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STRUCTURAL SHIFTS IN REGIONAL FOREIGN DIRECT INVESTMENT FLOW

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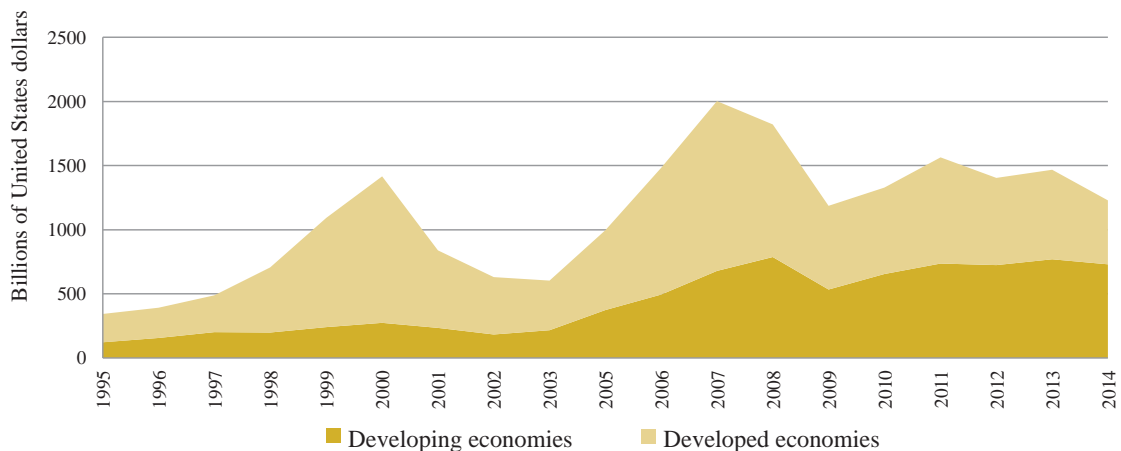
RECENT TRENDS IN FOREIGN DIRECT INVESTMENT

1. General global and regional trends

By the end of 2015 global foreign direct investment (FDI) inflows are expected to move closer to their 2013 level, followed by a mild but stable climb in 2016 and 2017 (UNCTAD, 2015).¹ The main drivers of this upward trend are found in improved growth prospects in the United States, the demand-stimulating effects of lower oil prices,

accommodating monetary policy, and continued investment liberalization and promotion measures. However in 2014 these factors were not strong enough to prevent the FDI inflow falling by 16% to \$1.23 trillion (figure 3.1). The fragile global economy, an uncertain policy environment and elevated geopolitical risks were the primary causes of the decline (UNCTAD, 2015).

Figure 3.1. FDI inflows to developed and developing economies, 1995-2014



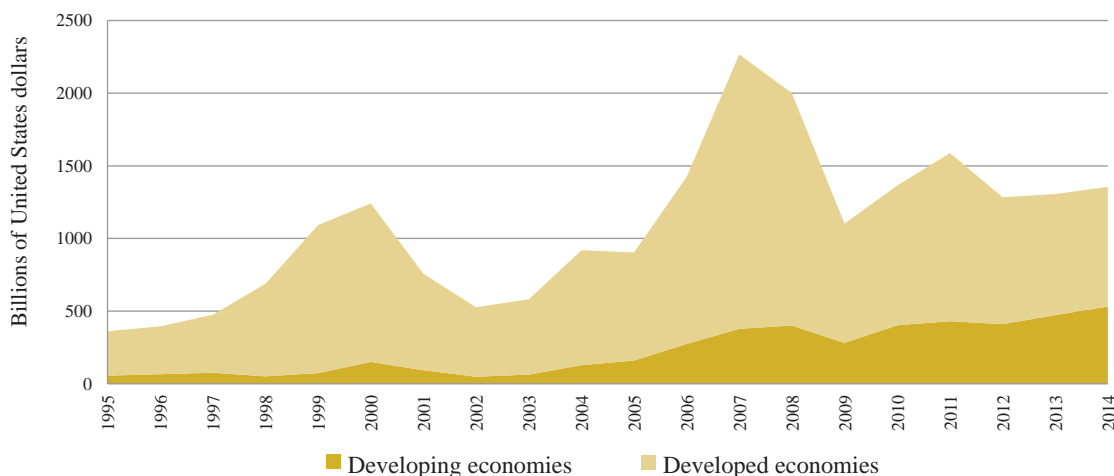
Source: ESCAP calculation based on UNCTADStat and UNCTAD, (2015.)

Developing economies have been less affected by the global financial crisis and they have also recovered faster than developed economies. Since 2012, the share of developing economies' in global FDI inflows has surpassed that of developed economies.

In 2014, developing economies received \$730 billion in FDI, a decrease of 5% from the previous year; however, this was

inconsequential compared to the 28% drop in FDI inflows to developed economies in the same year. Global FDI outflows in 2014 also showed an increasing share of developing economies. Although FDI outflows from developed economies still dominate at \$823 billion they dipped by 1% in 2014, while outflows from developing economies grew by 12% to reach \$531 billion (figure 3.2).

Figure 3.2. FDI outflows from developed and developing economies, 1995-2014

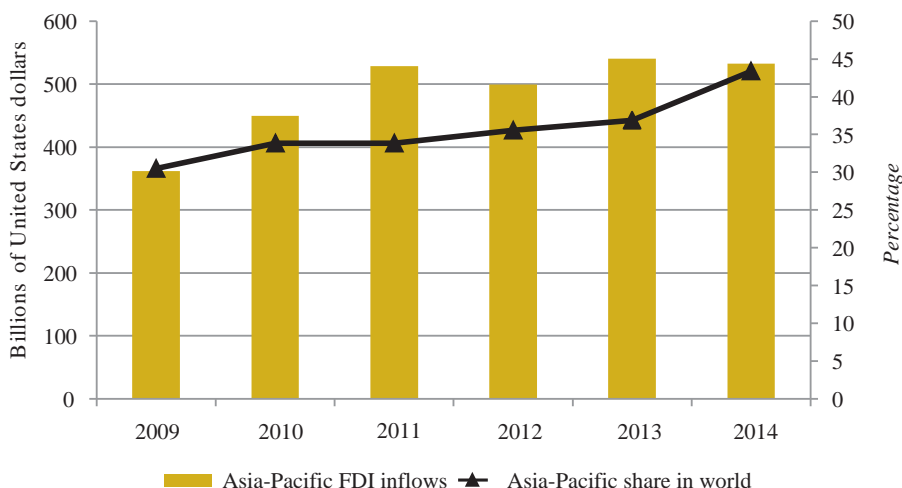


Source: ESCAP calculation based on UNCTADStat and UNCTAD, 2015.

