GLOBAL OPPORTUNITY INDEX 2022

Focus on Emerging Southeast Asia

Oscar Contreras, PhD, Joseph Bendix, and Benjamin Smith

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Executive Summary

This report uses the 2022 Global Opportunity Index (GOI) and its various categories to examine the attractiveness of emerging Southeast Asia as a foreign investment destination—especially when compared to other emerging markets and developing economies (EMDE). It also offers an in-depth look at the region's recent experience with private capital flows (emphasizing their composition and evolution over the past decade), explores cross-border M&A activity, and discusses domestic companies' participation in local capital markets.

By offering a broad outlook on the region's investment landscape, the report illuminates some of its relative strengths and weaknesses, thereby helping businesses make investment decisions and governments identify policies geared towards attracting foreign capital.

The report shows that when it comes to attracting foreign investors, emerging Southeast Asia compares well with other emerging markets and developing economies in the following two categories:

- **Economic Fundamentals**—especially **Economic Performance**, which accounts for a country's macroeconomic outlook, and **Workforce Talent**, which captures the quality and diversity of the labor force.
- **International Standards & Policy**—most notably **Economic Openness**, which measures a country's integration with the global economy.

However, the region underperforms other emerging markets and developing economies in the category of **Institutional Framework**—especially in **Transparency**, which measures both the availability of timely and accurate information about government policies and regulations and the strength of domestic auditing and reporting standards.

The analysis also illustrates that emerging Southeast Asia has a mixed performance in two crucial categories, scoring slightly better than its peers but showing significant differences among the region's economies:

- **Business Perception**, which measures major constraints faced by businesses and the quality of recovery and dispute-resolution mechanisms.
- **Financial Services**, which accounts for the depth and breadth of a country's financial sector.

Overall, the analysis indicates that emerging Southeast Asia is well positioned to attract foreign investors and—over the longer term—become an even bigger player among emerging markets and developing economies. However, to capitalize on these trends and stay competitive against other regions, policymakers in emerging Southeast Asia must take action to address some of the region's weaknesses.

Our report offers three policy recommendations.

1. **Better Institutional Frameworks.** Most governments in emerging Southeast Asia must take concrete measures to strengthen their institutional frameworks—particularly as they relate to corporate and government transparency. By enhancing the accountability of both private and public sectors, greater transparency would not only increase the region's attractiveness to foreign investors but also generate a more favorable business environment.

2. **Deeper Regional Integration**. Despite significant developments, economic integration among emerging Southeast Asian countries remains a work in progress. To achieve the goals of unifying the region's production base and becoming a globally competitive single market, further efforts are needed to liberalize trade in services, eliminate nontariff trade barriers, harmonize regulations, and increase capital mobility within the region. As emerging Southeast Asia becomes more fully integrated, foreign investors will be able to coordinate production processes better within the region and take advantage of each country's unique resources and opportunities.

3. **Maximize Social Impact.** Perhaps the region's biggest challenge is to increase the social impact of foreign capital. The region's success at attracting international investors has not benefited all its citizens uniformly, and emerging Southeast Asia is host to some of the most unequal countries in Asia. Governments must take a more proactive approach toward leveraging global capital flows to advance the region's development agenda, thereby delivering inclusive and sustainable growth across all segments of the population.

Introduction

Access to foreign capital is essential for emerging economies, and emerging Southeast Asia is no exception. When accompanied by sound domestic policies, foreign investment can help create jobs, trigger human capital formation, and bring new technologies and managerial practices. It can also contribute to international trade integration, foster innovation among local firms, and encourage a more competitive business environment. Moreover, in the current context, global capital inflows could play a vital role in supporting the region's economic recovery from the coronavirus pandemic.

Fortunately, the ability of emerging Southeast Asia to attract foreign investors has improved over time, turning the region into an increasingly important player among emerging markets and developing economies (EMDE). Between 2011 and 2015, inflows to the region accounted for about 9 percent of total capital flows directed to these economies. But that figure increased to about 11 percent during the 2016–2020 period. The region gained market share mainly from Latin America, whose fraction of EMDE capital inflows fell from 30 percent in 2011–2015 to about 22 percent in 2016–2020.

Despite its successful record, the region's attractiveness to international investors should not be taken for granted. To stay competitive against other emerging markets and developing economies, policymakers in emerging Southeast Asia must identify new areas of opportunity and undertake the appropriate policy reforms, thereby mitigating risks that could negatively affect foreign investors' confidence in the region.

This report uses the 2022 Global Opportunity Index to examine the attractiveness of emerging Southeast Asia as a foreign investment destination, especially when compared with other emerging markets and developing economies. By offering a broad outlook of a country's investment landscape, the Global Opportunity Index is designed to help businesses make investment decisions and governments identify policies geared towards attracting foreign capital. The Index is based on a combination of 100 variables organized around five broad categories—each one capturing a different aspect of the country's investment climate: Business Perception, Economic Fundamentals, Financial Services, Institutional Framework, and International Standards & Policy.[1]

Beyond exploring emerging Southeast Asia's attractiveness to foreign investors, the report also offers an in-depth look at the region's recent experience with private capital flows, explores cross-border M&A activity, and discusses domestic companies' participation in local capital markets.

The analysis indicates that emerging Southeast Asia performs well in two categories compared with other emerging markets and developing economies. The first is **Economic Fundamentals**—especially **Economic Performance**, which accounts for a country's macroeconomic outlook, and **Workforce Talent**, which captures the quality and diversity of the labor force. The second category is **International Standards and Policy**—most notably **Economic Openness**, which measures a country's integration with the global economy. The overall performance in these areas is encouraging for emerging Southeast Asia, as it reflects the success of various initiatives undertaken by governments across the region over recent decades.

By contrast, the region underperforms versus other emerging markets and developing economies in the category of **Institutional Framework**—especially **Transparency**, which measures both the availability of timely and accurate information about government policies and regulations, and the strength of domestic auditing and reporting standards. This is problematic for potential foreign investors, as it indicates that countries in the region have institutions that struggle with lack of clarity, unaccountability, and potential conflicts of interest.

Moreover, the analysis illustrates that emerging Southeast Asia has a mixed performance in two crucial areas, scoring slightly better than its peers but showing significant differences among the region's economies. The first area is **Business Perception**, which measures major constraints businesses face and the quality of recovery and dispute-resolution mechanisms. The second is **Financial Services**, which accounts for the depth and breadth of a country's financial sector.

The report also discusses recent developments in the region's capital markets. First, domestic capital markets in emerging Southeast Asia have grown (relative to the banking sector) and have become more developed. Second, the region's growing middle class and rising purchasing power have bolstered equity issuance, especially in the consumer products sector. Finally, debt financing has outpaced equity financing by a factor of four over the past decade, largely driven by government and agency bonds.

Overall, the report highlights that emerging Southeast Asia remains highly diverse despite increased economic integration. International investors must be aware of local conditions and avoid relying on a one-size-fits-all approach across the region. When considering investing in emerging Southeast Asia, foreign investors must carefully analyze each country's unique characteristics and determine how well these characteristics fit into their overall business strategies.

Despite this diversity, the report also indicates that most of the region's economies would greatly benefit from taking concrete measures to strengthen their institutional frameworks—particularly as they relate to corporate and government transparency. Countries in the region must take tangible steps to enhance investors' access to timely and accurate information about government policies and regulations (including how they are developed, implemented, evaluated, and, ultimately, modified over time). On the corporate front, governments must also improve access to financial and other business information about local firms, which requires strengthening domestic auditing and reporting standards and practices.

Finally, beyond attracting and retaining foreign capital, governments in emerging Southeast Asia must also ensure that the related benefits are distributed fairly across the population. While some policies have already been implemented, governments must take further action to increase the social impact of global capital inflows, thereby ensuring that they contribute to broad-based, sustainable, and inclusive growth within the region.

Emerging Southeast Asia Performance in GOI 2022

Figure 1 shows the ranking of the seven emerging Southeast Asian countries in the 2022 Global Opportunity Index. With more than 70 positions separating the best- and worst-ranked countries, the Index indicates that emerging Southeast Asia is highly diverse, offering foreign investors a wide range of opportunities.

We can identify the key differences among countries from the region by analyzing the Index's five constituent categories and 14 subcategories:

- **Business Perception** measures the constraints facing businesses and the ease for businesses to resolve disputes.
  - Recovery & Resolution Process
  - Business Constraint
- **Economic Fundamentals** captures a country's macroeconomic outlook, workforce talent, and potential for future innovation and development.
  - Future Environment of Growth
  - Economic Performance
  - Workforce Talent
- **Financial Services** measures the depth and breadth of a country's access to financial services.
  - Financial Access
  - Financial Size & Condition
- **Institutional Framework** captures the extent to which a country's institutions help or hinder business activity.
  - Transparency
  - Innovation
  - Investors' Rights
  - Public Governance

- **International Standards & Policy** measures how integrated a country is within the international community and the likelihood they will conform to international standards.
    - Economic Openness
    - Tax & Regulation
    - Patent & Trademark

Figure 1: GOI 2022 Ranking: Emerging Southeast Asia

	Business Perception	Economic Fundamentals	Financial Services	Institutional Framework	International Standards & Policy	Total Index Ranking
Cambodia	113	62	90	99	81	95
Indonesia	53	36	78	54	69	57
Lao PDR	104	100	97	104	84	98
Malaysia	25	34	24	21	46	25
Philippines	82	77	95	95	67	83
Thailand	19	19	31	46	68	34
Vietnam	73	24	72	91	79	67

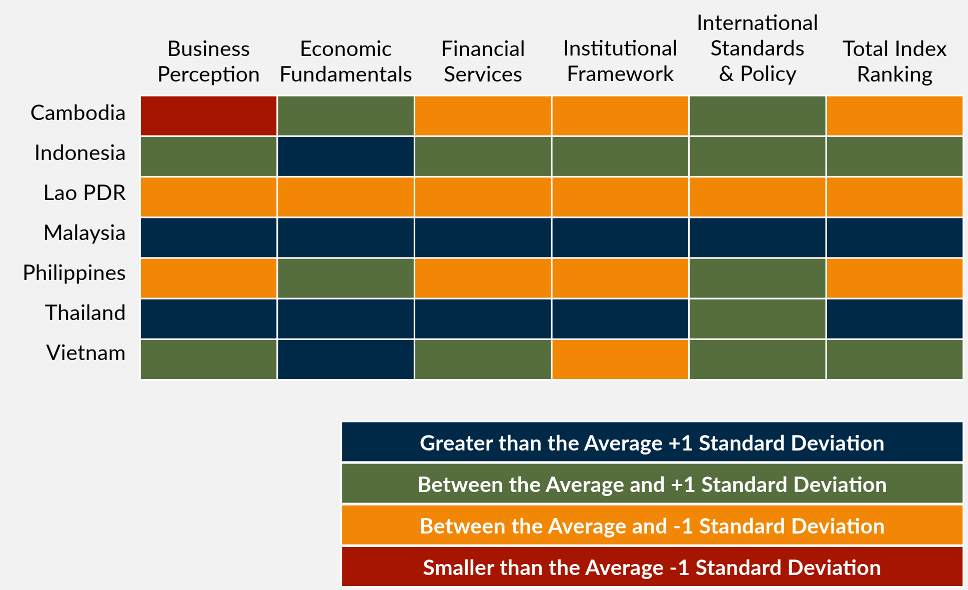
Color Key	<30	31-60	61-90	91-120	120+

Source: *Milken Institute (2022)*

COMPARISON WITH EMDE BENCHMARK GROUP

For better assessment of the attractiveness of emerging Southeast Asia, it is helpful to compare its performance with a benchmark group. We use countries classified as Emerging Market and Developing Economies (EMDE) by the International Monetary Fund as this benchmark. The similarities in development indicators establish a fair baseline for comparison.

Figure 2. Comparing Emerging Southeast Asian Countries with EMDE Benchmark

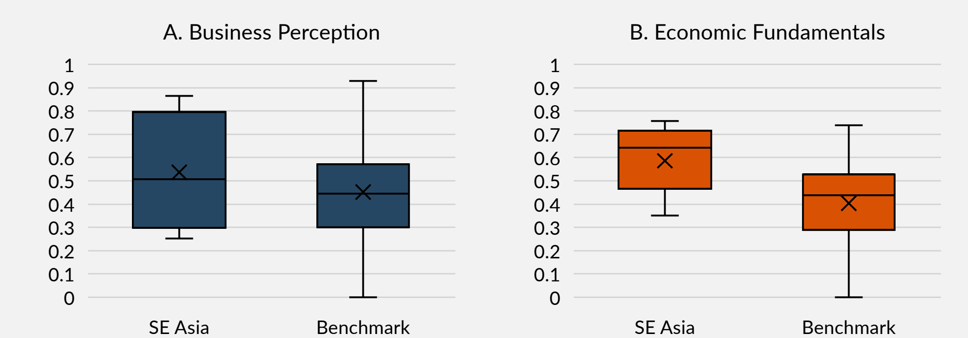


Note: *Values are compared against the mean value of the 84 countries included in the EMDE benchmark group.*

Source: *Milken Institute (2022)*

Figure 2 shows that Malaysia and Thailand are the two strongest countries in the region, significantly outperforming the average EMDE score. The remaining five countries are comparable to the average EMDE score, with Cambodia and Laos being the two weakest performing countries.

Figure 3. Emerging Southeast Asia vs. EMDE Benchmark, Category Level



Note: *The figure shows boxplots for each category of the Index and group of countries. Each boxplot displays the upper and lower quartiles of the distribution (upper and lower edges of the box), the median (denoted by the horizontal line inside the box), the mean (represented by the "X" marker), and the maximum and minimum values (whiskers) excluding outliers. See the appendix for a list of countries classified as EMDE.*

Source: *Milken Institute (2022)*

Figure 3 shows that the emerging Southeast Asia region is more heterogeneous than the benchmark EMDE group. But despite this heterogeneity, the region performs better than the EMDE group in total index ranking. At the category level, emerging Southeast Asia fares better than the EMDE group in Business Perception, Economic Fundamentals, Financial Services, and International Standards & Policy. The region underperforms the benchmark only in Institutional Framework.

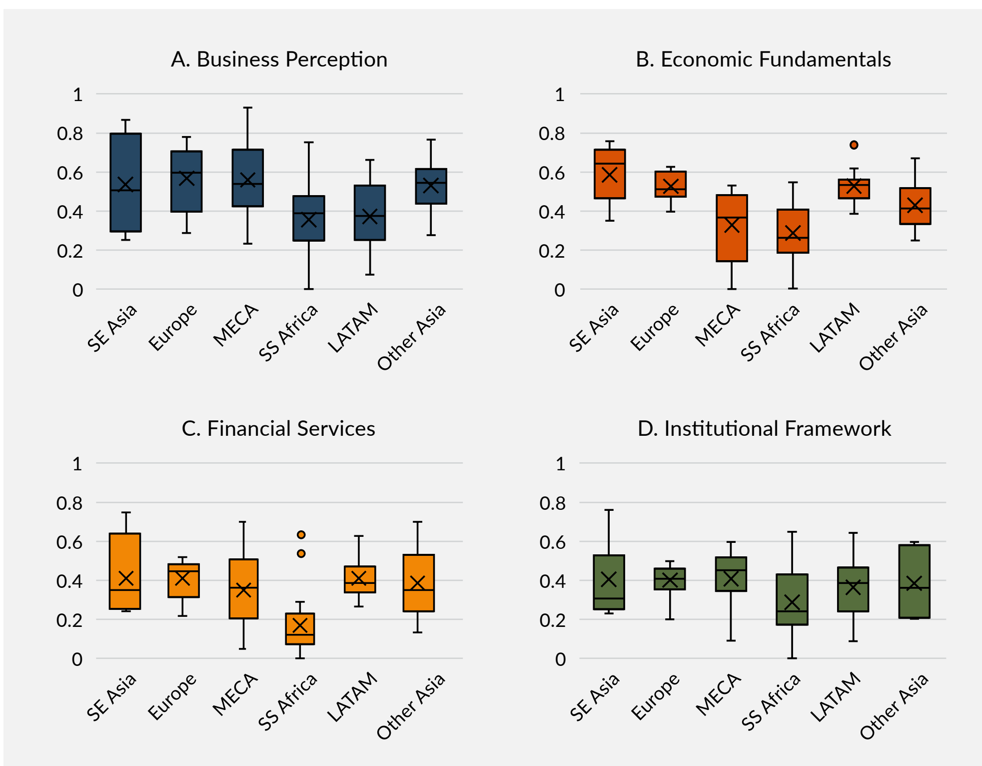
REGIONAL COMPARISON

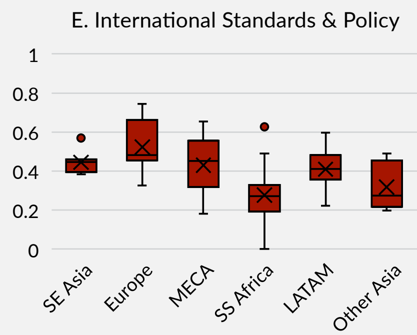
Disaggregating the EMDE benchmark group by geographic region shows that emerging Southeast Asia is a promising market for foreign investors (see Figure 4). The region performs better than the Middle East and Central Asia, Sub-Saharan Africa, Latin America and the Caribbean, and Other Emerging and Developing Asia. And it scores lower only than Emerging and Developing Europe.

At the category level, emerging Southeast Asia is the best-performing region in Economic Fundamentals. It is also strong in International Standards & Policy, scoring higher than all the other regions excluding Emerging and Developing Europe and the Middle East and Central Asia.

The emerging Southeast Asia region underperforms in Institutional Framework, with only emerging countries from Sub-Saharan Africa scoring worse. The region has a mixed performance in Business Perception and Financial Services, showing a high variance in both categories. Therefore, countries from the region that perform well in both areas can significantly differentiate themselves from their neighbors.

