ASEAN: AN UPCOMING MANUFACTURING POWERHOUSE

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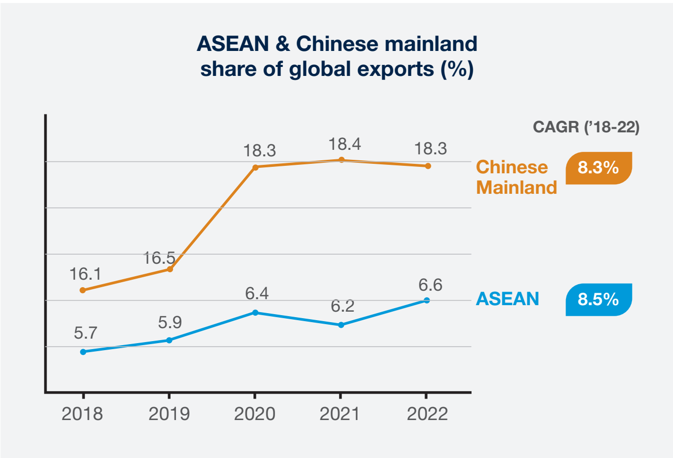
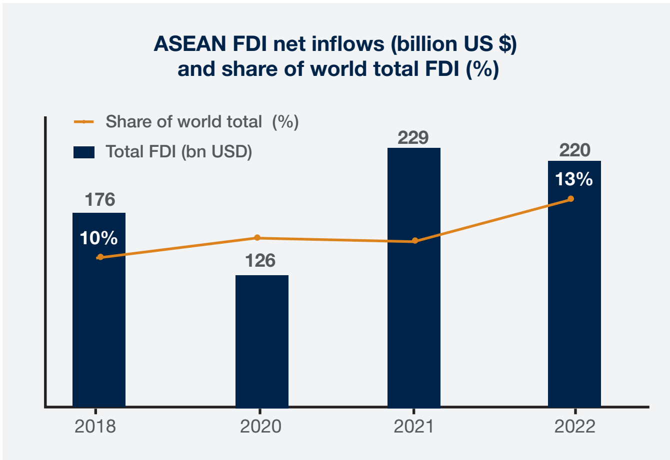
As the global geopolitical landscape becomes increasingly uncertain, volatile and complex, corporates are beginning to focus on diversification and improved resilience of existing supply chains. Improved resilience means Boards and Financial sponsors are reevaluating existing value chain models and exercising options to absorb short and long-term risks. For many organizations this means relooking at the Chinese mainland-centric manufacturing models.

However, the Chinese mainland remains a major supplier to the world, despite current tariffs and trade barriers such as the 25 percent import duty on a range of products including aluminum and cars and sanctions by the US Department of Commerce on multiple Chinese mainland companies. Despite this, the Chinese mainland's export volume to the US and Europe has grown by 5 percent and 9 percent annually in the past four years with manufactured and industrial goods still accounting for more than 70 percent[1] of the Chinese mainland exports. Therefore, building a diversified and more resilient supply chain, will require extensive planning, investments, and forward thinking.

With most manufacturing concentrated in the Chinese mainland, ASEAN countries have a significant role to play as they are likely to be a natural choice for many corporates opting for a diversification strategy. ASEAN countries have physical proximity to the Chinese mainland and have similar cost advantages and favorable demographics. While still early, ASEAN countries have started gaining share of global exports. In recent years, ASEAN has been the largest recipient of FDI inflow among emerging markets.



Source: UN Comtrade Database



Source: World Bank

1. Source: UN Comtrade Database and World Bank

Key Drivers in the Shift toward ASEAN Countries

Structural Factors

1 Geographical proximity to the Chinese mainland

Proximity to the Chinese mainland, established transport infrastructure and contiguity of supply chains are key factors in adopting ASEAN as an alternative manufacturing destination. This enables a gradual and segmented shift of work packages to the region more easily. For example, the semi-conductor auxiliary value chain has developed in Vietnam and Malaysia.