Asia and the Pacific as a whole received a significant FDI inflow totalling \$533 billion in 2014, which boosted its share of global FDI inflow to 43%, up from 38.7% in 2013 (figure 3.3). Although the amount of FDI inflow into the Asia-Pacific region declined by 1.5% the region's share increased because the global decline was 10 times greater.

"The Asia-Pacific region has firmly established its leading position as the investment destination and also continued to grow as a major outward investor."

Figure 3.3. FDI inflows to the Asia-Pacific region and their share in global FDI inflows, 2009-2014

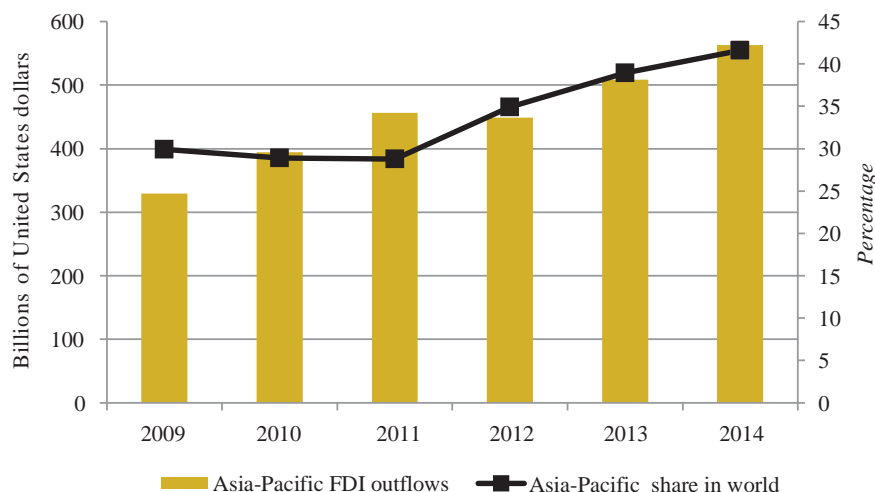


Source: ESCAP calculation based on UNCTAD, (2015).

The Asia-Pacific region has not only emerged as the leading investment destination; it has also continued to grow as a major outward investor, continuously increasing its share of global FDI outflow since 2010, with total FDI from the region reaching \$563 billion in 2014, representing 41.6% of total global FDI outflow. Developing Asia-Pacific invested

\$450 billion abroad in 2014 – a 20% increase compared with 2013 – with 6 of the 20 largest outwardly investing economies located in the region. On the other hand, investment from three developed economies in Asia and the Pacific recorded a 15% decrease in 2014 compared with the previous year, pulled down by Japan’s decline of 16% (figure 3.4).

Figure 3.4. FDI outflows from the Asia-Pacific region and their share in the global FDI outflows, 2009-2014



Source: ESCAP calculation based on UNCTAD (2015).

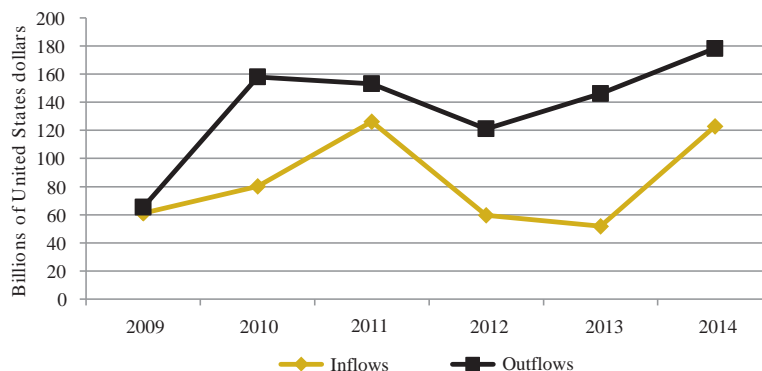
2. Trends in mergers and acquisitions and greenfield FDI flows²

Globally, FDI reached \$399 billion in 2014 through mergers and acquisitions (M&A), which represented a 28% increase from the previous year. Multinational enterprises (MNEs) regained confidence in resuming acquisitions but continued to follow a more conservative approach in managing their significant cash reserves; instead of greenfield investment they opted more for cross-border acquisitions. In the Asia-

Pacific region, FDI inflows through M&A surged to \$123 billion in 2014, an increase of 137% compared with 2013 (figure 3.5). A number of large deals, including MNEs from China, Singapore and Hong Kong, China, contributed to the increase (UNCTAD, 2015).

“Cross-border M&A have been increasing with MNEs regaining their confidence and managing their cash reserves with lesser risk.”

Figure 3.5. FDI flows through mergers and acquisitions in the Asia-Pacific region, 2009-2014



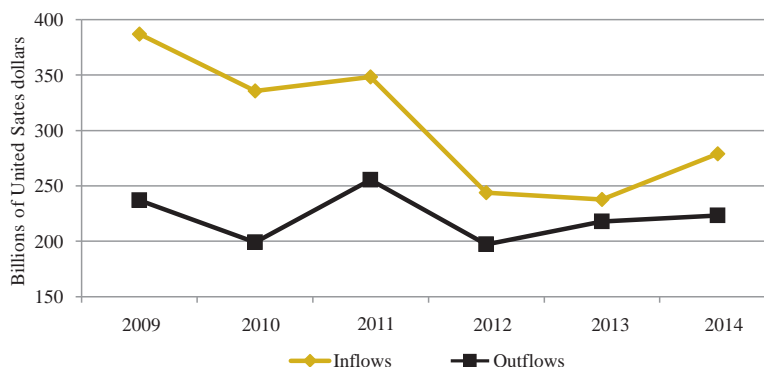
Source: ESCAP calculation based on UNCTAD (2015).

The growth in greenfield FDI inflows in Asia and the Pacific was less pronounced, totaling \$279 billion in 2014, which was a 17% increase from the previous year (figure 3.6). This increase is significant in the context of the 2% decline in greenfield investment at the global level, amounting to \$696 billion. Despite increasing importance of cross-border M&As in the Asia-Pacific region, greenfield FDI still accounts for the majority of FDI.

Whether this change in the composition of FDI shares of

greenfield and M&A will have impact on the region's growth is uncertain. First, the decision as to the mode of investment depends on several factors, such as the financial position of the firms involved as well as country and industry characteristics. Moreover, there is often a lack of distinction between greenfield and M&A in reporting statistics; this could be the reason that most of the empirical and theoretical literature has not distinguished between these two modes of FDI (Calderon, Loayza and Serven, 2004; and Nocke and Yeaple, 2007).