Figure 4. Emerging Southeast Asia vs. EMDE Regional Groupings, Category Level





SE Asia = Emerging and Developing Southeast Asia
Europe = Emerging and Developing Europe
MECA = Middle East and Central Asia
SS Africa = Sub-Saharan Africa
LATAM = Latin America and the Caribbean
Other Asia = Other Emerging and Developing Asia

Note: *The figure shows boxplots for each category of the Index and group of countries. Each boxplot displays the upper and lower quartiles of the distribution (upper and lower edges of the box), the median (denoted by the horizontal line inside the box), the mean (represented by the "X" marker), and the maximum and minimum values (whiskers) excluding outliers. See the appendix for a list of countries classified as EMDE.*

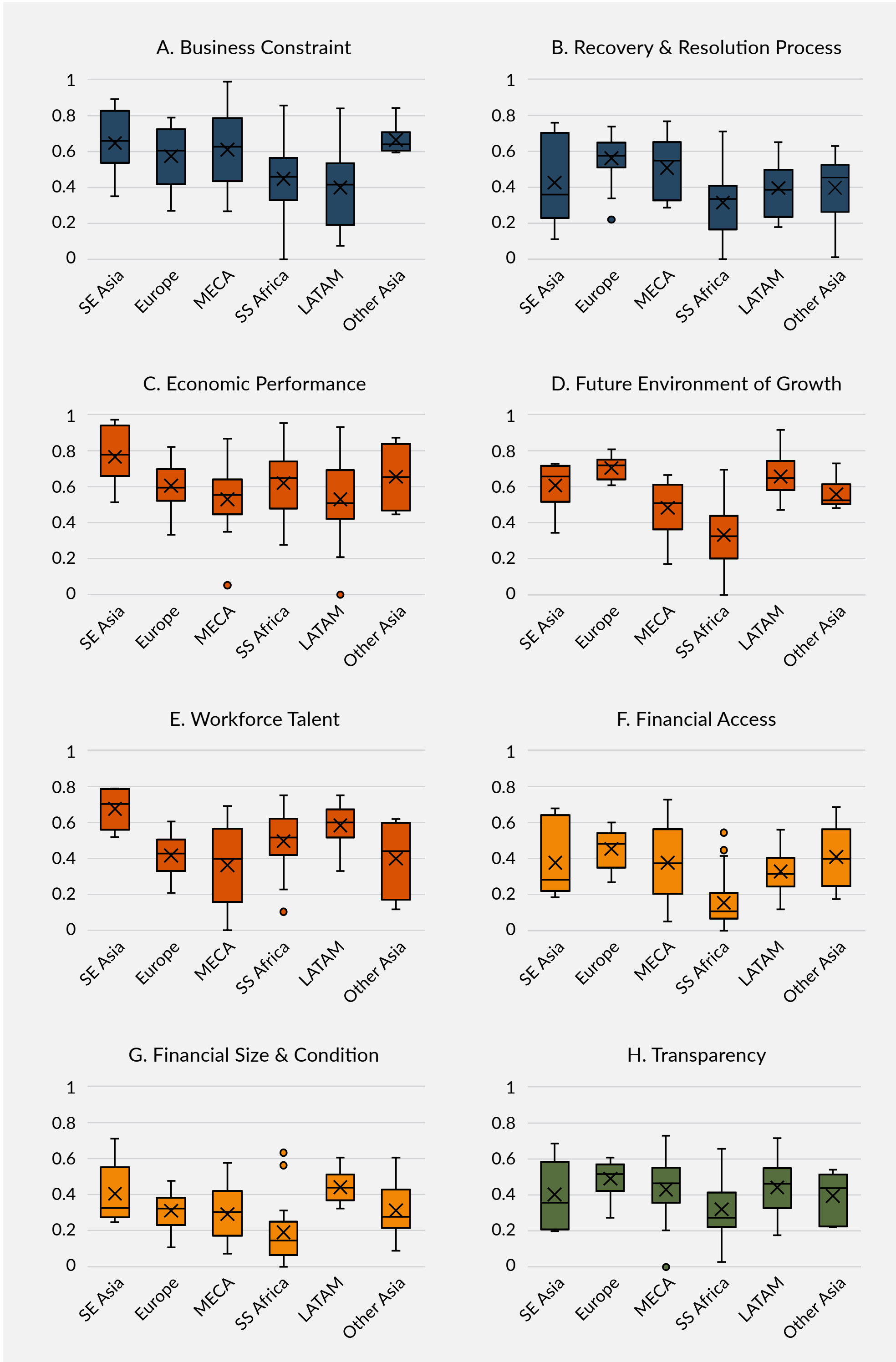
Source: *Milken Institute (2022)*

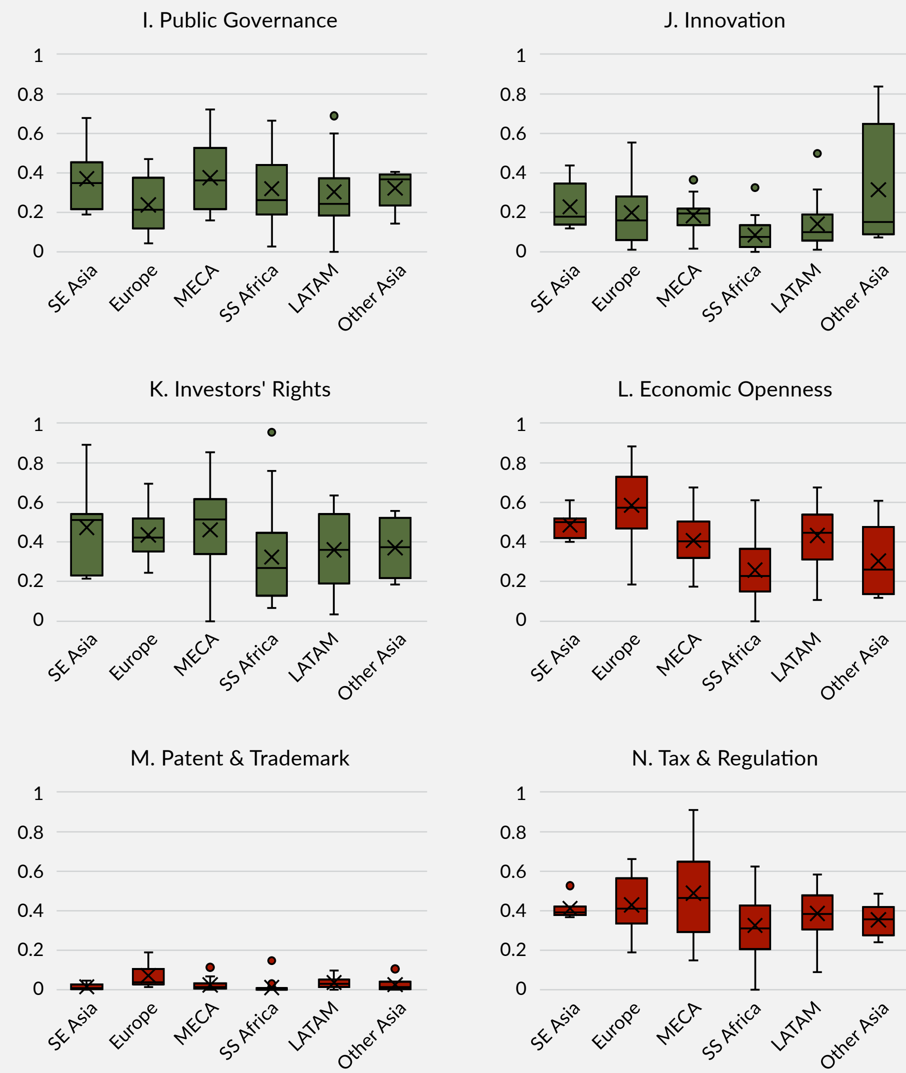
The Index's subcategories illustrate the specific areas in which countries excel and those that need improvement (see Figure 5). The two best-performing areas for emerging Southeast Asia are Economic Performance and Workforce Talent—both subcategories of Economic Fundamentals. This is an encouraging sign for most investors, particularly those who place much weight on demonstrated economic growth and a highly qualified and diverse workforce.

Transparency, a subcategory of Institutional Framework, shows emerging Southeast Asian countries performing worse than all other regions, excluding Sub-Saharan Africa. This is problematic for potential foreign investors as it indicates that countries in the region have institutions that struggle with a lack of clarity and accountability, along with conflicts of interest.

Another area in which the region performs poorly is Financial Access, a subcategory of Financial Services. As with Transparency, when it comes to Financial Access emerging Southeast Asia performs better only than Sub-Saharan Africa. Weakness in this subcategory suggests that countries in the region have significant portions of the population without access to traditional financial services.

Figure 5. Emerging Southeast Asia vs. EMDE Regional Groupings, Subcategory Level





SE Asia = Emerging and Developing Southeast Asia
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Source: *Milken Institute (2022)*

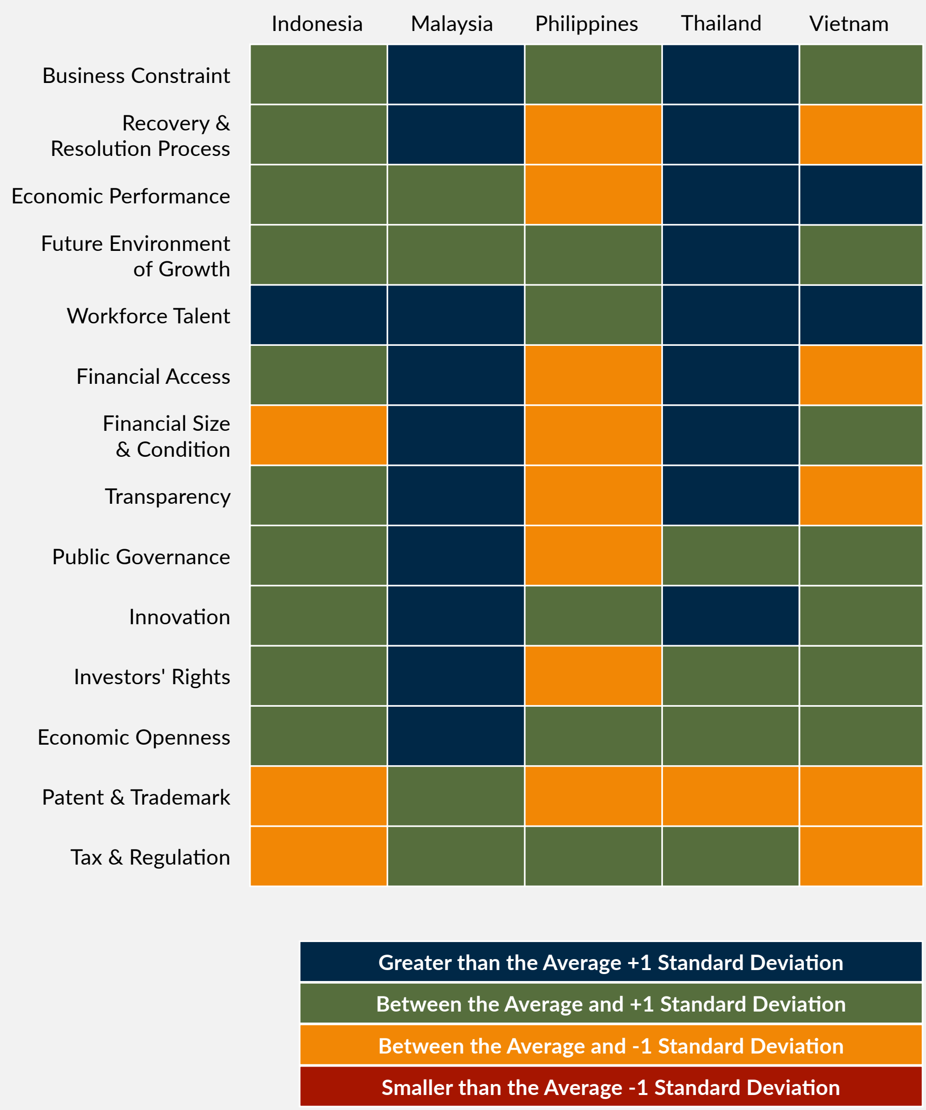
TOP-5 EMERGING SOUTHEAST ASIAN ECONOMIES

The remainder of this section focuses on the five largest emerging countries in Southeast Asia: Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

As Figures 6 and 7 show, the best-performing country among the region's largest economies is Malaysia. It uniformly scores above the average rating for EMDE countries in all 14 of the subcategories. Thailand is another attractive large economy in the region, let down only by its performance in International Standards & Policy and Institutional Framework. Indonesia performs very well in Economic Fundamentals, with a particularly strong rating for Workforce Talent indicating that the country has a highly skilled labor pool. However, Indonesia is let down by its performance in both Financial Services and International Standards & Policy.

Vietnam and the Philippines are the two weakest of the region's five largest emerging economies, performing below the EMDE benchmark group in more than 5 of the 14 subcategories. For both countries, the biggest area for improvement is Institutional Framework. Thus, both economies would benefit from tackling corruption, increasing transparency, and improving public governance. Additionally, efforts should be made to improve access to financial services for currently underserved communities and—more broadly—to develop further the size and condition of the financial sector.

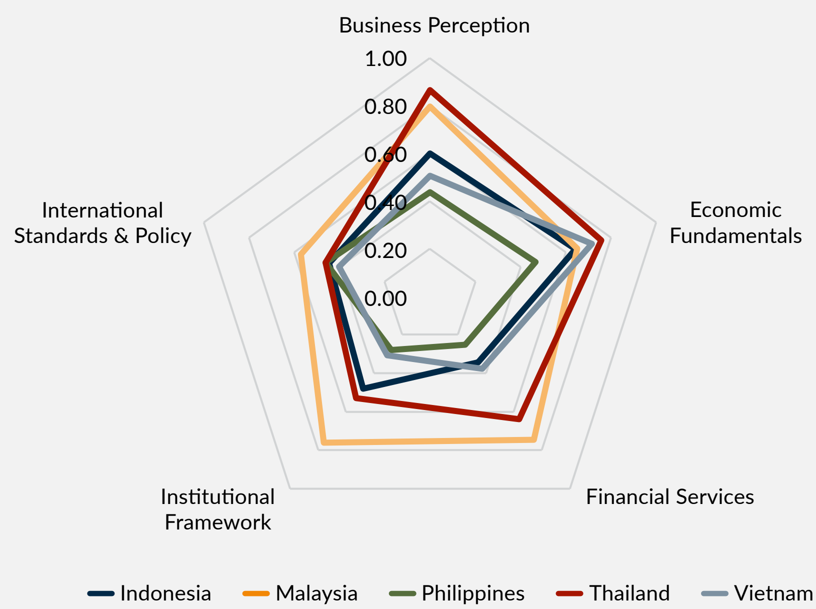
Figure 6. Top-5 Emerging Southeast Asian Economies vs. EMDE Benchmark Group



Note: *Values are compared against the mean value of the 84 countries included in the EMDE benchmark group.*

Source: *Milken Institute (2022)*

Figure 7. Performance of Top-5 Emerging Southeast Asian Economies

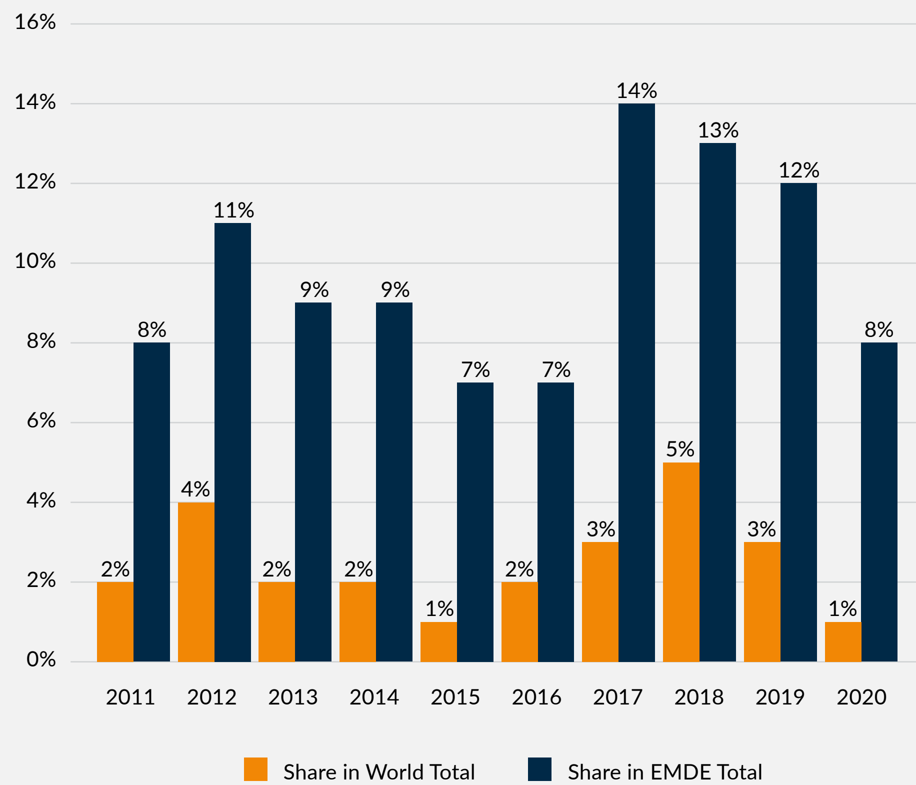


Source: *Milken Institute (2022)*

Recent Trends in Private Cross-Border Capital Flows to Emerging Southeast Asia

Although emerging Southeast Asia attracts a relatively small fraction of global capital inflows, that fraction has increased over the past decade.[2] The share of international capital flows going to the region rose from an average of 2.2 percent between 2011 and 2016 to about 2.5 percent from 2016 to 2020 (see Figure 8). Notably, this increase in foreign capital reflects recent improvements in macroeconomic policy frameworks and growth-enhancing reforms across the region.[3] The rise was not due to an overall surge in capital inflows to emerging markets and developing economies. Over the same two periods, the share of international capital flows directed to EMDE economies decreased from 25 percent to 23 percent.