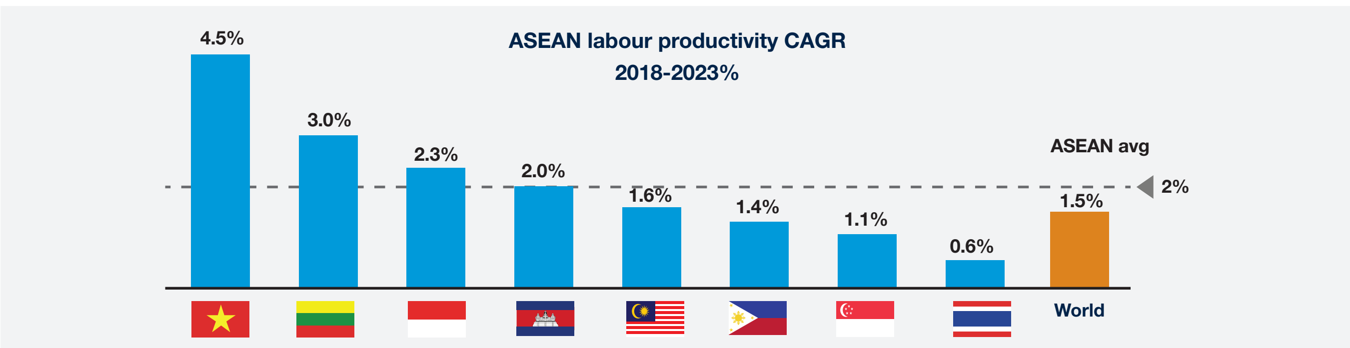
Malaysia and Thailand fare best on the logistics performance index, but Vietnam and Indonesia are making rapid progress with increasing investment.

World bank's logistics performance index (LPI) 2023

Country	Criteria Rank						LPI Score	LPI Grouped Rank
	Customs Grouped Rank	Infrastructure Grouped Rank	International Shipments Grouped Rank	Logistics Competence and Quality Grouped Rank	Timeliness Grouped Rank	Tracking and Tracing Grouped Rank		
Singapore	1	1	2	1	1	1	4.3	**1**
Malaysia	31	30	8	28	30	29	3.6	**26**
Thailand	31	25	22	38	46	34	3.5	**34**
Philippines	59	47	47	46	21	49	3.3	**43**
Vietnam	43	47	38	53	59	41	3.3	**43**
Indonesia	59	59	57	65	59	65	3.0	**61**

2 Favorable factors of production

ASEAN countries have the advantage of a demographic dividend. They are collectively the world's third largest labor force, offering significantly cheaper manpower vs. the Chinese mainland (for example, Vietnam labor costs are 50 percent[2] lower compared to the Chinese mainland) and have a growing middle class. Public investments in upskilling the workforce are helping transform this labor force. While productivity is still lower than the Chinese mainland, the improvements are trending on the right trajectory.



Source: International Labor Organization

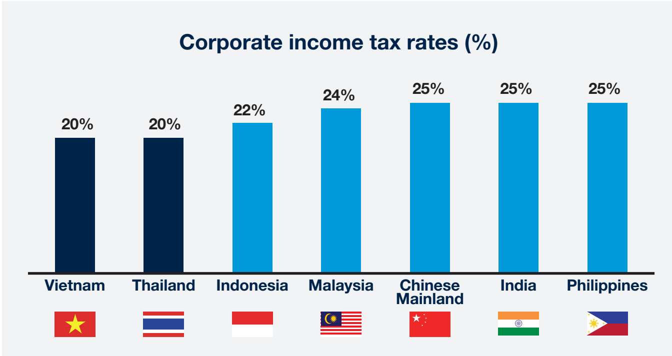
2. Source: Statista

3 Government initiatives and incentives

Outside of proximity to the Chinese mainland and low labor costs, countries have actively taken steps to be first in line. Some of these countries have made foundational changes and invested in reforms to provide an overall conducive environment to become one of the preferred manufacturing destinations. This factor will be covered in greater detail in our section on country-level analysis.

4 Competitive corporate tax rates

Corporate income tax rate is one of the key factors contributing towards overall cost of doing business in a country. Vietnam and Thailand have a significantly lower corporate tax rate compared to others. This, when combined with specific investment-based tax incentives like Vietnam's four-year tax exemption for enterprises investing in projects in prioritized industries (electronics, automobiles, machinery engineering, hi-tech industries), is a very attractive proposition for potential investors.