Figure 3.6 Greenfield FDI flows in the Asia-Pacific region, 2009-2014



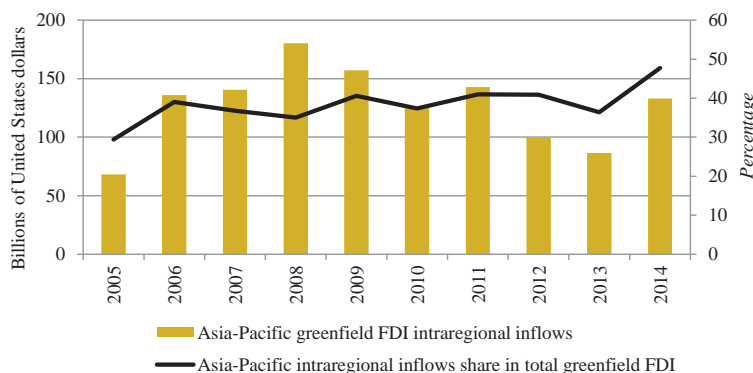
Source: ESCAP calculation based on fDi Intelligence data, 2015.

3. Intraregional greenfield FDI trends⁴

Intraregional greenfield FDI flows have fluctuated for the past decade, but their share in total greenfield FDI has remained at a stable level. Intraregional investment is replacing investment from the developed economies, which have traditionally supplied the bulk of FDI in the Asia-Pacific

region. Reflecting the decrease in total greenfield FDI into the region, intraregional greenfield FDI has also been declining in recent years. However, in 2014, intraregional greenfield FDI flows reached \$279 billion, which is a 95% increase compared with the amount in 2005, and accounting for 48% of total regional greenfield FDI inflows (figure 3.7).

Figure 3.7. Intraregional greenfield FDI inflows in the Asia-Pacific region and their share in total greenfield FDI inflows to the region, 2005-2014

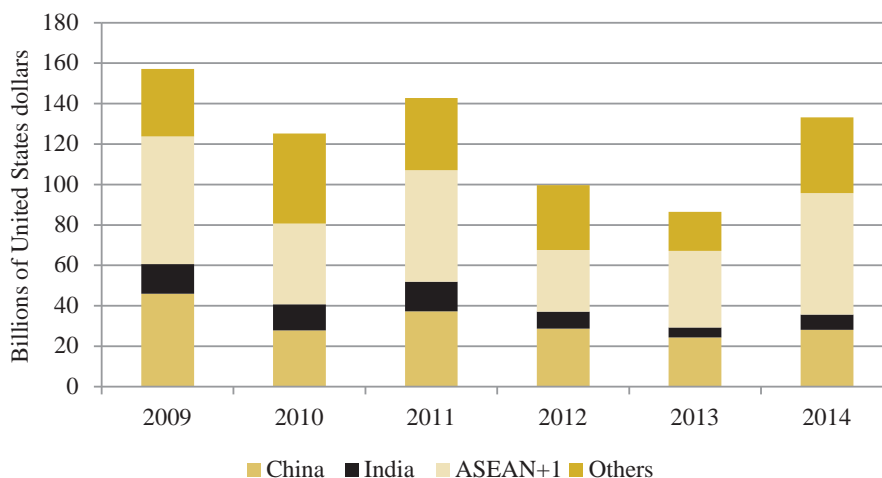


Source: ESCAP calculation based on fDi Intelligence data, 2015.

South-South FDI flows have grown in recent years and tend to occur more within each economy's immediate geographic region (UNCTAD, 2015). In Asia and the Pacific region, China is now the biggest intraregional investor, accounting for 21% of total intraregional greenfield FDI inflows in 2014.

Most intraregional greenfield FDI has targeted the bigger economies with established FDI inflows. However, smaller economies, especially those in ASEAN, increasingly receive higher levels of FDI inflows from other Asian-Pacific economies (figure 3.8).

Figure 3.8. Destinations of intraregional FDI flows, 2009-2014

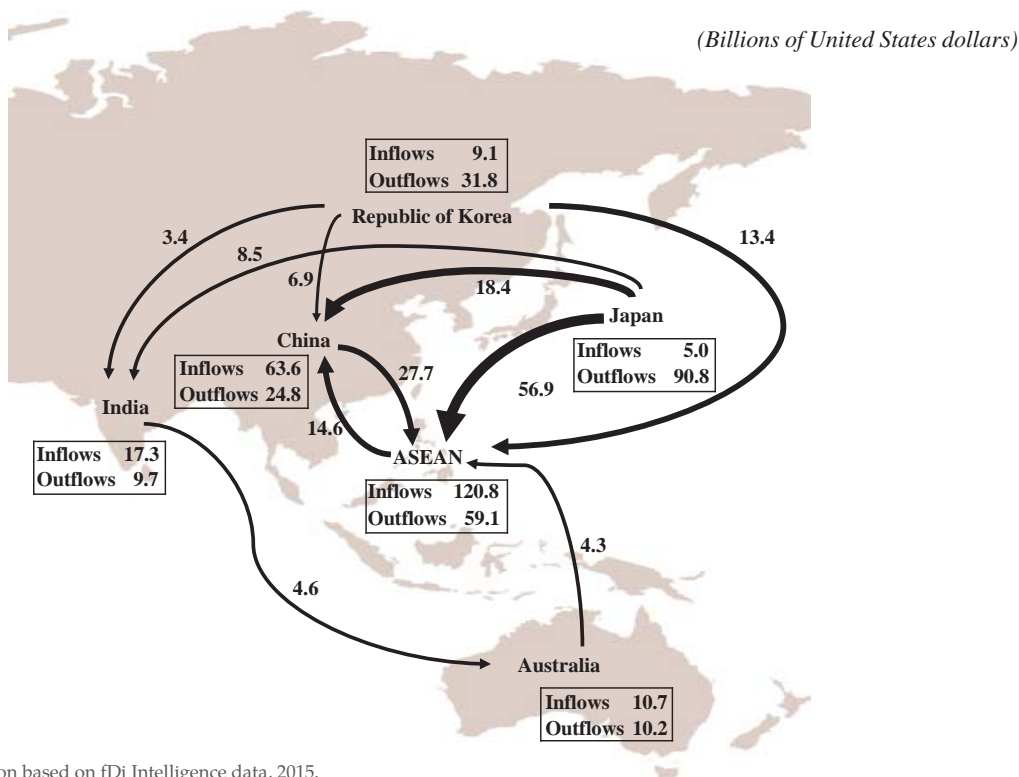


Source: ESCAP calculation based on fDi Intelligence data, 2015.