Figure 8. Private Cross-Border Capital Inflows to EMDE Southeast Asia

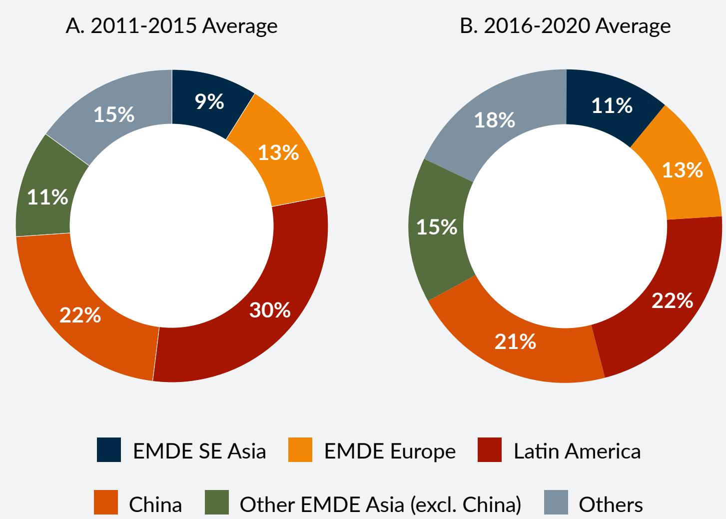


Note: *See the appendix for a list of countries included in the EMDE category.*

Source: *Authors' calculations based on IMF International Financial Statistics (2021)*

This increase in capital inflows has highlighted the region's importance among emerging markets and developing economies. Indeed, between 2011 and 2015, inflows to emerging Southeast Asia accounted for just about 9 percent of global capital flows directed to these economies. But that figure increased to about 11 percent during the 2016–2020 period. The region mainly gained territory from Latin America, where the share of EMDE capital inflows fell from 30 percent in 2011–2015 to about 22 percent in 2016–2020 (see Figure 9). Only other emerging and developing countries in Asia (excluding China) experienced a more significant improvement than emerging Southeast Asia—with their share of EMDE inflows increasing from about 11 percent during 2011–2015 to about 15 percent during 2016–2020.

Figure 9. Private Cross-Border Capital Inflows by Destination
(Share in EMDE Inflows)



Note: *See the appendix for a list of countries included in each category. Totals may not add up to 100 due to rounding.*

Source: *Authors' calculations based on IMF International Financial Statistics (2021)*

EMDE Southeast Asia is playing an increasingly important role among emerging markets and developing economies across all three major types of international capital inflows: foreign direct investment (FDI), foreign portfolio investment, and bank-related and other private flows. The region's share of FDI inflows to emerging economies increased from about 7 percent in 2011–2015 to just below 9 percent in 2016–2020. Over the same two periods, the region's share of portfolio investment inflows to emerging economies increased from 10 to 11 percent. Bank-related inflows showed the most substantial rise, climbing from 11 percent during the first half of the 2010s to about 14 percent during 2016–2020.

While the importance of EMDE Southeast Asia among emerging markets and developing economies has, on average, increased over the past decade, it has exhibited a relatively high level of volatility. Following an initial improvement between 2011 and 2012, the region's share of capital flows to EMDE economies declined from 11 percent in 2012 to around 7 percent in 2015. It then remained relatively stable until 2017, when it rose sharply to 14 percent—its highest point over the past decade. Ever since, the region's share in capital flows to emerging economies has again steadily declined, reaching a level of about 8 percent in 2020.

DEFINITION OF CAPITAL INFLOWS

Cross-border capital flows can be categorized in various ways, depending, for example, on the direction in which they flow, the type of lender or borrower, and the legal form of the contract governing the transaction.

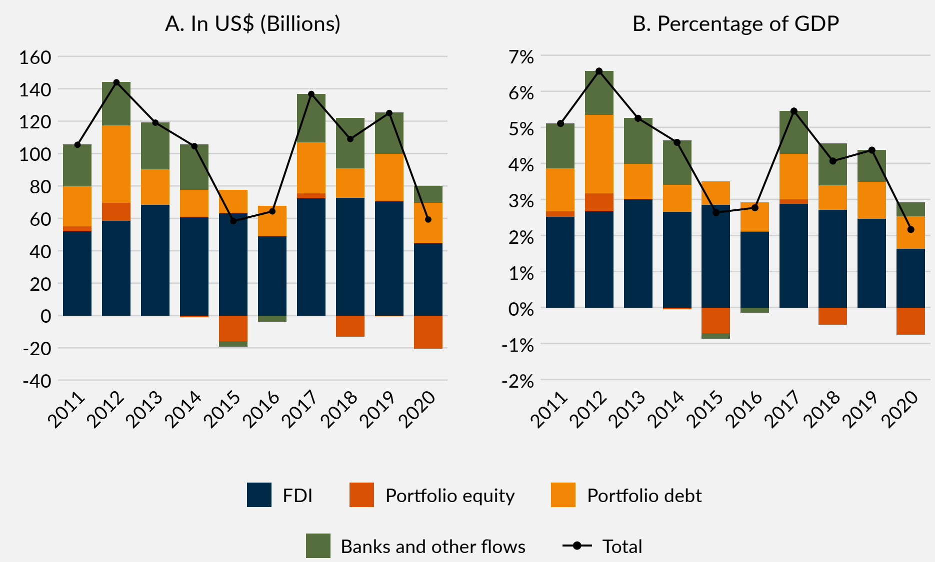
Because we are interested in foreign investors' attitudes towards emerging Southeast Asia, we will focus on "gross" inflows, defined as any change in external liabilities incurred by the recipient economy.[4] Put differently, gross inflows refer to the "net" sale of domestic assets to foreign investors. For example, if foreign investors buy $5 million of local assets in a particular country and during the same period sell $3 million, we report this as a capital inflow of $2 million. Note that these inflows can be either positive or negative. Gross capital inflows will have a negative sign when foreign investors sell more assets of a country than they buy within a given period.

We also focus on "private" inflows, therefore excluding some types of instruments—involving, for instance, governments and multilateral organizations—that are primarily affected by non-market factors. Hence, when reporting capital inflows, we exclude reserve asset accumulations and flows to the general government and monetary authorities within the "Other Investment" component of the financial account.[5]

MAGNITUDE AND COMPOSITION OF CROSS-BORDER CAPITAL INFLOWS

Although the region's share of global capital inflows rose over the past decade, actual flows into emerging Southeast Asia declined over the same period (both in absolute terms and as a fraction of GDP); see Figure 10. Cross-border private capital inflows to the region fell from an annual average of $106.3 billion (equivalent to about 4.8 percent of the region's GDP) during the first half of the 2010s to $99 billion (or only about 3.8 percent of GDP) during 2016–2020. Over the same two periods, portfolio equity inflows fell from a yearly average of -$0.6 billion (-0.03 percent of GDP) to -$6.1 billion (-0.2 percent of GDP), portfolio debt inflows fell from $25.3 billion (1.1 percent of GDP) to $24.5 billion (0.9 percent of GDP), and bank-related inflows fell from $21.1 billion (1 percent of GDP) to $18.8 billion (0.7 percent of GDP). Only foreign direct investment inflows showed a positive trend in absolute terms, increasing from an annual average of $60.5 billion in 2011–2015 to an annual average of $61.8 billion in 2016–2020 (but still declining as a share of GDP, from about 2.7 to 2.4 percent).

Figure 10. Private Capital Flows to EMDE Southeast Asia by Component

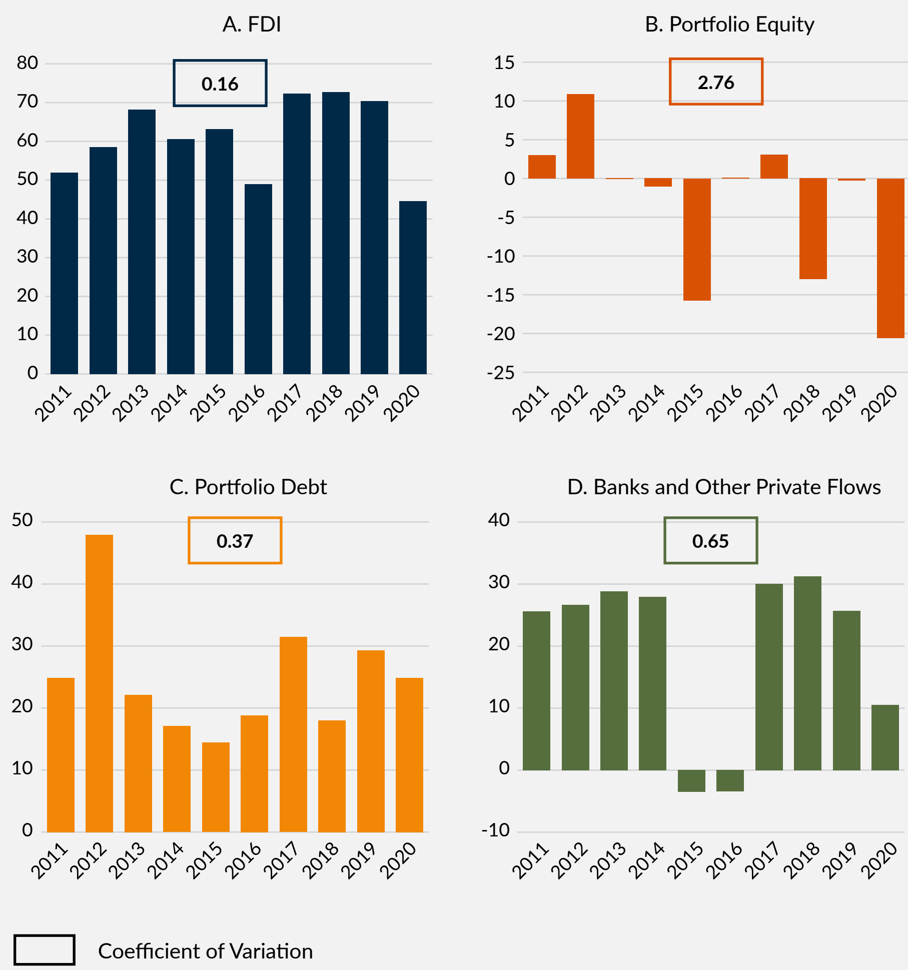


Note: *Due to data limitations, portfolio debt and equity inflows exclude Vietnam from 2015 onwards.*

Source: *Authors' calculations based on IMF International Financial Statistics (2021)*

As shown in Figure 11, different types of capital inflows to the region exhibit significantly different behavior in terms of volatility. The volatility of capital flows has long been a major concern for policymakers in emerging economies.[6] In Southeast Asia, in particular, the issue gained further relevance after the financial crisis of 1997, "when a combination of economic, financial and corporate problems triggered a sharp loss of confidence and capital outflows," ultimately plunging the countries of the region into a deep economic recession.[7] The figure illustrates that FDI is (by far) the most stable component of capital inflows to Emerging Southeast Asia, whereas portfolio equity is clearly the most volatile. Portfolio debt and bank-related flows fall somewhere in between, with the former being more stable than the latter. The relative stability of FDI as a source of finance is also true in other regions. This pattern reflects the unique nature of this type of inflow, which involves investment in fixed assets and is generally driven by companies' long-term business strategies and considerations.

Figure 11. Composition of Cross-Border Capital Inflows to EMDE Southeast Asia ***(US$ Billions)***



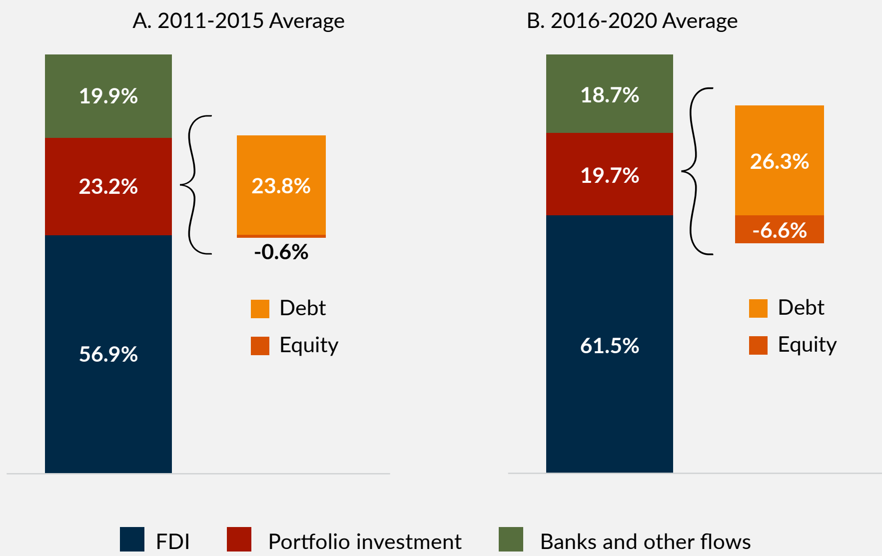
Note: *The coefficient of variation is the standard deviation normalized by the mean. Due to data limitations, portfolio debt and equity inflows exclude Vietnam from 2015 onwards.*

Source: *Authors' calculations based on IMF International Financial Statistics (2021)*

The composition of capital inflows to emerging Southeast Asia has remained relatively stable over the past decade. As shown in Figure 12, FDI has been (by far) the largest single source of capital inflows to the region, followed by portfolio investment, and bank-related inflows and other private investments. Moreover, the relative importance of FDI has risen over the past decade, jumping from about 57 percent of total inflows during the first half of the 2010s to 61.5 percent in

2016–2020. By contrast, the relative importance of both portfolio investment and bank-related inflows showed a modest decline. Over the same two periods, the share of portfolio investment in total cross-border capital inflows fell from 23.2 to 19.7 percent (driven mainly by a sharp reversal in portfolio equity inflows), whereas the share of bank-related and other private sources fell from just below 20 percent to 18.7 percent.

Figure 12. Importance of Various Types of Cross-Border Capital Inflows to EMDE Southeast Asia

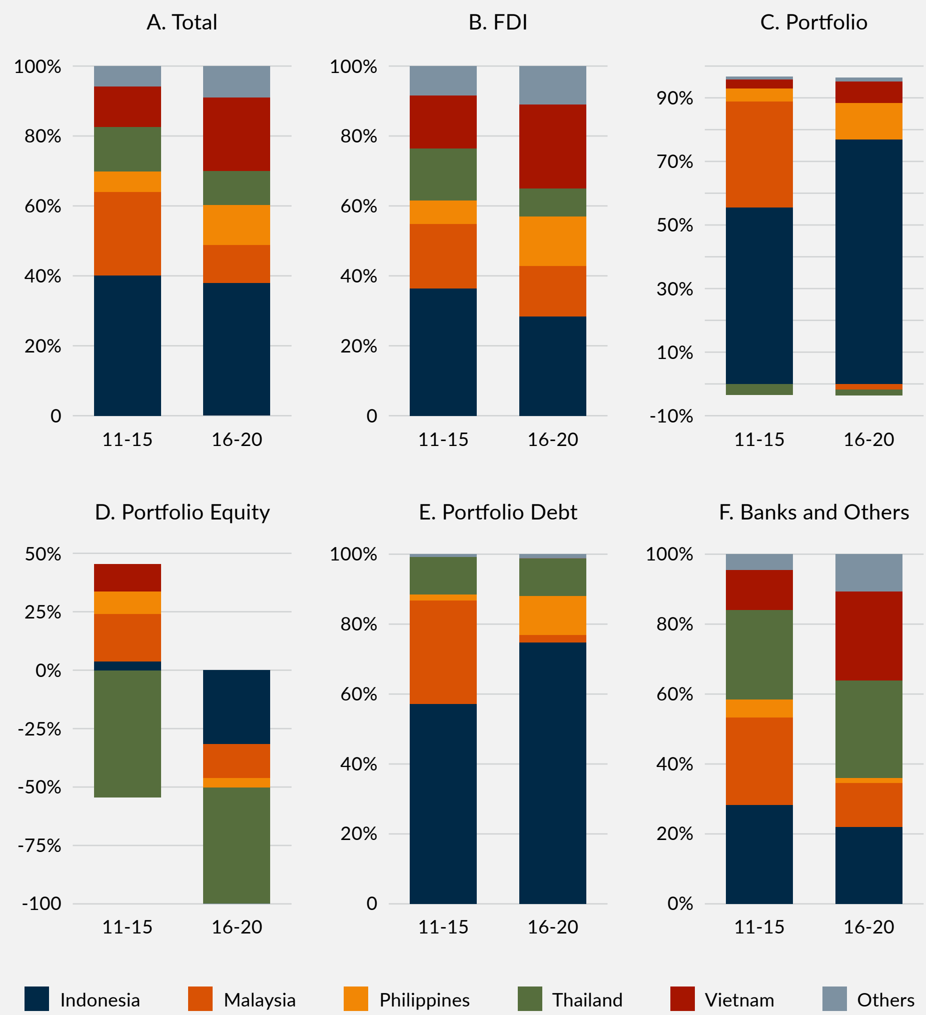


Note: *Totals may not add up to 100 due to rounding. Because of data limitations, portfolio debt and equity inflows exclude Vietnam from 2015 onwards.*

Source: *Authors' calculations based on IMF International Financial Statistics (2021)*

Finally, Figure 13 shows the distribution of capital inflows across the various economies of emerging Southeast Asia. When viewed in absolute terms, Indonesia is the largest recipient of cross-border capital in the region, accounting for 40 percent of total capital inflows between 2011 and 2015 and about 38 percent between 2016 and 2020. The importance of Indonesia is particularly large in portfolio investment inflows, accounting for 55 percent of these inflows during 2011–2015 and about 77 percent during 2016–2020.