Source: OECD, Tax Foundation

5 Extensive network of free trade agreements

Trade agreements are also a key competitive advantage, e.g., Vietnam has an extensive network of 18 active free trade agreements covering most of the largest economies in the world including the EU and the UK, the Chinese mainland, Japan, and South Korea. Vietnam is one of the few countries which has already ratified a free trade agreement with the EU, the second largest economy globally. No other country in ASEAN, nor India has developed such a wide range of free trade agreements.

Active Free Trade Agreements with the largest economies

	Chinese Mainland	Indonesia	Thailand	Vietnam	Malaysia	Philippines
US						
EU				✓		
Chinese Mainland		✓	✓	✓	✓	✓
Japan		✓	✓	✓	✓	✓
India		✓	✓	✓	✓	✓
UK				✓		
Brazil						
Canada				✓		
Russia				✓		
Mexico				✓		
South Korea	✓	✓	✓	✓	✓	✓
Australia	✓	✓	✓	✓	✓	✓

6 Ease of doing business

Historically, ASEAN countries' (except Singapore's) regulatory and bureaucratic structures have not moved with the pace needed to attract foreign investment. This has led to a lot of missed opportunities in the past. Recently, however, countries have made a concerted effort to reduce operationalization timelines. While all countries have moved the needle on ease of doing business, Malaysia and Thailand, with their longer reform history, are ahead on the curve compared to Vietnam, Indonesia and the Philippines.

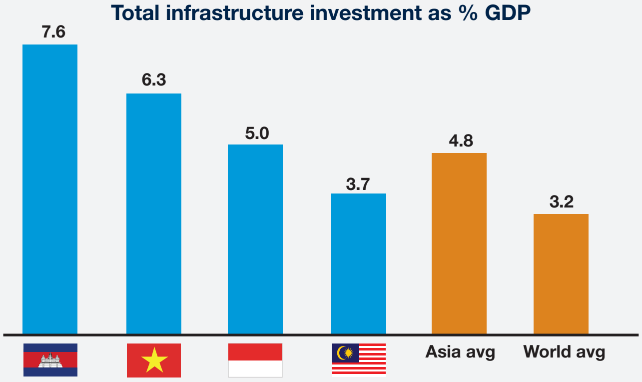
World Bank's Ease of Doing Business Ranking 2020

Country	Criteria Rank										
	Starting business	Dealing with construction permits	Getting electricity	Registering property	Getting credit score	Protecting minority investors	Paying taxes	Trading across border	Enforcing contracts	Resolving insolvency	Ease of doing business rank
Singapore	4	5	19	21	37	3	7	47	1	27	**2**
Malaysia	126	2	4	33	37	2	80	49	35	40	**12**
Thailand	47	34	6	67	48	3	68	62	37	24	**21**
Vietnam	115	25	27	64	25	97	109	104	68	122	**70**
Indonesia	140	110	33	106	48	37	81	116	139	38	**73**
Philippines	171	85	32	120	132	72	95	113	152	65	**95**

7 Infrastructure boost

Growing urbanization in ASEAN is boosting spend on vital infrastructure, which supports manufacturing. Major ASEAN governments are investing heavily in road, rail and port infrastructure across the region.

Total infrastructure investment as % GDP



Source: Global Infrastructure Hub

Country-level Analysis

1 Indonesia

A massive consumer base (a population of 277 million), a large cost effective labour force (160 million below 35 years of age), a favourable economic scenario (5 percent GDP growth, stable currency and declining Inflation) makes Indonesia a very attractive manufacturing location amongst ASEAN countries.

In recent years, the Indonesian government has increasingly taken steps to bolster its competitiveness and improve its standing in the Global Competitiveness Index (GCI). As a part of this effort, the government has:

1. **Expanded ease of doing business initiatives through legislation:** The Indonesian government recently enacted the Omnibus Law on Job Creation which introduces strategic policies aimed at easing business processes (reduced red tape, reduced prohibited lists, single window clearance, etc.), expanding the investment ecosystem and business operations (provisions for project-based incentives), and accelerating the development of the national manufacturing vision. This law is a significant step towards fostering economic growth and development.

   The government has also been very proactive in engaging at the highest levels with strategic partner countries and industry sectors. The Ministry of Investment and the President's Office are taking effort to attract the Chinese mainland investors to the electric vehicle value chain including battery tech, rare earth minerals, etc.