The importance of intraregional FDI is more evident when outflows are considered. Of the total \$222 billion in greenfield investment from the Asia-Pacific region, \$133 billion (60%) went to other economies in the region. In particular, China, Japan and the Republic of Korea have continued to be major investors in the Asia-Pacific region, with China and ASEAN members continuing to be the most attractive destinations (figure 3.9).

“Intraregional greenfield FDI flows were on the increase – of the total \$222 billion in greenfield investment from the Asia-Pacific region, \$133 billion (60%) targeted other economies in the region.”

Figure 3.9. Intraregional greenfield FDI flows between selected economies, and total inflows and outflows to and from those economies, 2012-2014



Source: ESCAP calculation based on fDi Intelligence data, 2015.

Intraregional investment is further promoted and encouraged with bilateral and multilateral investment agreements. In the Asia-Pacific region, growth of preferential trade agreements has been rapid, resulting in 168 such agreements that are now in force or have been signed and are pending ratification. Of these, the Asia-Pacific economies are parties to 43 agreements that cover “investment”.⁵ Some regional and subregional trade and investment agreements have been instrumental in easing and liberalizing intraregional investment, especially the ASEAN Comprehensive Investment Agreement (ACIA) which is considered to be one of the most advanced and ambitious regional investment tools (ESCAP, 2011).

Currently, some ambitious “mega-regional” agreements, which include investment provisions, are also being discussed, i.e. the Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP). By pursuing these mega-regional agreements, and by consolidating and advancing current regional and subregional agreements, it is hoped that some complexities resulting from the current interwoven bilateral trade and investment agreements will be tackled, thereby advancing the intraregional investment agenda in Asia and the Pacific.

4. FDI in services sectors almost fully recovered after the crisis⁶

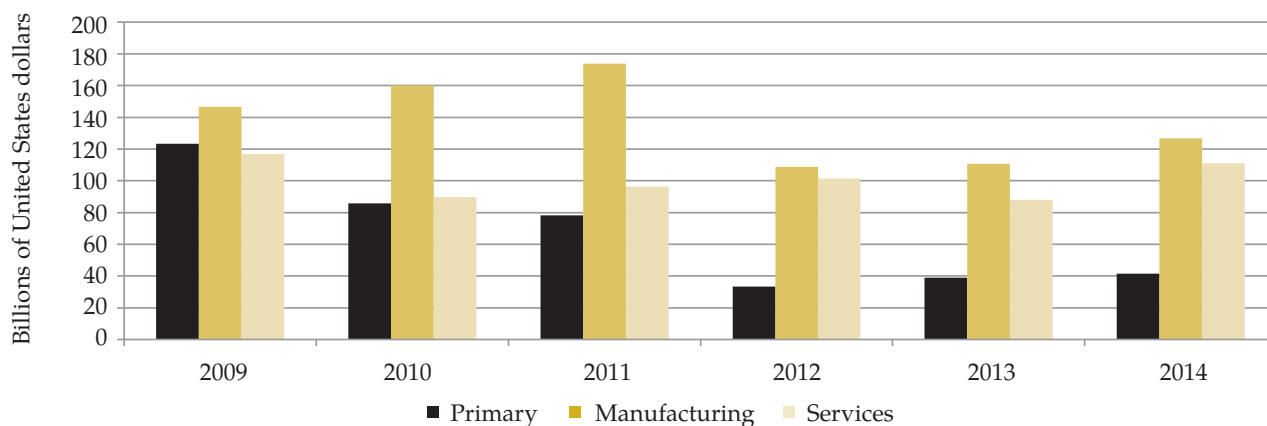
At the global level, services have progressively claimed increasing importance in the international investment landscape. In 2012, the year for which the latest UNCTAD

sectoral data are available, the services sector accounted for 63% of global FDI stock, while manufacturing and the primary sector accounted for 26% and 10%, respectively (UNCTAD, 2015). In 2014, based on available greenfield FDI data, the services sector accounted for 39% of global FDI inflows while the manufacturing and primary sectors accounted for 43% and 18%, respectively.

The development in services sector investments in Asia and the Pacific results from the ongoing shift in the sectoral composition of FDI from manufacturing to services at the global level. While greenfield FDI inflows to the primary sector have witnessed a notable decline, FDI inflows to services – which accounted for 40% of total greenfield FDI inflows in the region in 2014 – have remained more or less at the same level, with some minor fluctuations, since 2009. In addition, FDI inflows to the manufacturing sector, strategically important for the region, started to grow again after a sharp decline in 2012; however, they have yet to reach the 2009 level (figure 3.10).

“In the Asia-Pacific region, FDI inflows to services have remained at a stable level, accounting for 40% of total greenfield FDI inflows to the region.”

Figure 3.10. Greenfield FDI inflows to the Asia-Pacific region, by sector, 2009-2014



Source: ESCAP calculation based on fDi Intelligence data, 2015.

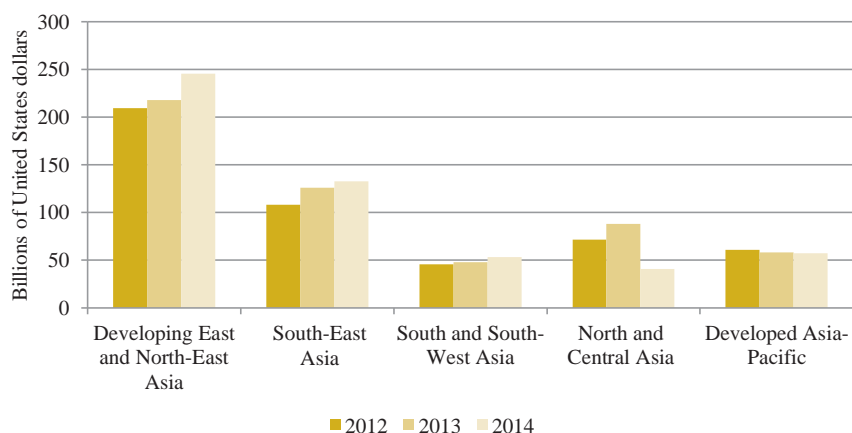
B ASIA-PACIFIC SUBREGIONAL TRENDS⁷

1. FDI inflows

Within the Asia-Pacific region, FDI inflows varied among the subregions and economies (figure 3.11). Developing East and North-East Asia and South-East Asia showed significant increases in the level of FDI inflows. These subregions received \$245 billion and \$133 billion in 2014, respectively.

China became the main global investment destination and received the largest FDI inflow in the world, surpassing the United States, with \$129 billion in 2014, an increase of 3.7% from the previous year. Hong Kong, China received \$103 billion in FDI inflow in 2014, second to China, with a 39% increase from the previous year.