Figure 13. Importance of Selected Countries in Private Capital Inflows to EMDE Southeast Asia (from 2011 to 2015 and from 2016 to 2020)



Note: *The category "Others" includes Brunei, Cambodia, Laos, Myanmar, and Timor-Leste. Because of data limitations, portfolio debt and equity inflows exclude Vietnam from 2015 onwards.*

Source: *Authors' calculations based on IMF International Financial Statistics (2021)*

Figure 13 also illustrates that the relative importance of the region's various economies has changed over the past decade. For example, Malaysia's share in total capital inflows experienced a sharp decline—falling from 24 percent in 2011–2016 to 11 percent in 2016–2020—driven mostly by smaller shares in total portfolio investment and (to a lesser extent) bank-related inflows. By contrast, Vietnam's share in total inflows jumped from 12 percent to 21 percent over the same two periods, mainly due to higher shares of FDI and bank-related inflows. The relative importance of the Philippines and Thailand also changed, although less dramatically. The Philippines' share in total inflows rose from 6 percent in the first half of the 2010s to 11 percent in 2016–2020; by contrast, Thailand's share showed a more modest decline, falling from 13 to 10 percent over the same two periods (primarily driven by a smaller share in total FDI inflows).

THE ASSOCIATION OF SOUTHEAST ASIAN NATIONS

The Association of Southeast Asian Nations (ASEAN) is the region's major international organization. Created in 1967 by the governments of Indonesia, Malaysia, the Philippines, Singapore, and Thailand, the group has since expanded to include Brunei (1984), Vietnam (1995), Laos (1997), Myanmar (1997), and—most recently—Cambodia (1999). According to the ASEAN Declaration, the organization's founding document, its efforts focus on promoting political and economic cooperation while maintaining peace, security, and stability within the region.

Home to more than 660 million people, ASEAN has a combined GDP of about US$3.2 trillion, ranking as the world's fifth-largest economy when viewed as a single entity. The region plays a crucial role in global trade, and it is one of the world's fastest-growing markets.

ASEAN has made notable progress in fostering economic integration in the region, with virtually all intra-ASEAN tariffs on goods eliminated.[8] A single customs window, known as the ASEAN Single Window, has also been developed to expedite cargo clearance within the region. In addition to its own internal free trade agreement, ASEAN has signed deals with economic powerhouses including Australia, the People's Republic of China, India, the Republic of Korea, and Japan.[9] The implementation of the ASEAN Economic Community in 2015 was a major milestone for the organization, furthering ASEAN's vision of creating a globally competitive single market and production base. But despite significant progress, economic integration among ASEAN member states remains incomplete. Further progress is needed to liberalize trade in services, eliminate nontariff trade barriers, and increase the mobility of capital flows within the region.

Although political integration has been slow, the organization made significant progress in 2007 with the signing of the ASEAN Charter. The charter endows the organization with a new legal personality and improves its decision-making processes and enforcement mechanisms.

The charter also ratifies ASEAN's focus on intergovernmental cooperation and consensus-building, based on a strong adherence to the principle of noninterference in member states' internal affairs and respect for national sovereignties.

While ASEAN's consensus-based approach has sometimes been criticized for slowing the pace of integration, it reflects the region's historical, political, and social contexts. A slow and incremental approach to integration may also be necessary to make the organization more resilient and politically viable in the longer term—especially in light of recent internal problems faced by other regional organizations such as the European Union.[10]

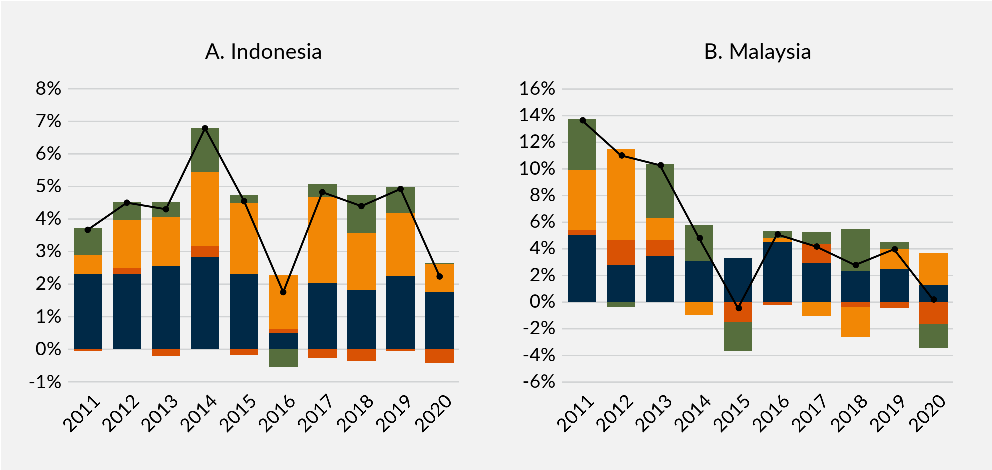
Despite its success in preserving regional stability and promoting economic integration, ASEAN faces multiple challenges. The ASEAN Economic Community is still a work in progress on the economic front. To realize its full potential and become globally competitive in a broader range of industries, ASEAN must ensure that all member states fully implement its economic initiatives. It must also deepen cooperation and promote a regional approach to crucial issues such as infrastructure, digital economy, and human capital development.

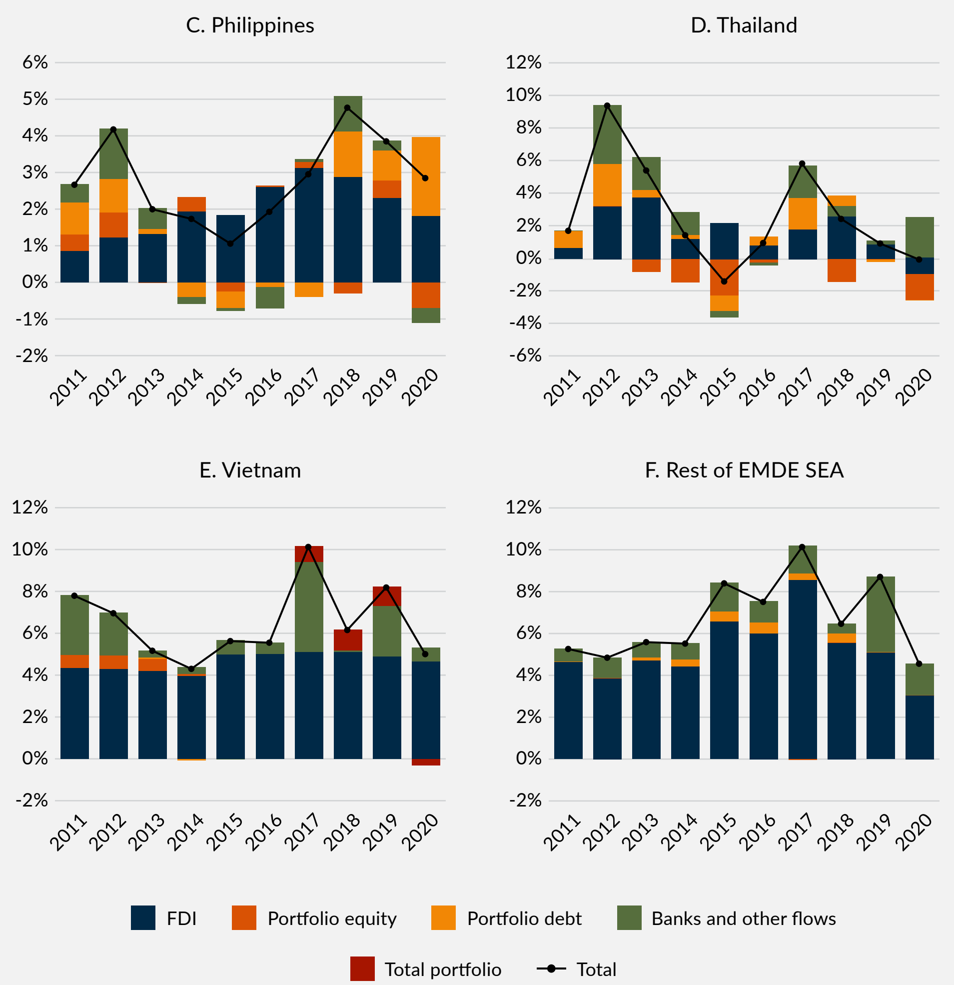
HETEROGENEITY WITHIN THE REGION

With a population of more than 650 million living across 10 different countries, emerging Southeast Asia is one of the most diverse areas in the world. The countries of the region differ greatly in size, level of economic and social development, and overall economic model. They also have significantly different political traditions and institutions, ranging from democracies to one-party states to monarchies. Naturally, each country's distinctive characteristics generate unique opportunities for foreign investors, affecting the size and composition of capital inflows and how these inflows have reacted to global conditions.

Figure 14 illustrates that the magnitude of capital inflows differs widely across the region's economies. When viewed as a percentage of GDP, cross-border capital inflows were substantially higher in Vietnam than in any of the region's major economies, with an annual average of about 6.4 percent between 2011 and 2020. Malaysia and Indonesia followed in second and third place, with yearly averages of 5.6 percent and 4.2 percent, respectively, over the same period. Among the region's five largest economies, the Philippines and Thailand exhibited the lowest capital inflows as a share of GDP, with annual averages of 2.8 percent and 2.7 percent, respectively. Finally, the importance of capital inflows during the past decade was particularly large across the region's smaller economies, where, on average, capital inflows accounted for just below 7 percent of GDP.

Figure 14. Cross-Border Capital Inflows to Selected EMDE Southeast Asian Countries *(Percentage of GDP)*





Notes: *Because of data limitations, total portfolio inflows are reported for Vietnam from 2015 onwards.*

Source: *Authors' calculations based on IMF International Financial Statistics (2021)*

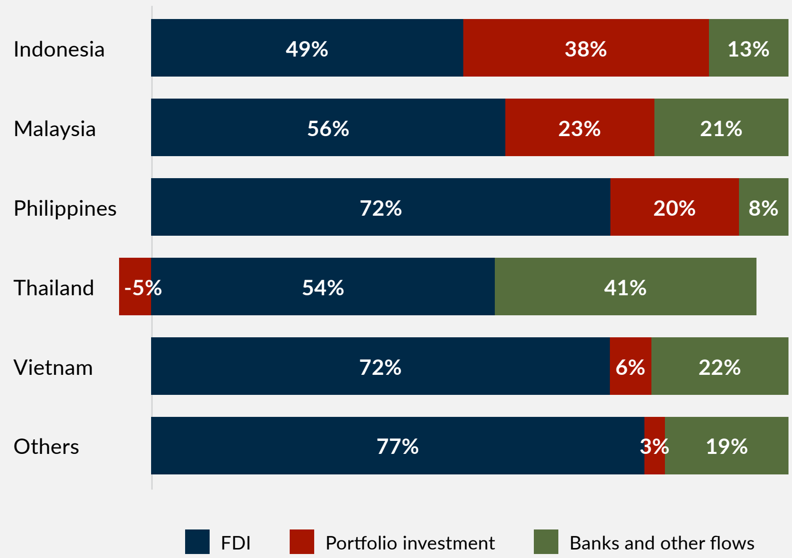
Figure 14 also illustrates that whereas, on average, capital inflows as a share of GDP declined in emerging Southeast Asia during the 2010s, there were significant differences across countries. Indeed, among the region's five largest economies, only three countries experienced a decline in capital inflows as a share of GDP over this period: Indonesia (from an average of 4.8 percent in 2011–2015 to an average of 3.7 percent in 2016–2020), Malaysia (from 7.9 to 3.2 percent), and Thailand (from 3.4 to about 2 percent).

By contrast, over the same two periods, capital inflows as a share of GDP increased in the Philippines (from 2.3 to 3.3 percent) and Vietnam (from just below 6 percent to around 7 percent). Among the region's smaller economies, capital inflows as a share of GDP increased from 6 percent in the first half of the 2010s to 7.4 percent in 2016–2020.

The volatility of cross-border capital inflows also varies significantly across the region's economies. Figure 14 shows that between 2011 and 2020, capital inflows were considerably more volatile in Thailand than in the rest of emerging Southeast Asia. Although the largest source of instability came from the behavior of portfolio investment, volatility in Thailand was high across all three major types of capital inflows (including foreign direct investment). Perhaps unsurprisingly, this volatility was driven mainly by the country's political instability during the first half of the 2010s. Capital inflow volatility was also relatively high in Malaysia, largely driven by the behavior of portfolio investment and (to a lesser extent) bank-related inflows. By contrast, capital inflows were relatively stable in Vietnam and Indonesia (the largest economy in Southeast Asia) and among the region's smaller countries.

As mentioned above, Thailand's unique behavior stems from the country's political instability during the first half of the past decade.[11] Following a series of anti-government protests that began in November 2013, the Thai Army (led by General Prayuth Chan-ocha) seized power in May 2014, revoking the 2007 Constitution and establishing a military government. In 2019, after five years of military rule, the country held elections and the army handed over power to a newly elected civilian government headed by the same general who led the 2014 coup.[12] Unfortunately, this was not an isolated episode. Despite having a competitive economy and strong economic fundamentals—including credible economic institutions, a solid external position, and a well capitalized banking sector—Thailand has a long history of political unrest, alternating between military rule and unstable civilian governments.[13] Since becoming a constitutional monarchy in 1932, the country has experienced 19 coups (12 of them successful) and has had 20 different constitutions.

Figure 15. Importance of Various Types of Cross-Border Capital Inflows to Selected EMDE Southeast Asian Countries



Note: *The category "Others" includes Brunei, Cambodia, Laos, Myanmar, and Timor-Leste. Totals may not add up to 100 due to rounding.*

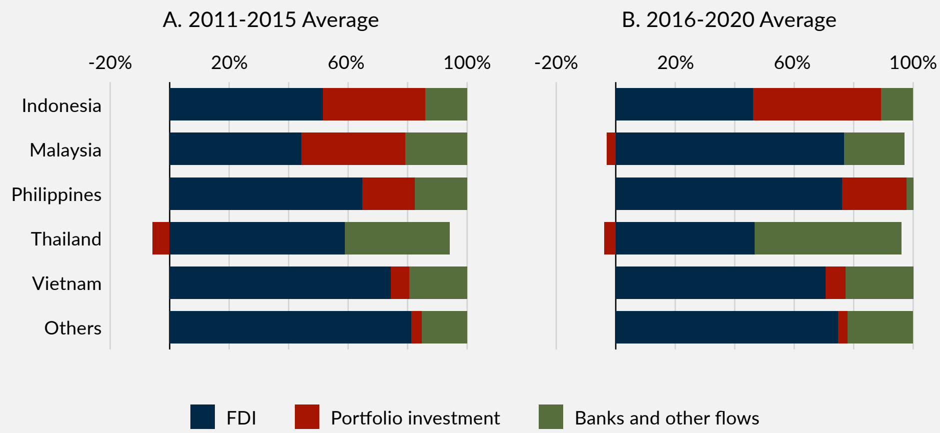
Source: *Authors' calculations based on IMF International Financial Statistics (2021)*

The recent composition of international capital inflows also varies substantially across the region (see Figure 15). The importance of foreign direct investment, for example, varies widely across the region's economies, with FDI accounting for more than 70 percent of total inflows between 2011 and 2020 in the Philippines and Vietnam, about 55 percent in both Malaysia and Thailand, but only 49 percent in Indonesia. Similarly, the importance of bank-related and other private inflows was exceptionally large in Thailand, whereas it was relatively low in the Philippines and, to a lesser extent, Indonesia. Finally, the importance of portfolio inflows over the last decade was significantly greater in Indonesia, Malaysia, and the Philippines than in Thailand and Vietnam. In fact, between 2011 and 2020, average cross-border portfolio investment to Thailand was negative, driven by sizable negative portfolio inflows in equity instruments.

Finally, Figure 16 illustrates recent changes in the composition of cross-border capital inflows across the region's economies. Over the past decade, the importance of FDI declined in Indonesia, Thailand, and (modestly) Vietnam, whereas it increased significantly in Malaysia and, to a lesser degree, the Philippines. Similarly, the importance of portfolio investment (particularly debt) increased in Indonesia and the Philippines but dropped sharply in Malaysia (from

35 percent of total inflows in 2011–2016 to a negative 3 percent in 2016–2020). The importance of bank-related and other private inflows decreased in Indonesia and, to a greater extent, the Philippines, but it increased substantially in Thailand and modestly in Vietnam. Finally, among the region's smaller economies, the importance of FDI saw a modest decline, which was partly compensated by a similar increase in bank-related and other private inflows.