2. **Launched large-scale and inclusive skilling and upskilling programs:** The government developed the Kartu Prakerja Program to enhance competencies of the Indonesian workforce and build a talent pipeline to execute the National Digital Economy Strategy. This programme has reached over 17.5 million individuals across more than 500 districts so far, helping develop a more productive, tech-ready workforce.

Large-scale and inclusive skilling, reskilling, and upskilling program

Kartu Prakerja Program is an inclusive training program with an end-to-end digital system to enhance the competencies of Indonesia's workforce. The program encourages lifelong learning, increases job opportunities, and helps prepare digital talent following the National Digital Economy Strategy.

Prakerja in 2024*

1.1 million - Target beneficiaries

IDR 5 trillion - Budget allocation

*will be determined by the Cipta Kerja Committee

17.57 million
Effective beneficiaries of Kartu Prakerja

53 million
Register on www.prakerja.go.id
(verified email, phone, citizen ID number)

514 Districts/Cities

- **51 percent** women
- **64 percent** from rural areas
- **29 percent** from 1-4 deciles
- **62 percent** aged 18-35
- **3 percent** with disabilities
- **3 percent** retired indonesian migrant workers (PMI)
- **86 percent** never attended training before
- **2 percent** from 3T

IDR 63.4 trillion
Total budget allocation for 2020-2023

Kartu Prakerja Ecosystem

- **245** **Training institutions**
- **1,216** **Training programs** Including future jobs, green skills, and AI/Machine learning
- **38** **Assessors** (Higher education institutions, CSOs, business associations)
- **3** **Job portals** Thousands of job vacancies every day
- **96 percent** Participants completed the training

Source: Bank of Indonesia

3. Accelerated infrastructure projects and government-backed assurance for foreign investors: The National Strategic Project (PSN) is an ambitious nation building program launched to develop capability and capacity across industrial, public, educational and health infrastructure, with a massive outlay of IDR 4,200 trillion across 245 training institutions fostering government intent to build and accelerate economic growth.

In 2023, there were 37 construction projects completed under PSN, totalling USD 9.2 billion in investment. The construction projects consist of seven dams, three ports, five toll roads, four regions, five railway stations, three airports, one energy project, an education project, a technology project, five cross border posts and two electricity projects. This is expected to have a multiplier effect on the Indonesian economy and attract further FDI.