Figure 3.11. FDI inflows to the Asia-Pacific developing subregions and developed economies, 2012-2014



Source: ESCAP calculation based on UNCTAD, 2015.

In South-East Asia, which comprises the 10 ASEAN members and Timor-Leste (which applied for ASEAN membership in 2011), FDI inflows amounted to \$133 billion in 2014, a 5.4% increase from 2013. Compared with 2009-2011, total FDI inflows during 2012-2014 increased for all

South-East Asian countries except Myanmar and Timor-Leste. FDI inflows to the Philippines and Thailand showed remarkable growth, with FDI inflows more than doubling in 2012-2014 compared with 2009-2011 (table 3.1).

Table 3.1. FDI inflows to South-East Asia, totals for 2009-2011 and 2012-2014^a

(Millions of United States dollars)

Countries ranked by size of FDI inflows	2009-2011	2012-2014	Percentage change
Singapore	126 899	188 975	49
Indonesia	37 889	60 535	60
Thailand	15 196	35 750	135
Malaysia	22 711	32 153	42
Viet Nam	23 119	26 468	14
Philippines	5 113	11 971	134
Cambodia	3 642	5 437	49
Brunei Darussalam	1 542	2 209	43
Myanmar	7 814	2 027	-74
Lao People's Democratic Republic	770	1 442	87
Timor-Leste	126	123	-2%

Source: ESCAP calculation based on UNCTAD, 2015.

^a In order to even out the volatile annual FDI flows, the total invested FDI flow during 2009-2009 and 2012-2014 is used instead of annual flows.

Since all but one of the countries in the South-East Asia subregion are members of ASEAN, their performance in terms of trade and investment should be examined in the context of their joint efforts towards the establishment of the ASEAN Economic Community (AEC) and associated investment regime adopted under the ASEAN Comprehensive Investment Agreement (ACIA).

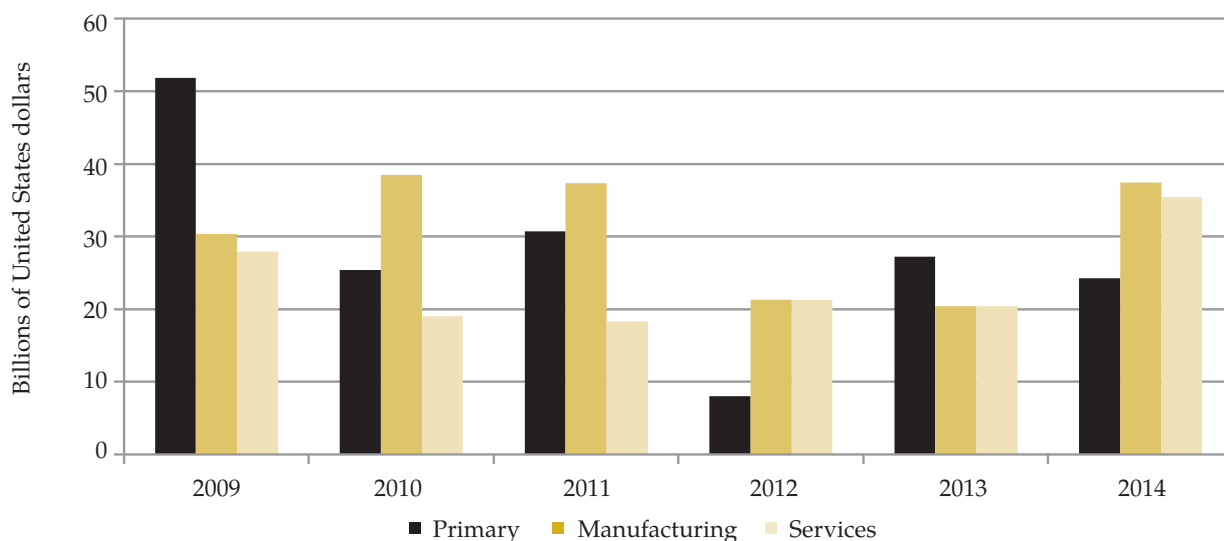
ACIA is among the most progressive regional investment agreements between developing economies (ESCAP, 2011). Despite the slow progress towards the AEC,⁸ South-East Asian countries have benefited from ongoing concerted efforts towards increasing stability and predictability of growth prospects in the subregion, which has been instrumental in attracting increased FDI inflows. These efforts have included improving the ease of conducting business, increasing infrastructure investment and providing investment incentives. In addition, South-East Asian countries have implemented measures to promote, liberalize and facilitate investment. In terms of the Ease of Doing Business Index, 7 out of 10 South-East Asian countries have improved their rankings or at least remained the same.⁹

“Progressive regional investment agreements such as ACIA, and ongoing concerted efforts towards AEC, are instrumental in attracting increased FDI inflows.”

South-East Asian countries receive significant amounts of FDI from within the subregion; intraregional investment within ASEAN accounted for 17.4% of total FDI inflows to the region (ASEAN, 2014). The subregion receives significant flows from East and North-East Asia, which provides an even stronger base for the future growth of economic cooperation among RCEP economies (Economist Intelligence Unit, 2014c).

The manufacturing sector in South-East Asia has received the bulk of FDI inflows due to the relocation of businesses from areas experiencing increasing labour costs, such as China, and to anticipating utilization of the benefits that will occur with the formation of RCEP. The services sector also increased its share in total FDI inflows to South-East Asia, to reach \$35 billion in 2014 (figure 3.12).

Figure 3.12. Greenfield FDI inflows to South-East Asia, by sector, 2009-2014

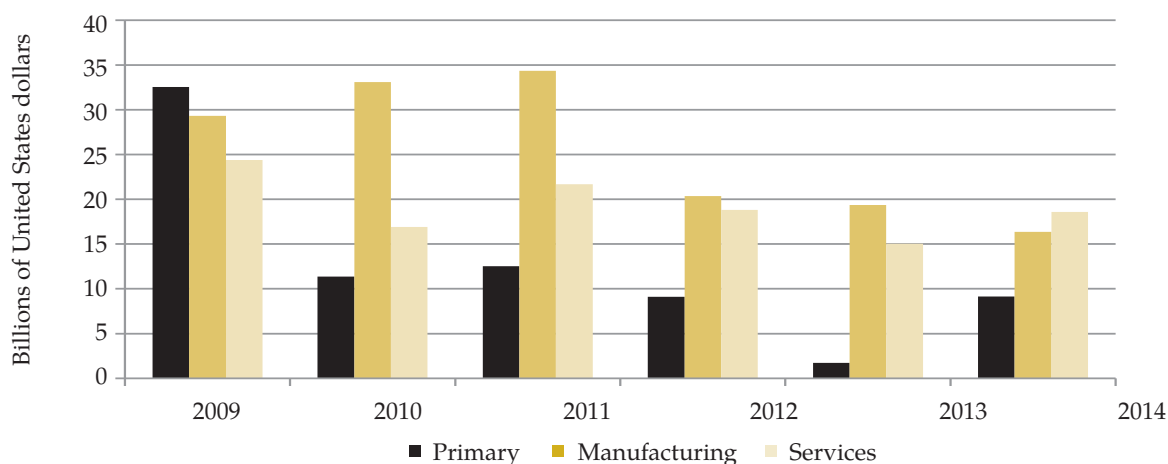


Source: ESCAP calculation based on fDi Intelligence data, 2015.