Figure 16. Change in Composition of Cross-Border Capital Inflows to Selected EMDE Southeast Asian Countries



Note: *The category "Others" includes Brunei, Cambodia, Laos, Myanmar, and Timor-Leste.*

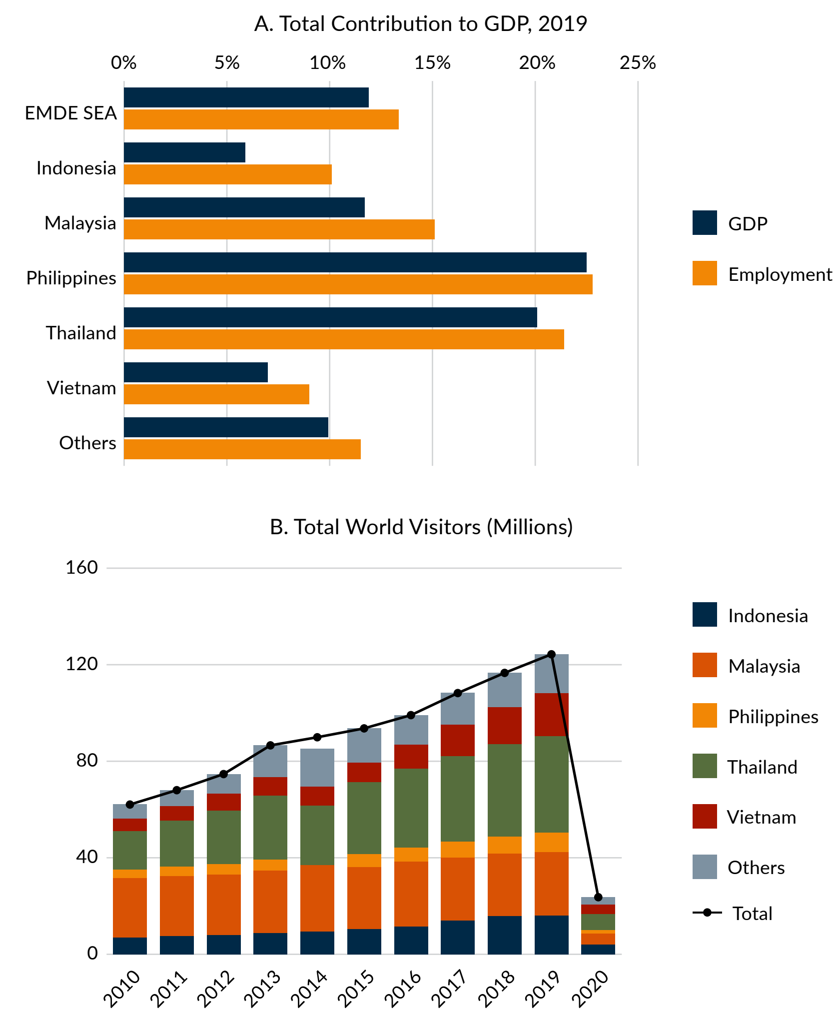
Source: *Authors' calculations based on IMF International Financial Statistics (2021)*

TRAVEL AND TOURISM IN EMERGING SOUTHEAST ASIA

Travel and Tourism is a crucial economic sector for emerging Southeast Asia. According to the World Travel & Tourism Council (WTTC), by the end of 2019—before the beginning of the COVID-19 pandemic—Travel and Tourism was responsible (directly or indirectly) for about 12 percent of the region's GDP (US$341 billion) and more than 13 percent of all jobs (about 42 million). That same year, emerging Southeast Asia welcomed about 124 million international tourists, almost twice as many as in 2010 (see Figure 17).

Unfortunately, the Travel and Tourism sector has been one of those most affected by the current COVID-19 pandemic. As governments reacted to the crisis, containment measures such as lockdowns and quarantines were implemented globally. These major restrictions on national and international mobility, along with a decline in travelers' confidence and income, have caused a sharp contraction in the sector. In emerging Southeast Asia, international tourist arrivals declined by 81 percent in 2020, resulting in over 100 million fewer travelers compared to 2019 (see Figure 17B).

Figure 17. Travel and Tourism in Emerging Southeast Asia

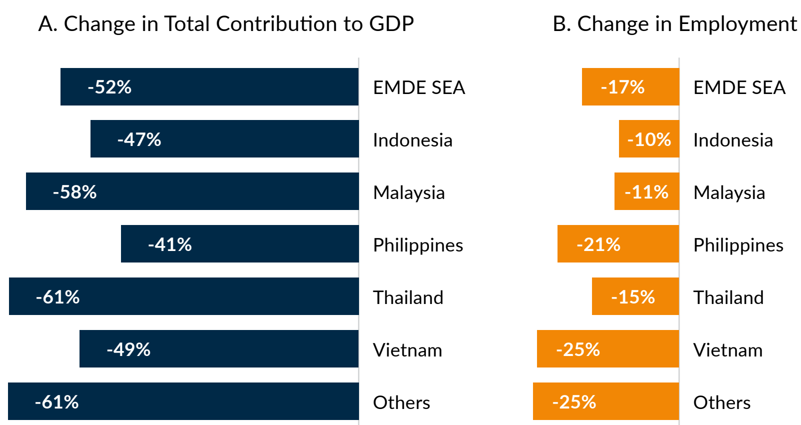


Note: *The category "Others" includes Brunei, Cambodia, Laos, and Myanmar.*

Source: *ASEAN Secretariat and WTTC (2021)*

The sharp decline in travel and tourism generally has had severe economic consequences for the region (see Figure 18). Between 2019 and 2020, the total contribution of Travel and Tourism to the region's GDP dropped by 52 percent (compared with a considerably smaller 3.5 decline in overall output). In contrast, the number of jobs sustained by the sector—directly and indirectly—fell by 17 percent, resulting in a loss of more than 7 million jobs.

Figure 18. Consequences of Decline in Travel and Tourism, 2019-2020



Note: *The category "Others" includes Brunei, Cambodia, Laos, and Myanmar.*
Source: *WTTC (2021)*

Although the pandemic affected both domestic and international tourism, the impact was substantially stronger on the latter. According to the WTTC, between 2019 and 2020, spending by domestic tourists (which accounted for about half of total tourism spending) decreased by 35 percent, whereas spending by international visitors declined by an unprecedented 78 percent.

Some governments in the region have responded with emergency programs, focusing on preventing massive layoffs and helping firms stay afloat until demand improves. Unfortunately, the sector's recovery is likely to be slow, and governments' ability to provide economic support is limited.[14] Going forward, governments will need to focus on policies to restore travelers' confidence and increase demand while also ensuring workers' safety and health.[15] While the outlook for the sector remains highly uncertain, one thing is undeniable: The road to recovery will require creativity and unprecedented levels of cooperation among governments.

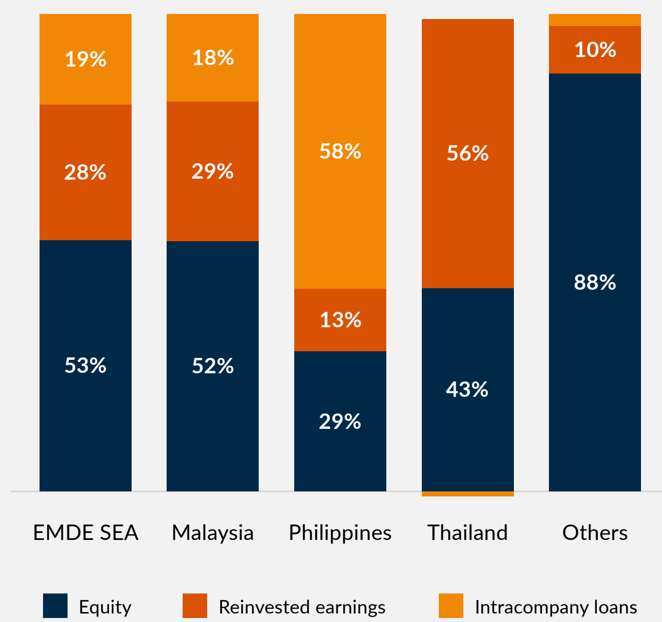
FOREIGN DIRECT INVESTMENT: A CLOSER LOOK

FDI is crucial for emerging economies, and EMDE Southeast Asia is no exception. FDI is by far the largest and most stable source of external finance across the region, accounting for about 60 percent of all cross-border capital inflows between 2011 and 2020. But even more important, it is a type of inflow that can significantly benefit the host economies.[16] Given the appropriate policies, FDI can trigger human capital formation, bring new technologies and business practices, contribute to international trade integration, and help create a more competitive business environment.[17] Moreover, in the current context, FDI could play a vital role in the region's economic recovery from the coronavirus pandemic.

Foreign Direct Investment by Component

Foreign direct investment involves three types of transactions.[18] First, multinational corporations can make direct investments abroad by acquiring existing assets of foreign companies (i.e., mergers and acquisitions) or by starting new businesses through "greenfield" investments in plant and equipment (this type of transaction is known as "equity capital"). Second, FDI can take the form of reinvestment of earnings, which refers to profits earned by domestic branches and subsidiaries of multinational corporations not repatriated as dividends to the firms' headquarters. Finally, FDI can occur through intracompany loans (or debt transactions), which consist of short- or long-term loans extended by foreign parent companies to their domestic affiliates.

Figure 19. Composition of FDI Inflows to EMDE Southeast Asia, 2011–2020 Average *(Percentage of Total FDI Inflows)*



***Note:** The category "Others" includes Cambodia, Laos, Myanmar, and Timor-Leste. Because of data limitations, Indonesia and Vietnam are excluded from the analysis. Totals may not add up to 100 due to rounding.*

***Source:** Authors' calculations based on IMF International Financial Statistics (2021)*

As shown in Figure 19, most FDI inflows into emerging Southeast Asia take the form of equity investment. On average, between 2011 and 2020, this type of inflow accounted for about 53 percent of the region's FDI flows. There are, however, marked differences across countries. For instance, over the same period, the share of equity capital was only about 29 percent in the Philippines, but it was just below 90 percent among the region's five smaller economies. Malaysia and Thailand fell somewhere in between with 52 percent and 43 percent, respectively. It is worth mentioning that the large share of equity capital is a good signal for emerging Southeast Asia. Not only is equity capital one of the strongest indicators of long-term interest among foreign investors, but it is also the most stable component of FDI and the most likely to result in new investments and capital expenditures.[19]

Reinvested earnings are also crucial for the region, accounting for around 28 percent of all FDI inflows between 2011 and 2020. The importance of reinvested earnings should be taken as another good sign, as they reflect the confidence of foreign investors who have already established operations in the region. As expected, the relative importance of reinvested earnings varies significantly among countries. Over the past decade, reinvested earnings accounted for about 56 percent of all FDI inflows to Thailand and 29 percent to Malaysia but only about 13 percent to the Philippines. The importance of reinvested earnings was minimal among the region's smaller economies, where they accounted for only about 10 percent of all foreign direct investment.

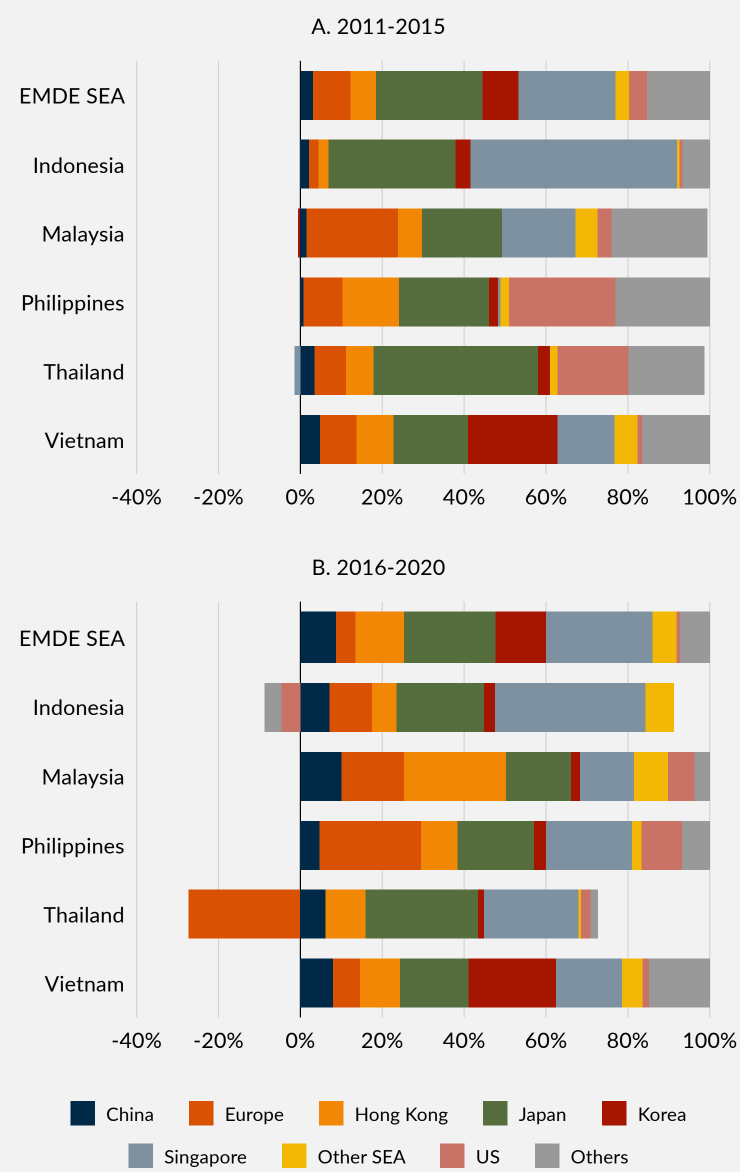
Finally, intracompany loans are the smallest component of FDI inflows to the region, with an average share of only about 19 percent over the past decade. Among the region's largest economies, intracompany loans are considerable in the Philippines (reaching almost 60 percent of total FDI) and practically nonexistent in Thailand. Intracompany loans were also negligible among the region's smaller economies, accounting for just above 2 percent of all foreign direct investment.

While intracompany loans are more volatile than equity investment, and their overall consequences are harder to assess (as they are often used simply for tax-planning purposes), they could play a crucial role in supporting FDI inflows during the current COVID-19 pandemic.[20] Indeed, evidence from previous economic crises indicates that foreign parent corporations have sometimes used loans to support their domestic affiliates when needed. If this behavior is confirmed, "[a]ny decline in reinvested earnings and equity capital flows could be partly offset by intracompany loans…that parent [companies] make to their struggling foreign affiliates."[21]

Foreign Direct Investment by Origin

Figure 20 illustrates the distribution of FDI into emerging Southeast Asia by origin. Over the past decade, most FDI flowing into the region came from Japan and Singapore—with Japan having a slightly stronger presence during the first half of the decade and Singapore during the second half. When combined, these two countries accounted for more than 50 percent of total FDI inflows during 2011–2015 and about 48 percent during 2016–2020. Korea and Hong Kong were next in importance—particularly during the second half of the decade—with each accounting for about 10 percent of total FDI inflows between 2011 and 2020.

Figure 20. FDI Inflows to Selected EMDE Southeast Asian Countries, by Origin *(Percentage of Total FDI Inflows)*



Note: *Data for Vietnam are based on FDI projects licensed by the federal government. Data for the Philippines include only equity other than reinvestment of earnings.*

Source: *Authors' calculations using data from Bank Indonesia, Bank of Thailand, Department of Statistics–Malaysia, General Statistics Office of Vietnam, and Philippine Statistics Authority (2021)*

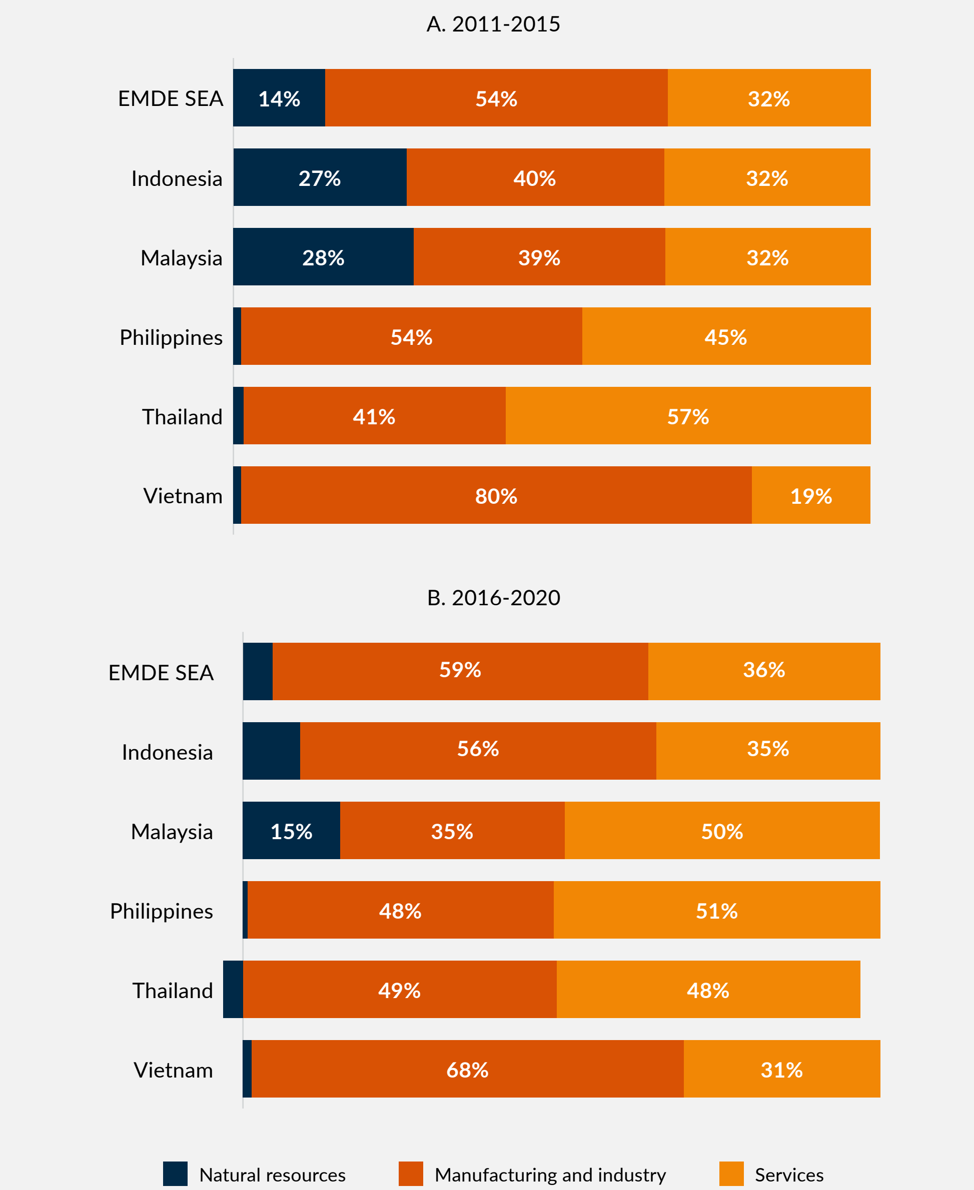
Europe and China were also important investors in the region. Still, they have shown opposite trends over time: While the importance of Europe appears to be declining (from 9 percent of total FDI in 2011–2015 to 4 percent in 2016–2020), the relevance of China has increased significantly (from 3 percent to 9 percent over the same two periods). Moreover, FDI from the US plummeted from 4 percent in 2011–2015 to about 1 percent in 2016–2010, consistent with a global fall in US investments due to recent US tax reforms.[22] Finally, although the share of FDI originating from other emerging Southeast Asian countries remains relatively small, it has expanded considerably over the past decade, jumping from 3 percent in 2011–2015 to 6 percent in 2016–2020.