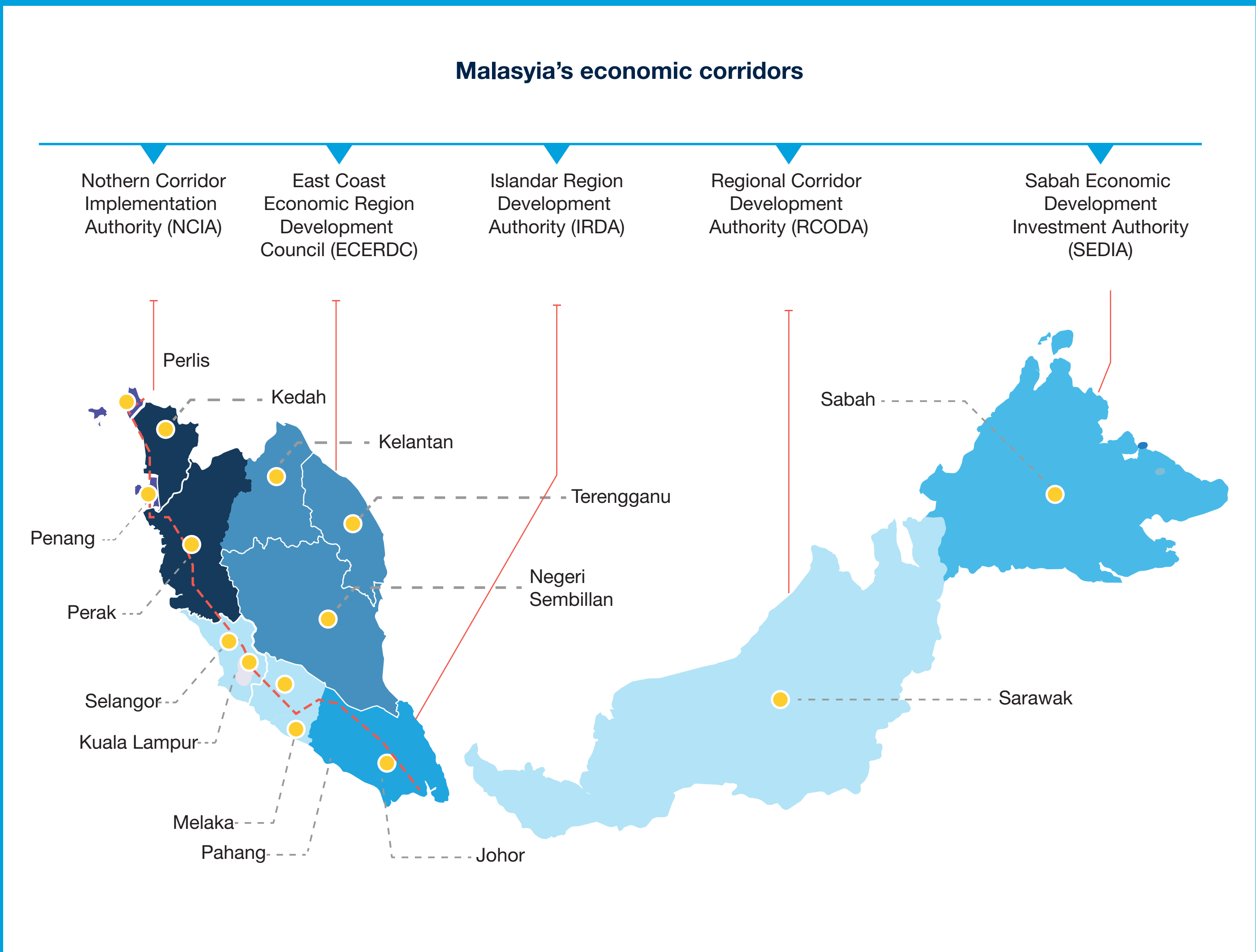
2 Malaysia

Malaysia contributes a strong share of GDP in the region (11 percent of ASEAN) despite a relatively smaller population (35 million, 5 percent of ASEAN). Malaysia has developed into an export-oriented diversified economy driven by technology and capital-intensive manufacturing industries.

Amongst ASEAN countries, Malaysia has deployed a more nuanced approach to attract higher value manufacturing investment, particularly in the semiconductor industry. The country has leveraged its historic advantages vis-à-vis its neighbors to develop a comprehensive ecosystem for the production and assembly of semiconductors, integrated circuits, and other electronic components. This has translated to significant investments from industry giants.

This strategy is built on the continuity of Malaysia's traditional advantages (education, infrastructure, policy, etc.) over its neighbors as well as some key policy interventions.

Malaysia has set up seven economic corridors offering various incentives to attract investors, including tax breaks, reduced land costs, streamlined business processes, and well-developed infrastructure to support business operations. Of these, the Northern Corridor Economic Region (NCER) in Northern Peninsular Malaysia has a focus on becoming a global industrial hub focusing on high-technology industries.

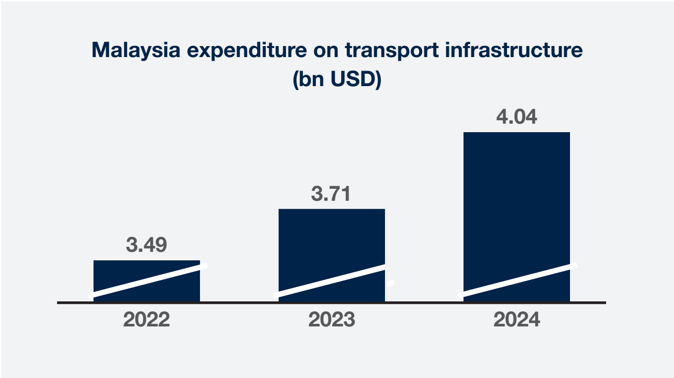


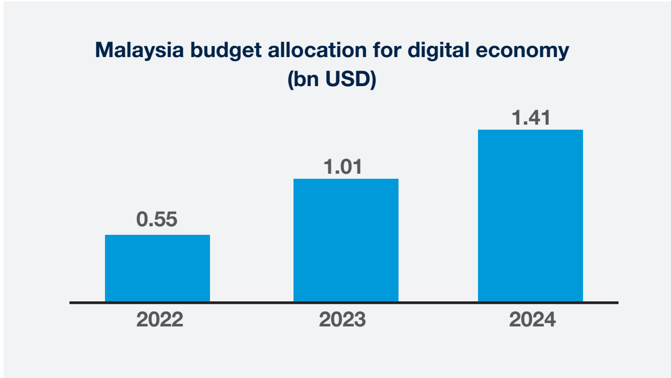
Source: ASEAN Briefing

Specific government support to attract FDI in these corridors include:

a) Infrastructure investment

Significant investments in digital and connectivity infrastructure have helped Malaysia integrate better into global value chains. Examples of these investments include over 500 dedicated industrial parks, 96.9 percent 4G coverage by end-2022, globally ranked seaports like Port Klang and Port of Tanjung Pelepas which integrates Malaysia seamlessly into both the digital and trade networks.





Source: Malaysia government

b) Supportive investment framework

These infrastructure investments are complemented by competitive investment incentives, a liberal equity policy that permits 100 percent foreign ownership in many sectors, and stringent IP protections that provide protection and ownership benefits to foreign corporations and a single nodal agency active in engaging with FDI investors.

i. **Competitive investment incentives**
The Malaysian government offers tax breaks like Pioneer Status (offering income tax exemption for 5-10 years) and Investment Tax Allowance (providing tax deductions on qualifying capital expenditure) for companies in targeted industries or locations.

ii. **Liberal equity policy**
Since 2003, Malaysia has allowed 100 percent FDI equity investment in manufacturing and selected services (health and social services, tourism services, transport services, business services and computer and related services).

iii. **Stringent IP protections**
Malaysia's IP laws are in conformance with international standards and has signed investment guarantee agreements (IGAs) with more than 60 countries. The US Chamber of Commerce's Global Innovation Policy Centre (GIPC), ranks Malaysia second in ASEAN.[1]

iv. **Single nodal agency for administrative ease**
The Malaysian Investment Development Authority (MIDA) is the government's principal investment promotion and development agency under the Ministry of International Trade and Industry to oversee and drive investments into the manufacturing and services sectors in Malaysia. Through MIDA, the government offers investment incentives, especially to targeted industries, focuses on upskilling the workforce and is also advancing digitalisation of administrative and licensing procedures.

Malaysia has been successful in accelerating investments under MIDA with over USD 28 billion of capital investments approved in 2023 (an 87 percent increase over 2022).

MIDA results in 2023 for the manufacturing sector

Indicators	2023	+/-vs 2022
Number of projects approved	883	+10%
Total Capital Investment (Mn USD)	33.108	+73%
-Domestic investment	5.126	+24%
-Foreign investment	27.982	+87%

Source: MIDA

1. Source: Annual International Intellectual Property (IP) index – 2022

3 Vietnam

Vietnam with a large young workforce of 55 million people, competitive minimum wages and a stable political environment, has emerged as a manufacturing hotspot over the last two decades, despite its limitation on infrastructure and skill levels. Today, Vietnam is the seventh largest exporter to the US, up from rank 12 in 2018 and has even achieved leading positions in some categories, such as apparel and accessories, where Vietnam is the second largest exporter after the Chinese mainland. On the other end of the spectrum, Vietnam exports more than USD 100 billion[3] of electronics which accounts for about a third of Vietnam's export, primarily driven by attracting South Korean electronics players to set up manufacturing hubs in Vietnam.

Even within ASEAN, Vietnam's proximity to the Chinese mainland with both land and sea borders has positioned it as a potential alternative base for manufacturing for many companies. Cities such as Hai Phong in Vietnam are just 865 km away from the Chinese mainland's manufacturing hub of Shenzhen. By situating manufacturing centers close to traditional hubs in the Chinese mainland, manufacturers have been able to reduce their transportation costs and avoid adding interruptions or delays to existing supply chains. Vietnam's comprehensive FTAs with Western countries add to this advantage. Outside of the macro factors, Vietnam has also focused on specific tools to punch above its weight:

a. **Tax incentives** Apart from the low overall corporate tax rate of 20 percent, Vietnam offers a range of tax breaks for FDI in manufacturing, including corporate income tax exemptions for a certain period, particularly in economic zones (EZs), import duty reductions on machinery and equipment needed for manufacturing operations and tax holidays for businesses operating in priority sectors.