The South and South-West Asia subregion has witnessed slow but steady growth of FDI inflows during the past three years, and in 2014, the subregion recorded a \$53 billion FDI inflow. This improvement was mainly due to the increase of FDI inflows to India and Pakistan, by 21.1% and 31.1%, respectively. These increases were due to improved

performance by the Indian economy, the recovery of investors' confidence and the rise of Chinese FDI flows to Pakistan. In terms of greenfield FDI, the subregion saw a recovery in primary sector investment in 2014 (figure 3.13).

Figure 3.13. Greenfield FDI inflows to South and South-West Asia, by sector, 2009-2014



Source: ESCAP calculation based on fDi Intelligence data, 2015.

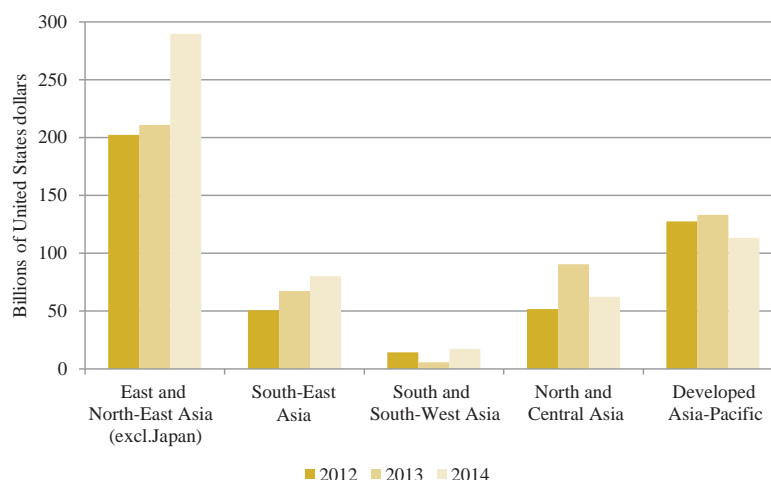
North and Central Asia experienced a pronounced drop of 53.3% in FDI inflows, receiving only \$41 billion in 2014, compared with \$88 billion in the previous year. This was mainly due to a virtual halt in FDI flows to the Russian Federation, which in 2014 fell by almost 70%. This drop can be explained by the international sanctions placed on the country, which have severely affected the economy in various ways; it has led to increased volatility in the Russian foreign exchange market and a significant depreciation of the rouble. The sanctions include restrictions on access to international financial markets, and have undermined domestic business and consumer confidence by depressing consumption and investment (World Bank, 2015). Also, an adjustment is due to the exceptional level of inflows reached in 2013 (UNCTAD, 2015).

The developed economies in Asia and the Pacific recovered from a big drop in FDI inflows in 2009 and 2010, but are still struggling to reach the pre-crisis level. The year 2014 did not bring much reprieve in this regard, as FDI inflows of \$57 billion to developed economies were actually 1.4% less than in the previous year.

2. FDI outflows

In 2014, the FDI outflow from the Asia-Pacific region totalled \$563 billion, an 11% increase from 2013 (figure 3.14). Unsurprisingly, East and North-East Asia as well as South-East Asia contributed to the increase of FDI outflows. China invested \$116 billion in 2014, an increase of 15% from the

Figure 3.14. FDI outflows from the Asia-Pacific developing subregions and developed economies, 2012-2014^a



Source: ESCAP calculation based on UNCTAD, 2015.

^a Due to the small share of outflows from the small island developing States in the Pacific, this subregion is not represented in figure 3.14

previous year, while Hong Kong, China invested \$143 billion, registering an exceptionally high increase of 77%. China has been a major regional player in the growth of developing economies' outward FDI; this is discussed in more detail in the following section.

In South-East Asia, which witnessed a 19% increase in FDI outflows amounting to \$80 billion in 2014, the Philippines almost doubled its outward FDI at \$7 billion, while Singapore invested \$41 billion abroad, an increase of 41%.

South and South-West Asia invested \$17 billion abroad in 2014, which is a 206% increase from the previous year. The high increase is partly a statistical effect due to the exceptionally low investment level in 2013, which was prompted by the huge decline that India experienced (ESCAP, 2014). FDI outflows were particularly high in India and the Islamic Republic of Iran in 2014, which recorded 487% and 314% increases in FDI outflows, respectively.

North and Central Asia showed a significant decrease in outward FDI, investing \$62 billion in 2014, which was a 31%

decrease compared with the previous year. As in the case of FDI inflows the drop was heavily dominated by the Russian Federation, which recorded a 35% decrease to \$54 billion in outward investment in 2014. This drop is large but when compared with previous years, given the exceptionally high outflows in 2013 that were driven mainly by a single transaction, the FDI outflows have not changed much.

Developed economies in the region not only received less inward investment, as noted above, they also showed sluggish outward investment. FDI outflows from developed economies in the region fell by 15%, to just \$113 billion in 2014, which put an end to the steady increase of FDI outflows from developed economies in the Asia-Pacific region since 2009. Japan, which has been driving the outcome of the developed economies in the Asia-Pacific region for past years, was behind the steady increase. Thus, when in 2014 FDI outflows from Japan declined by 16%, it pulled down the performance of the group.

C HIGHLIGHTS FOR SELECTED ECONOMIES

1. China

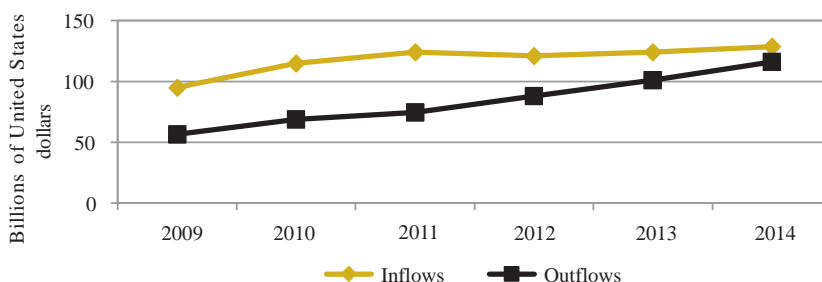
In 2014, China became the main investment destination, surpassing the United States in total FDI inflows. China received \$129 billion in 2014, an increase of 3.7% from the previous year (figure 3.15). However, the growth in FDI inflow is slowing due to rising labour costs and input prices, discouraging FDI in manufacturing (China Today, 2014). Many companies have moved their production base to other economies in the region, mainly to nearby low-wage economies such as Bangladesh, Cambodia, Indonesia, Sri Lanka and Viet Nam. However, while the ongoing economic reform and anti-corruption campaign will probably result

in structural changes in China's overseas investment, they are unlikely to alter its broader growth trend and, thus, the attraction as a destination for overseas investment flows (Economist Intelligence Unit, 2014b).