The aggregate data hide essential differences within the region (see Figure 20). For example, while Japan is a prominent investor across all economies, its importance is unusually large in Thailand, accounting for about 40 percent of all FDI in 2011–2015 and around 27 percent in 2016–2020. Similarly, inflows from Singapore have been particularly significant in Indonesia, accounting for more than half of total FDI in the first half of the decade and about 40 percent in the second half. On the other hand, Europe has a significant presence in Malaysia and the Philippines, and the US in the Philippines, a pattern consistent with the strong historical ties between these two countries. Finally, inflows from Korea were crucial for Vietnam—even more than those coming from Japan and Singapore—accounting for almost one-fourth of the country's FDI between 2011 and 2020.

Foreign Direct Investment by Sector

Figure 21 illustrates the distribution of foreign direct investment flowing into emerging Southeast Asia by economic sector. The manufacturing and industry sector—which includes manufacturing plus investment in construction and utilities such as electricity, gas, and water supply—is by far the largest single recipient of FDI in the region, accounting for about 54 percent of total FDI in 2011–2016 and 59 percent in 2016–2020. This outcome is not surprising: The increasing importance of the manufacturing and industry sector reflects the region's critical role in global supply chains, which is expected to rise even further given China's growing labor costs and current global trade tensions. The services sector ranks second, accounting for 32 percent and 36 percent, respectively, of the region's FDI over the same two periods. Last, the natural resources sector (which includes agriculture, forestry, fishing, and mining) is the least important in the region, and its relevance has further declined over time—from about 14 percent of total FDI in the first half of the decade to about 5 percent in the second half.

Figure 21. FDI Inflows to Selected EMDE Southeast Asian Countries, by Sector
(Percentage of Total FDI Inflows)



Note: *Data for Vietnam are based on FDI projects licensed by the federal government. Data for the Philippines include only equity other than reinvestment of earnings. Totals may not add up to 100 due to rounding.*

Source: *Authors' calculations using data from Bank Indonesia, Bank of Thailand, Department of Statistics—Malaysia, General Statistics Office of Vietnam, and Philippine Statistics Authority (2021)*

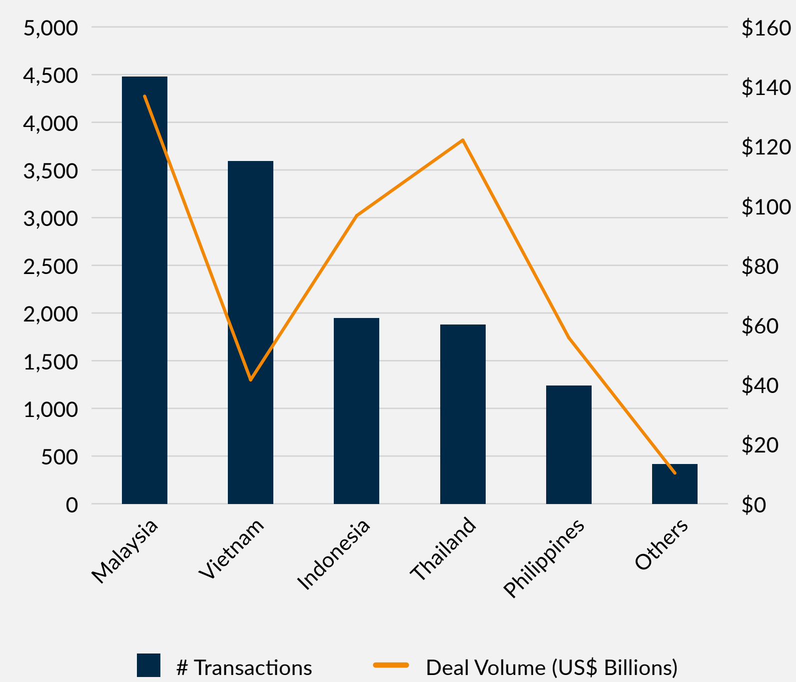
Finally, Figure 21 shows that the sectoral allocation of FDI varies widely across countries. Inflows into the manufacturing and industry sector, for instance, were relatively large in Vietnam—where they represented about 69 percent of total FDI inflows in 2011–2015 and 68 percent in 2016–2020—but they were relatively small in Malaysia—where they accounted for only about 39 and 35 percent of all FDI over the same two periods. Similarly, the importance of the services sectors was significantly greater in the Philippines and Thailand than it was in Vietnam (where it accounted for only about 25 percent of total FDI between 2011 and 2020). Finally, inflows into the natural resources sector were substantial in Malaysia and (to a lesser extent) Indonesia—especially between 2011 and 2016—but they were negligible in the Philippines, Thailand, and Vietnam.

Cross-Border Mergers and Acquisitions in Emerging Southeast Asia

Emerging Southeast Asia provides an interesting case study in the growth of cross-border mergers and acquisitions (M&A), with two recent macroeconomic changes (one directly related to the COVID-19 pandemic) making the region increasingly attractive to foreign investors. First, drastic government interventions and fluctuating monetary policies designed to bolster COVID-19 relief have led to currency depreciation, lower asset valuations, and decreased borrowing costs. Second, global trade policy shifts have made the region more attractive from a corporate strategy standpoint as supply chains move out of China.

In the first half of 2021, the total value of announced deals in emerging Southeast Asia totaled about US$40 billion (a 100 percent increase from the same period a year earlier). Part of this growth can be attributed to the delays in transaction proceedings during the early lockdown periods of the pandemic. Still, activity returned with enthusiasm as the pandemic impacts and externalities slowly became more predictable.

Figure 22. M&A Activity in Emerging Southeast Asia, by Target Nation (2011–2021)



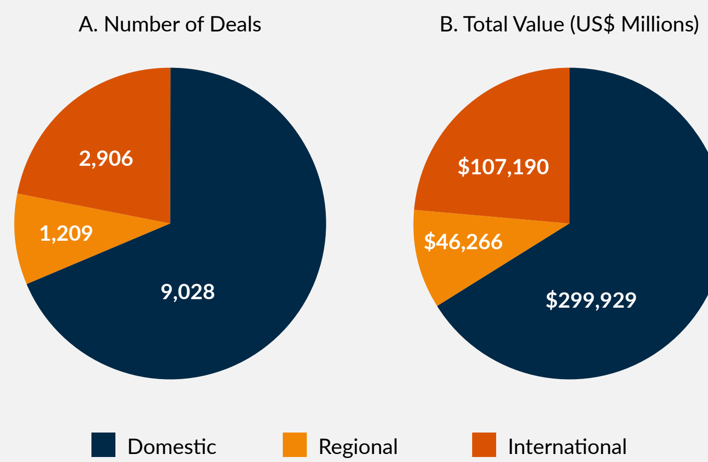
***Note:** Values include all transactions between 1/1/2011 and 6/31/2021. The category "Others" includes Brunei, Cambodia, Timor-Leste, Laos, and Myanmar.*

***Source:** Refinitiv EIKON (2021)*

Figure 22 illustrates M&A activity in emerging Southeast Asia over the last decade, displaying both the number of transactions and the aggregate deal value. Perhaps unsurprisingly, M&A activity in emerging Southeast Asia is dominated by the five largest economies: Indonesia, Malaysia, Philippines, Thailand, and Vietnam. Between 2011 and the first half of 2021, Malaysia attracted the most activity within the region, in terms of both the number of transactions and the aggregate deal value. The second place is split between Vietnam (by number of transactions, at 3,595) and Thailand (by aggregate deal value, at approximately US$122.2 billion).

Figure 23 breaks down the number of M&A transactions and the aggregate deal value by origin of the acquiring firm, focusing on the region's five largest emerging economies. From 2011 to the first half of 2021, domestic activity (occurring within country borders) accounted for about 68.7 percent of the transactions and 66.2 percent of the aggregate deal value. Regional activity (which includes cross-border transactions within emerging Southeast Asia) accounted for 9.2 percent of transactions and 10.2 percent of aggregate value. Finally, the remaining 22.1 percent of transactions and 23.6 percent of deal value came from outside the region.

Figure 23. M&A Activity in Emerging Southeast Asia, by Origin (2011–2021)

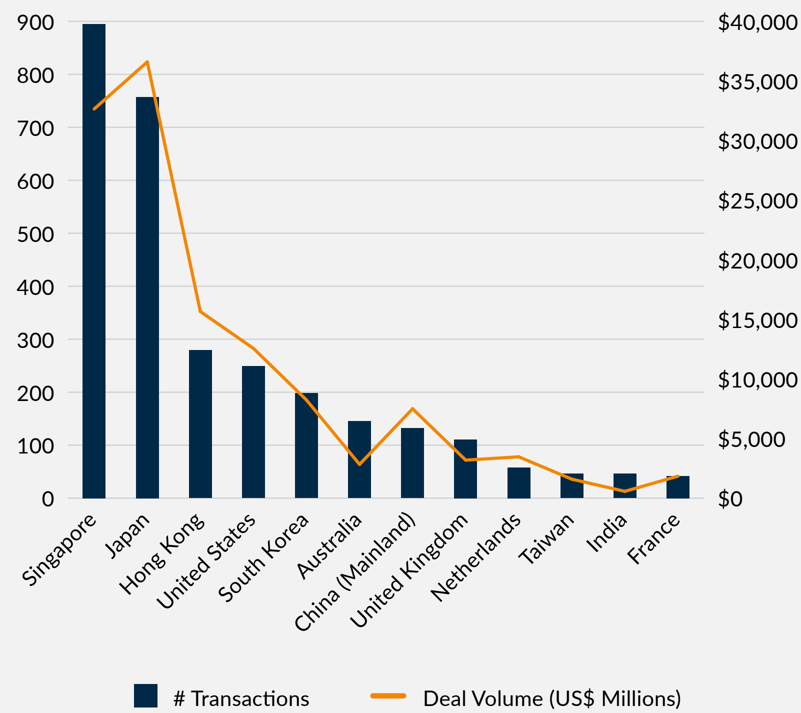


Note: *Values include all transactions between 1/1/2011 and 6/31/2021. Countries highlighted: Indonesia, Malaysia, Philippines, Thailand, and Vietnam.*

Source: *Refinitiv EIKON (2021)*

Focusing on cross-border M&A activity, Singapore predictably boasts the highest number of transactions executed in the region. It is Japan, however, that has invested the most in emerging Southeast Asia over the past decade, with a cumulative deal value of approximately US$36.6 billion. Hong Kong and the US round out the top four international investors, with about US$15.6 billion and US$12.6 billion, respectively. Geographic neighbors South Korea and China complete the list of acquirers that have invested more than US$7.5 billion through corporate M&A activity. A more detailed breakdown of the data can be viewed in Figure 24.

Figure 24. M&A Activity in Emerging Southeast Asia, by Origin (2011–2021)



Note: *Values include all transactions between 1/1/2011 and 6/31/2021. Countries highlighted: Indonesia, Malaysia, Philippines, Thailand, and Vietnam.*

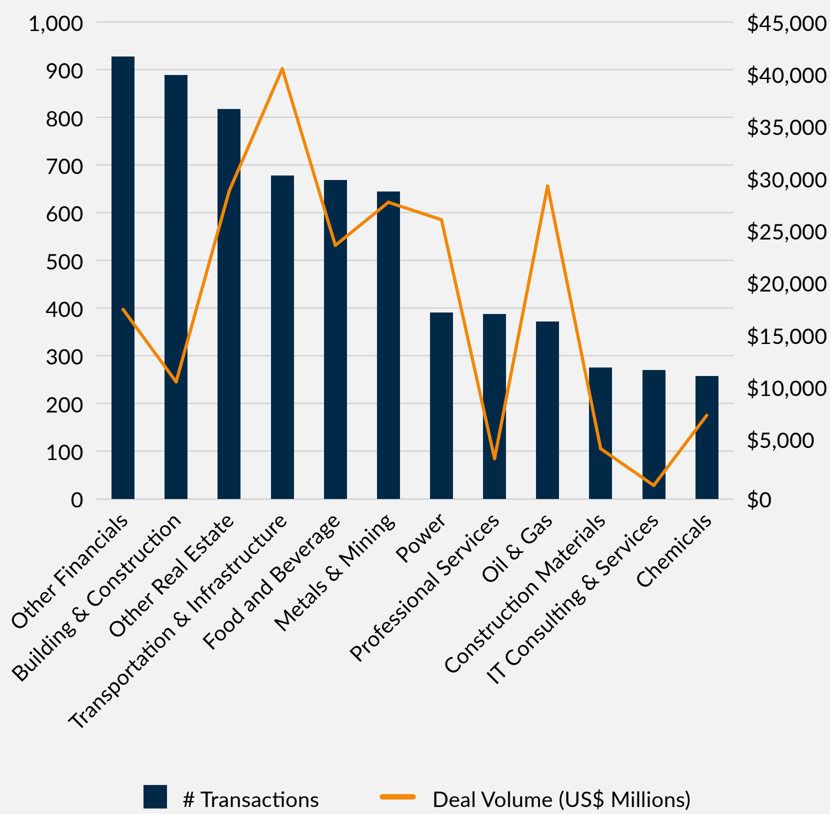
Source: *Refinitiv EIKON (2021)*

NEW OPPORTUNITIES

Emerging Southeast Asia is already well positioned to attract foreign investors. But China's growing labor and production costs, coupled with recent global trade policy shifts—primarily driven by new tariffs and supplementary trade barriers—are likely to increase the region's already critical role in global supply chains. Even as new trade deals are tentatively struck, this trend will probably be permanent because companies have come to recognize the importance of supply chain diversification in increasing resilience and mitigating future uncertainties.

The diversification of global supply chains has already acted as a catalyst for the build-out of new supply chains and transportation infrastructure across emerging Southeast Asian economies. Indeed, regional production and supply chain movements have already led to significant cross-border M&A activity in the region—most notably in the real estate, building, and construction materials industries—accounting for almost 2,000 transactions and totaling about US$45 billion in aggregate deal value over the past decade (see Figure 25).

Figure 25. M&A Activity in Emerging Southeast Asia, by Target Industry (2011–2021)



Note: *Values include all transactions between 1/1/2011 and 6/31/2021. Countries highlighted: Indonesia, Malaysia, Philippines, Thailand, and Vietnam.*

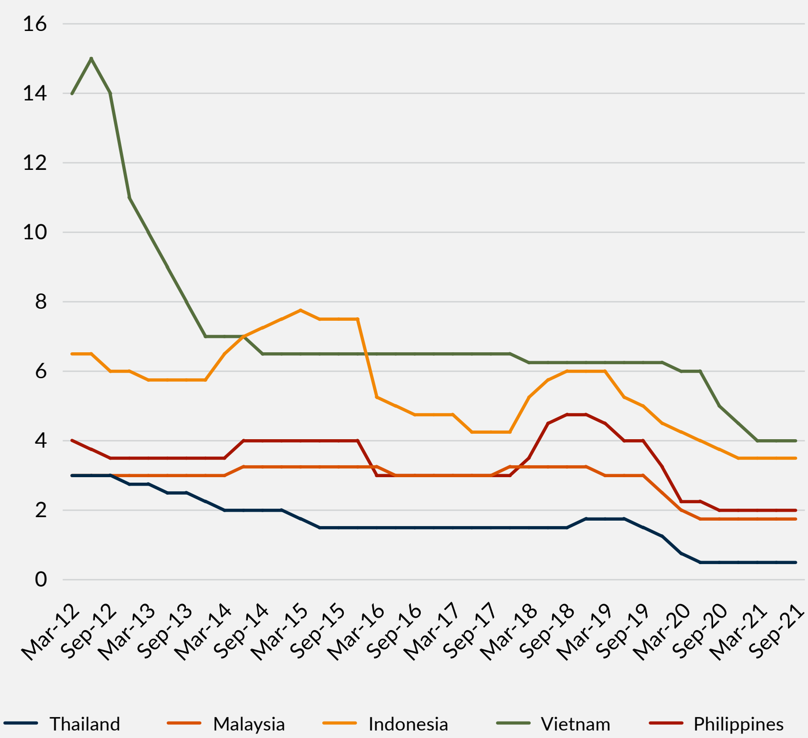
Source: *Refinitiv EIKON (2021)*

Not surprisingly, recognizing the potential for increased FDI, many emerging Southeast Asian governments have relaxed restrictions and enacted policies to capitalize on recent trade developments. In October 2019, for example, Malaysia announced customized incentive packages totaling about US$250 million to attract foreign investors from Fortune 500 companies and global unicorns dealing with high-end technology, manufacturing, or value-added industries. To qualify for the incentive, companies must invest at least US$1.25 billion and create no fewer than 150,000 jobs over the next five years. In the same legislation, Malaysia also announced lowering the threshold on foreign property ownership from approximately US$250,000 to US$150,000.

Similarly, shortly after the escalation of the US-China trade conflict in 2018, Thailand's National Legislative Assembly passed the Eastern Economic Corridor Bill, which offers tax and nontax incentives to foreign lenders involved in five high-priority projects focusing on regional connectivity and transport infrastructure. The special FDI privileges include: (a) corporate income tax exemption for up to 13 years; (b) exemption from import tariffs on parts, machinery, and raw material for use in R&D; (c) lowest personal income tax rate in the region at 17 percent; and (d) permission to own project land—otherwise restricted to 49.99 percent under the Foreign Business Act. The Eastern Economic Corridor Bill was largely successful, enabling investment of almost US$6 billion in new or expanded operations within the first six months after its enactment.

