economy-vulnerable-to-populist-politics/>. Retrieved: 4 September 2016

⁴⁷Phochan (2015) Investors Warn of Myanmar Challenges, *Eleven Myanmar*, 17 September 2015, Available: <http://www.elevenmyanmar.com/business/investors-warn-myanmar-challenges>. Retrieved: 4 September 2016

⁴⁸ (2016) PM Proposes Seven Point Agenda to Pursue ASEAN Economic Goals, *Vientiane Times*, 16 August 2016, Available: www.vientianetimes.org.la/Video_FileVDO/Aug16_PM_proposes.htm, Retrieved: 4 September 2016

More than ever, the political will to transform ASEAN into a competitive economic bloc is on the rise. ASEAN is entering a new chapter in history. Taken together, the 10 economies are already significant in size and predictions for their future growth are promising. Moreover, emerging signs suggest that key ASEAN economies are beginning to show more ambition for reform than at any time in recent years. Such reforms will not happen overnight. But the changes promised can alter the business and investment climate so that competitiveness grows exponentially for ASEAN as a whole and for the companies that can adapt.

European businesses will need to start developing their understanding and presence in ASEAN or risk being side-lined in the region. If they deepen engagement, European businesses have much to offer their counterparts in ASEAN. Many Europeans are ahead of their ASEAN counterparts on issues like innovation, implementation of anti-corruption mechanisms and corporate social responsibility measures.⁴⁹ Major European companies have also found ways to compete on a global playing field and in a number of sectors continue to hold their own, and provide alternatives to counterparts from the USA and Japan, as well as China.⁵⁰

There are good reasons for European business to continue to be an important participant in ASEAN's new economic story. However, there is a sense that businesses from the EU are hesitant to enter the market

due to the perceived complexities and risks in the region.

It is here that Singapore can play a complementary role to advance European business interests in ASEAN. European businesses should capitalise on Singapore's networks with the rest of the region to guide them through ASEAN's complex investment landscape.

This is already in motion through the recently opened Enterprise Europe Network Singapore Business Cooperation Centre which will provide a network of 600 partner organization across 63 countries, to partner with Singapore SMEs looking for business partners across Europe.⁵¹ As such the republic is well poised to support European businesses to look for partners in the region by using Singapore as a launching pad when investing in ASEAN.

European businesses could use Singapore as a platform to forge formal and informal business-to-business relationships and cooperate with local companies through mutually beneficial partnerships. Investors who enter ASEAN earlier rather than later can pre-emptively establish partnerships and production networks across the region, thereby gaining a first-mover advantage.

⁴⁹ Interview with Jan B. Djerf, General Manager, Head of South Asia/Pacific, Handelsbanken

⁵⁰ Interview with Ambassador Håkan Jevrell, Swedish Ambassador to Singapore

⁵¹ Pulch, Michael (2016) Helping SMEs strengthen S'pore-EU business ties, *Today Online*, 15 June 2016, Available: <http://www.todayonline.com/commentary/helping-smes-strengthen-spore-eu-business-ties>, Retrieved: 15 September 2016

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