“China became the main investment destination and received the largest FDI inflow in the world, surpassing the United States of America.”

Indeed, China is still attracting large amounts of FDI; with investors still preferring to stay in the country because of its excellent infrastructure and effective participation in global

Figure 3.15. FDI flows in China, 2009-2014



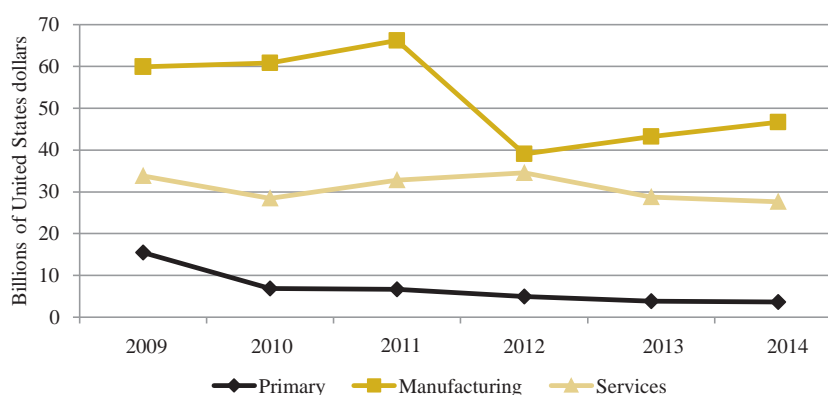
Source: ESCAP calculation based on UNCTAD, 2015.

China is likely to continue receiving significant amounts of FDI inflows (Economist Intelligence Unit, 2014a).

Greenfield FDI inflows in the manufacturing sector in China witnessed a sharp drop from 2011 to 2012; however, since then they have been increasing gradually. Greenfield FDI in other sectors has witnessed small declines in recent years, but still accounts for a significant portion of total greenfield FDI inflows (figure 3.16).

In contrast to inflows, FDI outflows from China have continued to rise rapidly (figure 3.15). During the past five years, FDI from China almost doubled and now accounts for 9% of total global FDI outflows. Initiatives by the Government, such as the “going global” strategy¹¹ and the “One Belt One Road” initiative¹² provide incentives for Chinese investment abroad. China has continued to invest in other BRICS economies as well as developed markets, becoming the largest investor in the United States in 2014. However, it is also increasingly investing in smaller

Figure 3.16. Greenfield FDI inflows to China, by sector, 2009-2014



Source: ESCAP calculation based on UNCTAD, 2015.

economies in the Asia-Pacific region and is establishing long-term partnerships, especially with new development finance institutions such as the Asian Infrastructure Investment Bank and the Silk Road Infrastructure Fund of

China (ESCAP, 2015a). Of the top 10 destinations for Chinese outward greenfield FDI, six were in the Asia-Pacific region (table 3.2).

Table 3.2. The top 10 destinations for greenfield FDI from China, 2012-2014^a

(Millions of United States dollars and percentage)

Destination country	Total invested in 2012-2014	Share in total
United States	19 950.2	19
United Kingdom	13 000.4	12
Russian Federation	12 738.7	12
Malaysia	12 216.1	12
Pakistan	9 402.3	9
Brazil	7 495.8	7
Republic of Korea	7 413.2	7
Peru	5 449.1	5
Indonesia	4 620.4	4
Australia	4 502.1	4

Source: ESCAP calculation based on fDi Intelligence data, 2015.

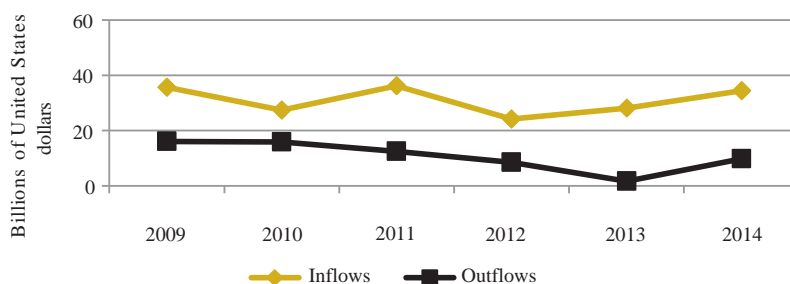
^a In order to even out the volatile annual FDI flows, the total invested FDI flow during 2012-2014 is used.

2. India

FDI inflows to India have been steadily rising after a 32% decrease in 2012 compared with 2011. In 2014, India attracted FDI inflows amounting to \$34 billion, a 22% increase. While this development is encouraging, the amounts received are

about a quarter of total FDI received in China in 2014. FDI outflows from India picked up from very low level in 2013, bouncing back to \$9.8 billion in 2014 (figure 3.17).

Figure 3.17. FDI flows in India, 2009-2014



Source: ESCAP calculation based on UNCTAD, 2015.

With the improved performance of the economy, large-scale divestments from large Indian MNEs have stopped and some international expansions have resumed. This upward trend is expected to continue in the foreseeable future. The Government has liberalized FDI in sectors such as defence, railways, construction development, medical devices and insurance since Narendra Modi became Prime Minister in 2014 (Economist Intelligence Unit, 2014d). In addition, the Government is pursuing simplification of the business environment by reducing excessive regulation and increasing predictability in the country's trade and investment regimes (Indo Asian News Service, 2015). Also, the "Make in India" programme¹³ could attract some new FDI in the manufacturing sector.