Following suit, in March 2021, Indonesia issued Presidential Regulation No. 10 (colloquially referred to as the "Positive List"), which relaxes FDI restrictions and implements fiscal and nonfiscal incentives to increase foreign ownership across the economy. A total of 245 "prioritized sectors" receiving foreign capital ownership investment are now eligible for tax incentives (allowances, reductions, holidays), customs incentives (duty exemptions), and nonfiscal incentives/assistance (simplified licensing, guaranteed energy/raw materials supply, immigration, and workforce support). Prioritized sectors are broadly defined in the legislation and satisfy specific criteria such as "of national strategic significance, capital intensive, labor intensive, requiring sophisticated technology, export-oriented, R&D oriented, and/or otherwise pioneering industries." This legislation is in direct contrast to 2016's Presidential Regulation No. 44 (the "Negative List"), restricting foreign ownership of many Indonesian industries. The Negative List was revoked as the Positive List was enacted.

Figure 26. Central Bank Policy Rates in Emerging Southeast Asia *(Percent)*



Source: *Bloomberg, World Bank (2021)*

Finally, in response to the economic challenges presented by the COVID-19 pandemic, the region's central banks lowered interest rates from already historic lows. Figure 26 illustrates the target interest rates set by central banks across the five largest economies in emerging Southeast Asia.

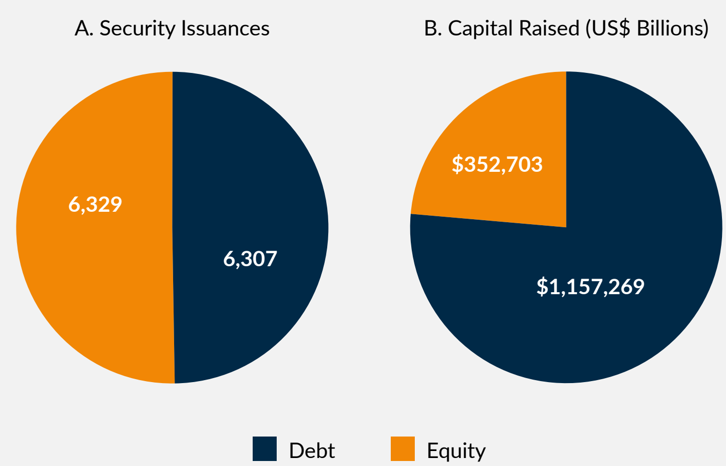
Favorable monetary policies and financial conditions, combined with growing levels of market confidence, have increased the appetite for mergers and acquisitions. Record tight credit spreads, and the resulting low loan-servicing costs due to refinancing, have fostered cash build-ups on balance sheets for corporations and increased dry powder for financial sponsors. As excess cash reserves grow, companies (no longer in survival mode) will revert to inorganic growth strategies, pursuing horizontal acquisitions of competitors and vertical acquisitions along the supply chain.

In emerging Southeast Asia, large global financial sponsor groups have already begun increasing investment, in terms of both the number of deals and the size of transactions. Global private equity firm General Atlantic, for example, has demonstrated interest in the region, investing more than US$55 million in the Indonesian life-sciences and pharmaceutical firm Kalbe Genexine Biologics (KGBio). According to the deal announcement, the 2021 minority investment will support KGBio's ongoing clinical developments, commercialization needs, and production capacity expansion. Also in 2021, General Atlantic and Dragoneer Investment Group co-led the US$250 million Series B financing round of Vietnam-based VNLIFE. The financing round—one of the largest conducted in the country—also included the participation of PayPal Ventures and Singapore's Economic Development Board. VNLIFE is a leading technology company and the parent organization of VNPAY, Vietnam's largest interoperable cashless payment network, boasting 22 million users and supporting 150,000 merchants.

Security Issuance and Domestic Financing

Continuing the analysis of the five largest emerging Southeast Asian economies (Indonesia, Malaysia, Philippines, Thailand, and Vietnam), Figure 27 looks at the number of debt and equity issuances by domestic corporations, along with the aggregate capital raised by each type of financial instrument over the past decade. While total issuance is evenly split between equity and debt, about 76.6 percent of total capital raised comes from debt securities. Of the roughly US$1.2 trillion capital raised through debt, it is important to note, almost US$800 billion comes in the form of investment-grade corporate debt. The rest, approximately US$360 billion, comes in the form of sovereign or government debt.

Figure 27. Security Issuance and Capital Raised in Emerging SEA (2011–2021)



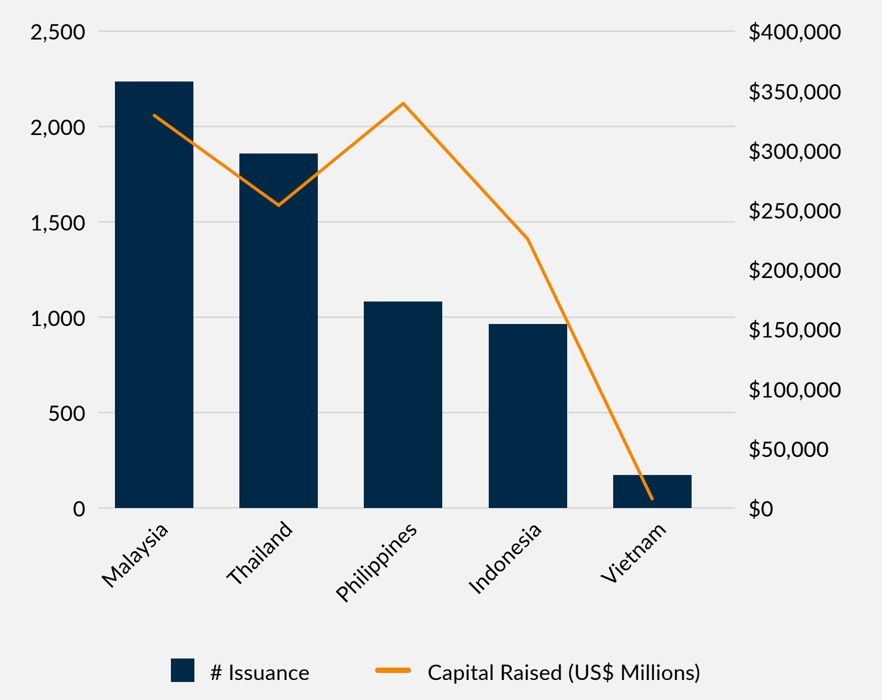
Note: *Values include all transactions between 1/1/2011 and 6/31/2021. Countries highlighted: Indonesia, Malaysia, Philippines, Thailand, and Vietnam.*

Source: *Refinitiv EIKON (2021)*

Figure 28 illustrates the number of debt issuances and total debt capital raised by domestic governments and private entities headquartered within the region's five largest emerging economies. Malaysia, home to the third-largest bond market in Asia (after Japan and the Republic of Korea), is also home to the world's largest sukuk (Islamic or sharia-compliant) bond market. While the Malaysian bond market trades issuances originating from all over the globe, about 49 percent of all Malaysia-based issuances and 65 percent of all Malaysia-based capital raised over the past decade have come in the form of Islamic or sharia-compliant financing.[23]

The first such financial instrument was developed in Malaysia in 2000, quickly gaining popularity after Bahrain followed suit in 2001. Malaysia's novel development of a sharia-compliant debt instrument has allowed the country to grow and develop its financial services sector rapidly. The creation of sukuk bonds provided a much-needed avenue of capital raising and investment for nations and people who follow the precepts of Islam. According to the most recent census report from 2010, almost 62 percent of the Malaysian population identifies as Islamic; Buddhism, with less than 20 percent of the population, is the next largest religious denomination in the country.

Figure 28. Debt Security Issuance, by Country (2011–2021)



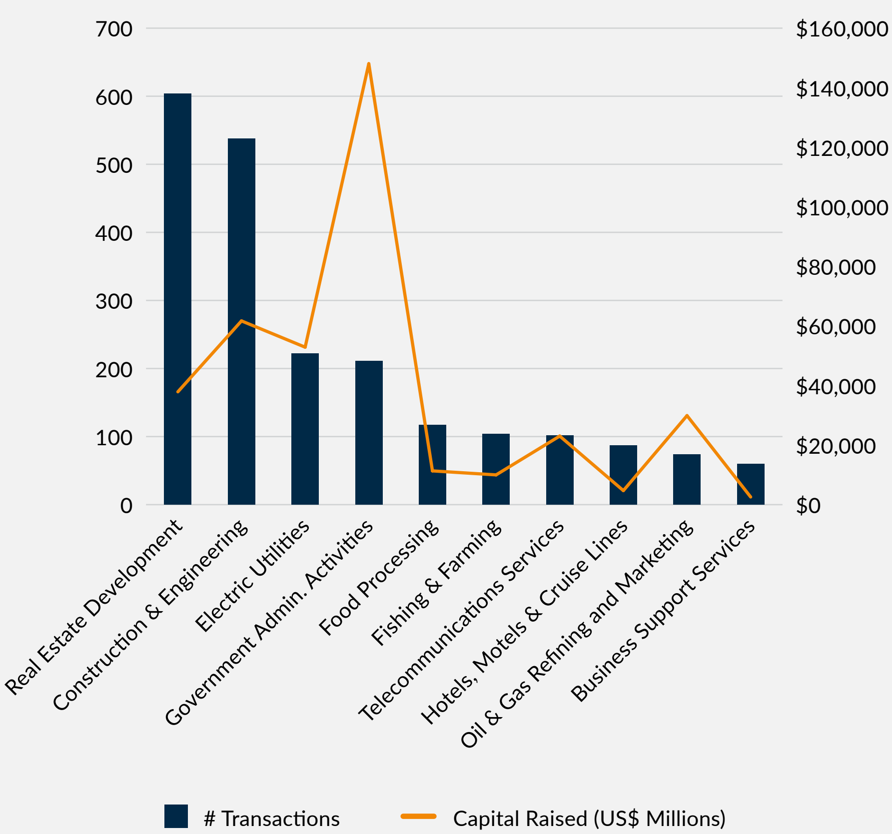
Note: *Values include all transactions between 1/1/2011 and 6/31/2021. Countries highlighted: Indonesia, Malaysia, Philippines, Thailand, and Vietnam.*

Source: *Refinitiv EIKON (2021)*

The Philippines ranked third in terms of number of issuances but first in terms of total funds raised through debt over the past decade. This is largely because the Philippines is home to the Asian Development Bank (ADB), a regional development bank modeled mainly on the World Bank.[24] In fact, since January 2011, the ADB has originated 642 debt issuances, raising about US$210 billion and accounting for more than 62 percent of the total debt capital raised in the Philippines.

While the ADB accounts for a significant fraction of the total supranational and sovereign debt in emerging Southeast Asia, expensive economic stimulus measures resulting from the COVID-19 pandemic have also contributed to the growth of agency debt across the region.

Figure 29. Debt Issuance in Emerging SEA, by Industry (excluding Financial Debt), 2011–2021



Note: *Values include all transactions between 1/1/2011 and 6/31/2021. Countries highlighted: Indonesia, Malaysia, Philippines, Thailand, and Vietnam.*

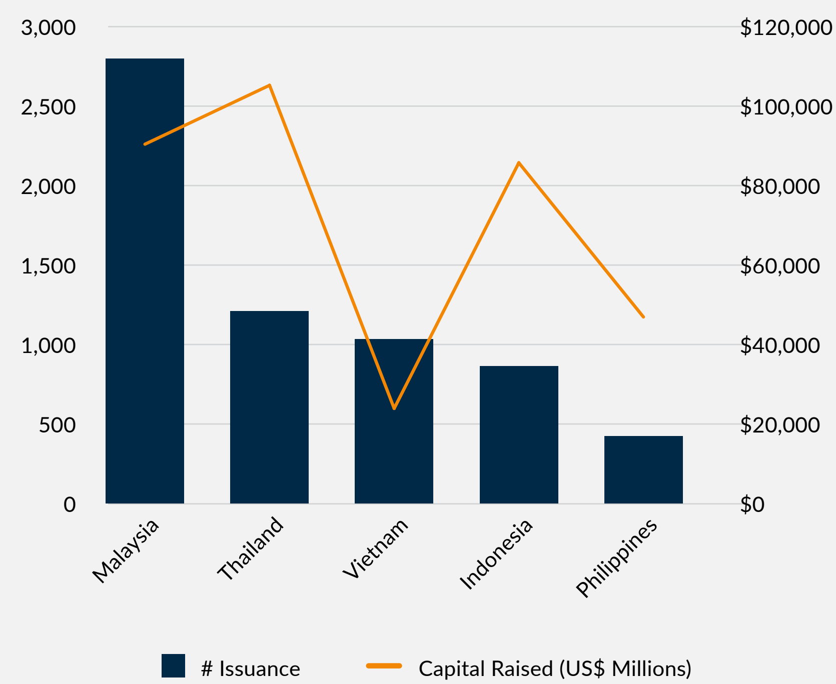
Source: *Refinitiv EIKON (2021)*

As a result of the economic hardships imposed by the early lockdowns and resulting economic externalities due to the COVID-19 pandemic, governments in emerging Southeast Asia have enacted various targeted stimulus packages based upon the make-up of their respective economies. Figure 29 shows the outsized capital raised by government administration activities relative to the number of debt issuances by industry. Since March 2020, sovereign governments and supranational agencies residing within the region have issued the following debt to provide economic and fiscal relief to their populations:

- Indonesia: 19 issues, totaling US$18.68 billion
- Malaysia: 7 issues, totaling US$625 million
- Philippines: 5 issues, totaling US$11.07 billion (this figure does not include the 166 issuances by the Asian Development Bank, totaling over US$53.5 billion)
- Thailand: 6 issues, totaling US$2.10 billion

While governmental and agency debt issuances have raised the most capital in the region over the past decade, the real estate development and construction industries have issued the most debt instruments over the same period. This trend can be partly explained by these industries' high capital expenditure and working capital requirements and the increased demand for commercial and residential real estate. Additionally, debt capital was used to finance some of the M&A activity in the real estate development and construction industries highlighted in the previous section.

Figure 30. Equity Security Issuance by Country (2011–2021)



Note: *Values include all transactions between 1/1/2011 and 6/31/2021.*

Source: *Refinitiv EIKON (2021)*

Pivoting away from debt issuance, Figure 30 illustrates the total issuance and aggregate capital raised by equity securities originating in the five largest emerging Southeast Asian economies. The figure shows no clear ranking among countries. While Malaysia ranks first in terms of the number of issuances since 2011, Thailand has raised the most capital through the origination of equity securities. Still, Indonesia is at the top when it comes to the average capital raised per issuance, at US$99.23 million.

The middle- and upper-middle-class growth that has characterized the region (Indonesia and Thailand, most notably) has primed the markets to set new records in capital raised through equity issuance. According to the World Bank, Thailand's household consumption as a percent of GDP has risen from 48.90 percent in 2018 to 52.88 percent in 2020. New research from the McKinsey Global Institute in a report titled "The Future of Asia" finds that Indonesia's consumption could grow by US$400 billion over the next decade, while also stating that e-commerce in Indonesia is projected to grow at a compound annual growth rate of 25 percent from 2020 to 2025. Partly as a result, in the last two years, new IPO records have been set for Indonesia and Thailand in the e-commerce and retail industries (respectively), both within the consumer products sector of the economy.

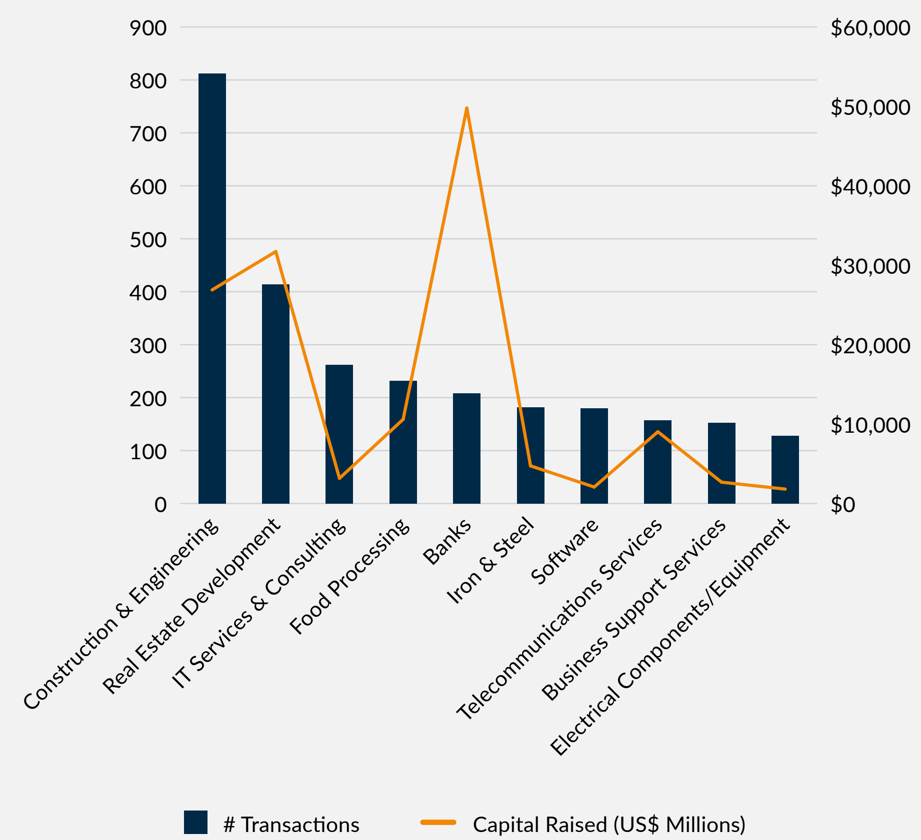
On February 20, 2020, Central Retail Corporation (Thailand's largest retailer) raised just under $2.5 billion in a record-setting IPO. The company operates hundreds of malls, electronics, grocery, and 24-hour convenience stores across the country, as well as a fashion and beauty distribution business that works alongside brands such as Guess, Topshop, Polo Ralph Lauren, and Aesop.