   Vietnam offers corporate tax incentives for high tech industries, large scale projects with investment greater than USD 240 million (along with some other eligibility criteria) and projects of social importance. Vietnam also has investment tax allowances, whereby companies can deduct a portion of their qualifying capital expenditure from their taxable income.
   The government offers exemptions or reductions on import duties for machinery, equipment and raw materials: essential machinery / equipment and raw materials that are not readily available used in the manufacturing process can be imported at lower or zero-duty rates. This is attractive for companies bringing advanced technology, specialized equipment or as part of the reexport strategy.

   The Vietnamese government has been very active in signing double taxation agreements, with over 80 double taxation agreements signed so far including Singapore, the UK, and the US.

Industrial zones in Vietnam: A comparative study

	KER	Industrial Specialization	Related Logistics Connections	Tax Incentives
Dinh Vu Industrial Zone	Northern	• Heavy industry • Petrochemicals	**Road:** Highway 5 **Airport:** Cat Bi international **Port:** Hai Phong port	• 4 year CIT holiday • 9 year CIT reduction • Import duty exemption for select goods
Hao Khanh Industrial Zone	Central	• Electronics • Garments • Agriculture processing	**Airport:** Da Nang international **Port:** Tien Sa and Han river **Rail:** North-South railway	• 2 year CIT holiday • 3 year CIT reduction • Import duty exemption for select goods
Vietnam Singapore Industrial Zone	Southern	• Electronics • Food processing • Construction materials • Mechanics	**Airport:** Access to Tan Son Nhat international **Port:** Saigon port **Rail:** North-South railway	• 2 year CIT holiday • 4 year CIT reduction

3. Source International Trade Administration

b. **Industrial zones**
Vietnam has focused on establishing economic zones as an attractive entry point for FDI providing access to labor, easy access to ports / logistics, and preferential tax rates.

c. **Land rental exemption policies** Vietnam offers land rental exemptions to incentivize investment in manufacturing, particularly in designated areas which are either industrial parks (competitive rates or moratorium) or specific regions associated with government development programs for underdeveloped or difficult socio-economic areas.

d. **Skilled workforce development initiatives** for manufacturing: The government's commitment to workforce development is evident through various initiatives, including the recent approval of the 2021-2030 vocational education and training strategy. Under the strategy, the government expects to raise the rate of laborers with diploma or certificates to 30 percent over the next five years and 35-40 percent by 2030.

e. **Infrastructure investment**
Vietnam's infrastructure investment is the highest in ASEAN at 6 percent of GDP; projects like the North-South Expressway and Long Thanh International Airport are focused on improving trade infrastructure. The government aims for Vietnam to achieve a cargo transportation capacity of 4.4 billion tons per year, and a road transport capacity capable of moving 2.76 tons of cargo and 9.43 million passengers per year by 2030.

However, the steep rise in FDI in Vietnam over the last few years has put some pressure on infrastructure capacity, with power shortages in the summer of 2023 being a key indicator. Clear focus and sustained investment by the government, and enhanced PPP initiatives will be key to expanding the infrastructure capacity sufficiently.

f. **Regulatory debottlenecking**
The national government has empowered regional governments (provincial / city people's committees) to enact resolutions (e.g. Res 98) to manage investments in a decentralized fashion. These resolutions will empower the local provincial / city people's committee to reduce regulatory hurdles, manage public infrastructure, manage investments, labor etc. These acts have also provided reasonable autonomy to the local committees to provide investment incentives based on socio-economic and sectoral needs.

Looking Ahead

Countries in ASEAN have been rolling out policies and incentives to attract a lion's share of FDI in manufacturing, even as they invest in infrastructure and economic zones to prepare for this inflow.

For companies looking to build resilient supply chains, we believe now is the right time to implement diversification in the manufacturing and sourcing portfolio.

As global trade dynamics continue to evolve, ASEAN stands poised to become the next manufacturing powerhouse, attracting companies seeking long-term stability, operational efficiency, and access to the burgeoning consumer market.

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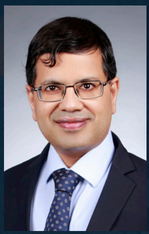

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