Indonesian capital markets have also seen success with regard to IPOs in the consumer products space. On August 6, 2021, Indonesia set national IPO records with the listing of PT Bukalapak, the country's first listed tech unicorn. Raising US$1.5 billion on an over-subscribed IPO, Bukalapak hit the country's equity daily 25 percent price appreciation limit within minutes of going live, giving the company a valuation of more than US$6 billion. It should be noted that the country's only stock exchange, the Indonesia Stock Exchange (IDX), has imposed limits on daily share price appreciation/depreciation, capped at approximately 25 percent/10 percent on any equity share priced above Rp5,000 (about US$0.35). These caps were instituted in 2015 to cushion the adverse effects of high global market volatility and fluctuating exchange rates.

But PT Bukalapak is not likely to hold the record for long. Indonesia's largest tech group, GoTo, a recent entity created by the US$18 billion merger of the e-commerce platform PT Tokopedia and the ride-share/digital-payment solutions company Gojek, has announced tentative plans for a 2022 IPO. The recently formed entity, backed in part by Alibaba, the Softbank Vision Fund, and the Singapore Sovereign Wealth Fund, just completed a pre-IPO funding round, securing more than US$2 billion in growth equity.

While the consumer products sector has presented the largest IPOs to date in the region, it does not represent the most active equity-issuing industry. This is likely to be due to the constant private market (M&A) roll-up in an effort to find cost synergies and consumer base growth in a sector characterized by thin product margins and costly supply chains. E-commerce and retail operations in the region mirror the US consumer products landscape, with low barriers to entry and high pricing competition. In such conditions, only the largest companies can take advantage of economies of scale and distinguish themselves enough to warrant investor attention.

Figure 31. Equity Issuance in Emerging SEA, by Industry (2011–2021)



Note: *Values include all transactions between 1/1/2011 and 6/31/2021. Countries highlighted: Indonesia, Malaysia, Philippines, Thailand, and Vietnam.*

Source: *Refinitiv EIKON (2021)*

Figure 31 shows the region's leading industries when it comes to aggregate equity capital raised. Once again, the construction and real estate industries rank the highest by number of transactions. As a function of industry capital requirements and germane products offered, however, the banking industry has attracted the most capital through equity security issuance.

Conclusion: The Road Ahead

Attracted by the region's sound economic frameworks, strategic location, and fast-growing domestic markets, foreign capital has played a crucial role in promoting growth and development within emerging Southeast Asia. But despite this record, the region's attractiveness to international investors should not be taken for granted. To stay competitive against other emerging markets and developing economies, emerging Southeast Asia must identify new areas of opportunity and undertake the appropriate policy reforms, thereby mitigating risks that could negatively affect foreign investors' confidence in the region.

The report shows that emerging Southeast Asia compares well with other emerging markets and developing economies in two crucial areas when it comes to attracting foreign investors: **Economic Fundamentals** and **International Standards & Policy**. However, the region underperforms in **Institutional Frameworks**—especially in **Transparency**—and has a mixed performance in **Business Perception** and **Financial Services**—scoring slightly better than its peers but showing significant differences among the region's economies.

There is no single recipe for success when attracting and retaining foreign capital. But our analysis highlights that improving institutional frameworks— particularly as they relate to corporate and government transparency—is critical to increasing the region's attractiveness to international investors and, more broadly, generating a healthier business environment. Governments in the region must commit to the highest transparency standards (adapted to reflect national culture, history, and values) while simultaneously enhancing their investment frameworks to provide greater predictability and certainty to all parties involved. Accomplishing these goals will not be easy, as governments will have to overcome political obstacles and develop new institutional capabilities needed to support pro-transparency legislation. It will also require going beyond national solutions and adopting a regional approach, thereby fostering Southeast Asia's identity as a single economic market.

But remaining a primary destination for foreign investors is not emerging Southeast Asia's only challenge. Equally important is the need to increase the social impact of foreign capital, thereby ensuring that it contributes to the region's development agenda. To accomplish these goals, governments in the region must take a more proactive approach to attract and retain quality investment, promote responsible business conduct, and—more broadly—guarantee that global capital inflows contribute to broad-based, sustainable, and inclusive growth within the region.

Appendix: Economy Grouping

Table A1. List of Markets by Economic Group

Advanced Economies

Australia	Germany	Lithuania	Slovenia
Austria	Greece	Luxembourg	Spain
Belgium	Hong Kong	Macao	Sweden
Canada	Iceland	Malta	Switzerland
Cyprus	Ireland	Netherlands	Taiwan
Czech Republic	Israel	New Zealand	United Kingdom
Denmark	Italy	Norway	United States
Estonia	Japan	Portugal	
Finland	Korea	Singapore	
France	Latvia	Slovak Republic	

EMDE Europe

Albania	Croatia	Montenegro	Russia
Belarus	Hungary	North Macedonia	Serbia
Bosnia and Herzegovina	Kosovo	Poland	Turkey
Bulgaria	Moldova	Romania	Ukraine

EMDE Southeast Asia

Brunei	Lao PDR	Philippines	Vietnam
Cambodia	Malaysia	Thailand	
Indonesia	Myanmar	Timor-Leste	

Latin America and the Caribbean

Argentina	Costa Rica	Haiti	Paraguay
Belize	Dominican Republic	Honduras	Peru
Bolivia	Ecuador	Jamaica	Suriname
Brazil	El Salvador	Mexico	Trinidad and Tobago
Chile	Guatemala	Nicaragua	Uruguay
Colombia	Guyana	Panama	Venezuela

Other EMDE Asia (excl. China)

Bangladesh	Maldives	Nepal	Sri Lanka
Bhutan	Marshall Islands	Palau	Tonga
Fiji	Micronesia	Papua New Guinea	Tuvalu
India	Mongolia	Samoa	Vanuatu
Kiribati	Nauru	Solomon Islands	

Rest of EMDE Economies

Afghanistan	Egypt	Liberia	Seychelles
Algeria	Equatorial Guinea	Libya	Sierra Leone
Angola	Eritrea	Madagascar	Somalia
Armenia	Eswatini	Malawi	South Africa
Azerbaijan	Ethiopia	Mali	South Sudan
Bahrain	Gabon	Mauritania	Sudan
Benin	Gambia	Mauritius	Syria
Botswana	Georgia	Morocco	Tajikistan
Burkina Faso	Ghana	Mozambique	Tanzania
Burundi	Guinea	Namibia	Togo
Cabo Verde	Guinea-Bissau	Niger	Tunisia
Cameroon	Iran	Nigeria	Turkmenistan
Central African Rep.	Iraq	Oman	Uganda
Chad	Jordan	Pakistan	Uzbekistan
Comoros	Kazakhstan	Qatar	West Bank
Congo, Dem.	Kenya	Rwanda	and Gaza
Rep. of	Kuwait	São Tomé	Yemen
Congo, Rep. of	Kyrgyzstan	and Príncipe	Zambia
Côte d'Ivoire	Lebanon	Saudi Arabia	Zimbabwe
Djibouti	Lesotho	Senegal	

Source: *IMF—World Economic Outlook (2021)*

Endnotes

1. For more details on the Global Opportunity Index, see Benjamin Smith and Micah Rabin, *Global Opportunity Index 2022: White Paper* (Milken Institute, 2022).

2. See box on page 20 for the definition of capital inflows used in the report.

3. For a discussion of recent reforms in the region, see ASEAN Secretariat and UNCTAD, *ASEAN Investment Report* (2021), https://unctad.org/webflyer/asean-investment-report-2021; OECD, *OECD Investment Policy Reviews: Southeast Asia* (2019), https://www.oecd.org/investment/oecd-investment-policy-review-southeast-asia.htm; and K.S. Jomo, ed., *After the Storm: Crisis Recovery and Sustaining Development in Four Asian Economies* (NUS Press, 2014).

4. See OECD, *Measurement and Identification of Capital Inflow Surges* (October 2018), https://www.oecd.org/daf/inv/Measurement-identification-of-capital-inflow-surges-technical-note.pdf.

5. We also exclude capital movements associated with financial derivatives (which represent a small fraction of total flows) and with offshore financial centers (which tend to be unrelated to domestic factors).

6. For a discussion of the potentially negative effects of cross-border capital inflows and possible policy responses, see Nicolas Magud, Carmen Reinhart, and Kenneth Rogoff, *Capital Controls: Myth and Reality—A Portfolio Balance Approach* (NBER, 2011), https://www.nber.org/system/files/working_papers/w16805/w16805.pdf.

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8. See ASEAN Secretariat, *Fact Sheet of ASEAN Economic Community* (2018), https://asean.org/wp-content/uploads/2021/08/33.-November-2018-Fact-Sheet-on-AEC-1.pdf.

9. Ayman Falak Medina, "ASEAN's Free Trade Agreements: An Overview," *ASEAN Briefing* (January 21, 2021), https://www.aseanbriefing.com/news/aseans-free-trade-agreements-an-overview.

10. See Asia House, *Re-Thinking ASEAN Integration: European Precedents and Southeast Asian Futures* (2019), https://asiahouse.org/wp-content/uploads/2019/04/ASEANresearch0525.pdf.

11. See Martin Russell, *Thailand: From Coup to Crisis* (European Parliamentary Research Service, November 2020), https://www.europarl.europa.eu/RegData/etudes/ATAG/2020/659330/EPRS_ATA(2020)659330_EN.pdf.

12. For a discussion of Thailand's 2019 elections, see D. McCargo and S.T. Alexander, "Thailand's 2019 Elections: A State of Democratic Dictatorship?," *Asia Policy* 26, no. 4 (2019), https://www.nbr.org/publication/thailands-2019-elections-a-state-of-democratic-dictatorship.

13. For recent discussions of the Thai economy, see World Bank, *Thailand Economic Monitor: The Road to Recovery* (July 2021), http://documents.worldbank.org/curated/en/260291626180534793/Thailand-Economic-Monitor-The-Road-to-Recovery; and OECD, *Multi-Dimensional Review of Thailand (Vol. 2). In-Depth Analysis and Recommendations* (2019), https://doi.org/10.1787/9789264307674-en.

14. World Bank, *World Bank East Asia and Pacific Economic Update, October 2021: Long COVID* (2021), http://hdl.handle.net/10986/36295.

15. See Matthias Helble, Cyn-Young Park, Won Hee Cho, and Sol Francesca Cortes, "Can Vaccination Help Restart Tourism?" *ADB Briefs* (August 2021), http://dx.doi.org/10.22617/BRF210321-2.

16. Recent evidence suggests that a significant share of global FDI is phantom in nature, involving empty corporate shells with no real business activities. While this phenomenon is currently concentrated in a relatively small number of tax havens, it could potentially affect all economies. For a recent discussion on "phantom FDI," see J. Damgaard, T. Elkjaer, and N. Johannesen, "What Is Real and What Is Not in the Global FDI Network?" (2019), https://www.imf.org/en/Publications/WP/Issues/2019/12/11/what-is-real-and-what-is-not-in-the-global-fdi-network.

17. For a discussion of how FDI can promote economic development, see World Bank, *Global Investment Competitiveness Report* 2019/2020 (2020), https://openknowledge.worldbank.org/handle/10986/33808. For a recent discussion of the role of FDI in facilitating global value-chain integration, see Christine Qiang, Yan Liu, and Victor Steenbergen, *An Investment Perspective on Global Value Chains* (World Bank, 2021), https://openknowledge.worldbank.org/handle/10986/35526.

18. See OECD, *Benchmark Definition of Foreign Direct Investment* (2008), https://www.oecd.org/investment/fdibenchmarkdefinition.htm.

19. See Eduardo Levy Yeyati and Jimena Zúñiga, "Varieties of Capital Flows: What Do We Know?" *IADB Discussion Paper* (2016), https://publications.iadb.org/publications/english/document/Varieties-of-Capital-Flows-What-Do-We-Know.pdf.

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23. Under Islamic law, the use of interest is prohibited. Therefore, classic debt instruments cannot be used to raise capital or as investment vehicles. To circumvent the traditional use of interest, sukuk bonds are created with ameliorated ownership rights to the underlying asset purchased by the capital raise. Owners of the sukuk bond are then granted equity rights to the returns/cash flows of the asset specified in the sukuk offering.

24. The Asian Development Bank is dedicated to reducing poverty in Asia and the Pacific through lending that promotes economic growth. According to the ADB, about 80 percent of its lending goes to the public sector and is concentrated in five operational areas: education; environment, climate change, and disaster risk management; finance-sector development; infrastructure; and regional cooperation and integration.

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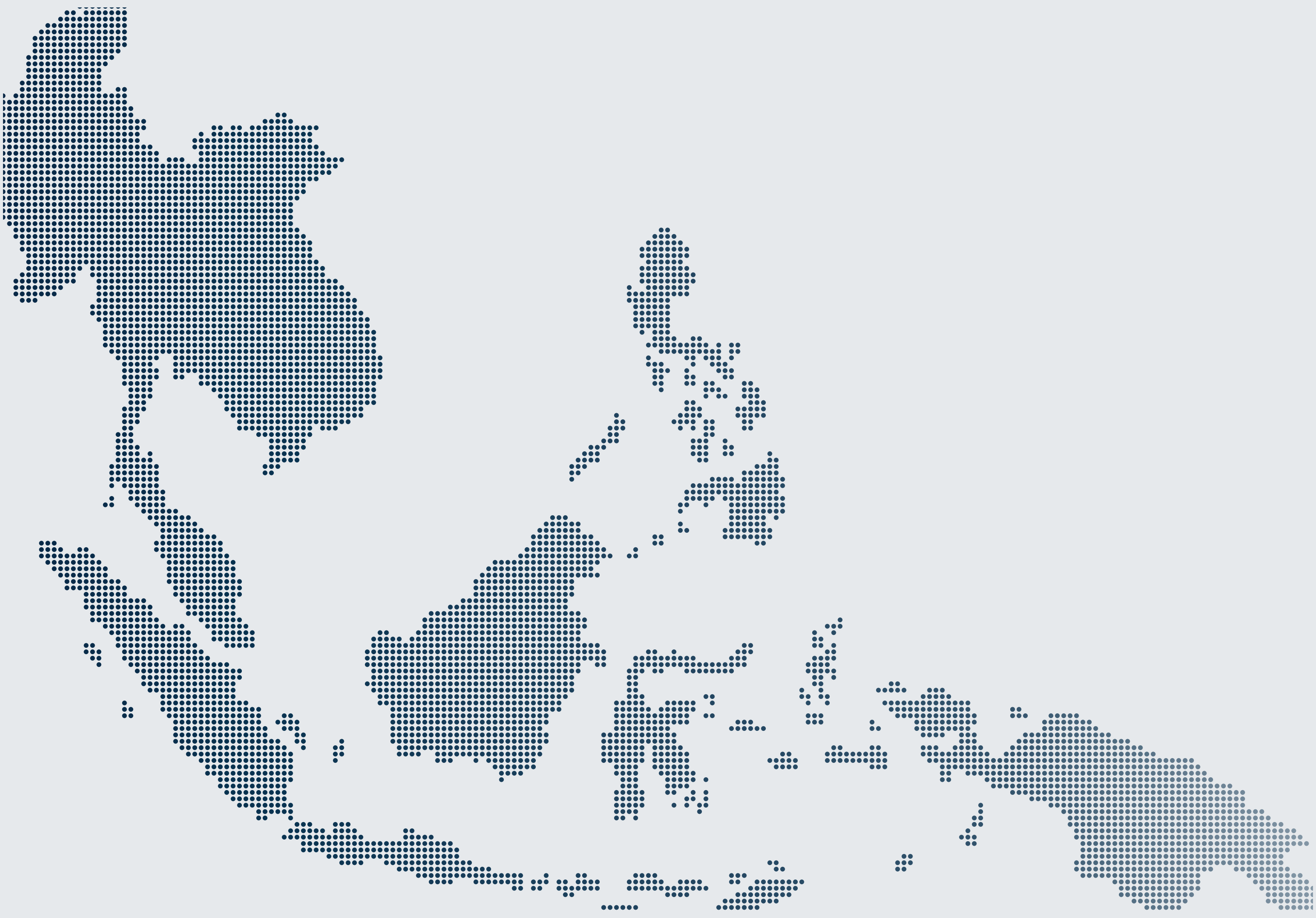
ABOUT THE AUTHORS

Oscar Contreras, PhD, is an economist specializing in international finance within the research department at the Milken Institute. He has over 10 years of experience in macroeconomics and financial markets with a focus on emerging economies. Before joining the Institute, Contreras was a senior economist in the research department of the Central Bank of Mexico, where he was responsible for providing analysis of monetary policy issues and conducting original research on macroeconomic and financial topics. Before his work at the bank, he was an assistant professor at the University College for Financial Studies in Madrid, Spain. Contreras holds a PhD in economics from Northwestern University and a BA (Hons) in economics from the Center for Economic Research and Teaching in Mexico City.

Joseph Bendix is a research analyst in international finance in the research department at the Milken Institute. His work focuses on topics related to systemic risk, capital flows, and investment. More specifically, he is in charge of identifying and analyzing market-level data sets in many of the research reports produced by the Institute. Bendix lends his experience to developing presentations for the Institute’s conferences throughout the year. He holds a bachelor’s degree in economics and a Master of Science in finance from the University of San Diego.

Benjamin Smith is a research analyst in international finance within the research department at the Milken Institute. His specialty areas include the intersection between technology and financial services, global economic policymaking, and foreign direct investment. Prior to joining the Milken Institute, Smith worked on trade policy issues with research institutes in the US and Canada and published articles on US economic policy with a leading international affairs magazine. Smith holds an MA in political science from Colorado State University and a BA from Keele University.



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