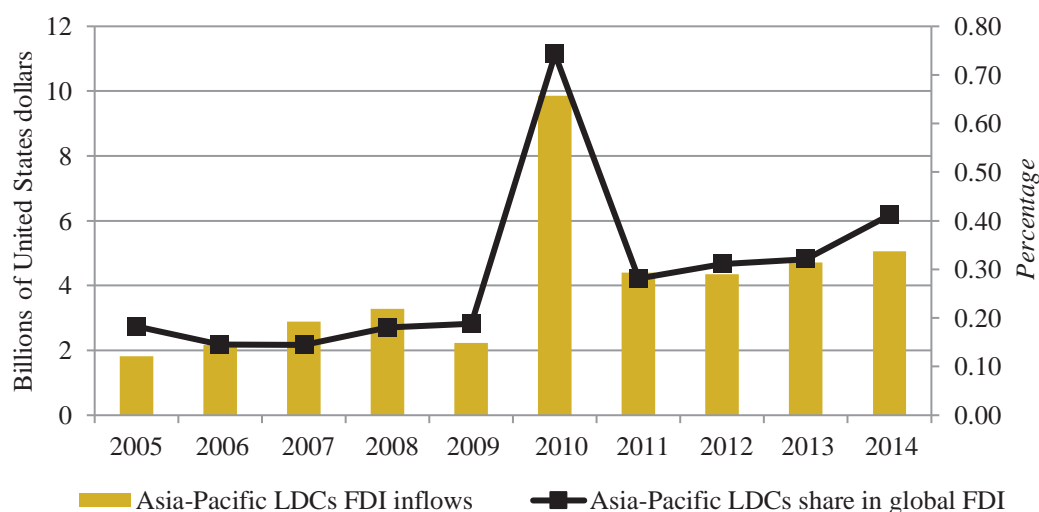
While India has achieved higher economic growth than China, it still has a long way to go to match China's role in the region's trade and investment flows. India's success will depend on its ability to accelerate the implementation of necessary structural reforms in order to improve its business and investment environment. Currently, India faces various structural bottlenecks, including delays in project approval, ill-targeted subsidies, a low manufacturing base and low agricultural productivity, difficulty in land acquisition, weak transportation and power networks, and strict labour regulations and skill mismatches (WTO, 2015).

3. Least developed countries

FDI inflows to the least developed countries in the Asia-Pacific region have been modest but have steadily risen during the past decade. Collectively, the Asian-Pacific least developed countries attracted \$5.1 billion worth in FDI in 2014 (figure 3.18), which is 2.8 times larger than the amount received in 2005, although the share is still relatively small overall at less than 1% of total FDI to the Asia-Pacific region. Despite its small contribution, these countries are steadily increasing their share in global FDI inflows – recording 0.41% in 2014, compared with 0.18% in 2005 (figure 3.18).

Asian least developed countries have improved their economic performance over time. The average annual growth rate of output per capita during 1991-2012 was more than 3.5%. The rates for least developed countries globally, and African least developed countries in particular, were 2.6% and 1.9%, respectively. Labour productivity also increased by an average of 4% per annum during 2000-2012. However, these economies continue to struggle with a poor business climate, lack of soft and hard infrastructure, insufficient government resources, and other macroeconomic and political constraints, which prevent them from attracting higher levels of FDI (UNCTAD, 2014a).

Figure 3.18. FDI inflows to Asia-Pacific least developed countries and their share in global FDI inflows, 2005-2014^a



Source: ESCAP calculation based on UNCTADStat and UNCTAD, 2015.

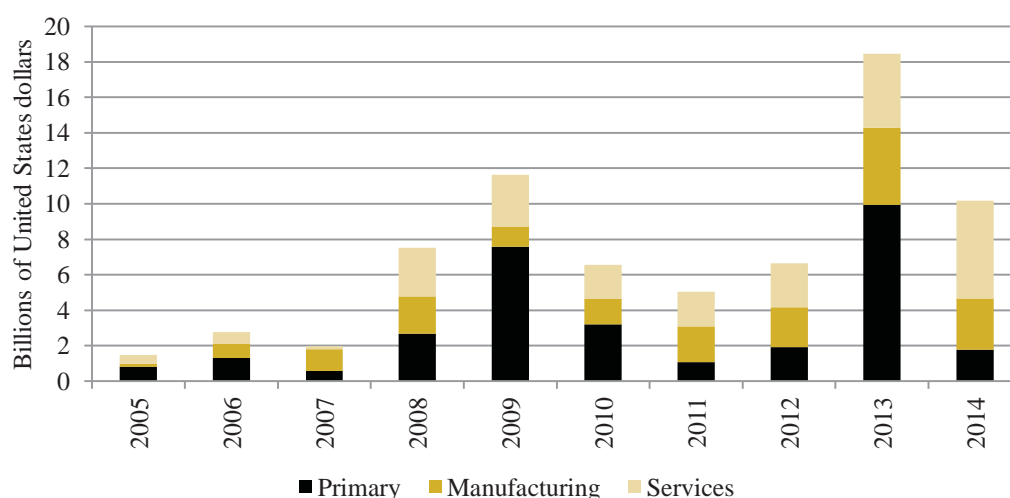
^a The peak in 2010 was mainly due to exceptionally large FDI inflows to a single country, Myanmar. FDI data for Myanmar in the World Investment Report 2015 showed dramatic changes from data of previous years, including the exceptionally large figure for 2010. It is explained by the fact that the national data source changed the system of data collection. This very recent development requires further research.

Different levels of government support and investment policies partly explain the varied performances across least developed countries in the Asia-Pacific region. For example, Bangladesh has promoted FDI for several decades with very liberal investment policies and incentive regimes. Coupled with low wages and preferential access to major export markets, this strategy has helped the country to attract a steady inflow of FDI, even if it has been concentrated mainly in the textiles and apparel sector. Nepal has become one of the most open and trade-dependent economies in the South Asian region (Sahoo, Nataraj and Dash, 2014), which has contributed to the sharp increase of FDI flows in the past decade – with \$30 million FDI inflows in 2014, 15 times greater than that of 2005. However, the May 2015 earthquake destroyed much of Nepal’s infrastructure and has since severely impeded economic activity in the country. Therefore, FDI inflows in infrastructural development are essential to enable the country to recover from this disaster. However, the lack of advanced infrastructure (apart from other issues that contribute to the high costs of doing business in Nepal) discourages FDI. Nepal therefore needs to implement policies that will help it to escape from this catch-22 situation, in particular through more effective regional economic integration.

The least developed countries in the Pacific subregion also fall under the category of small island developing States, i.e. Kiribati, Solomon Islands, Tuvalu and Vanuatu. The structural characteristics of these economies limit FDI options – a lack of adequate transport, communications and energy infrastructure, poor quality human capital, inefficient labour markets, low productivity capacities and the concentration on a narrow set of commodities/sectors – are limiting exports and inhibiting the establishment of global production networks (ESCAP 2015b; UNCTAD, 2014b; Feeny, Iamsiraroj and McGillivray, 2014). In addition, all Pacific least developed countries have very small economies and, therefore, small domestic markets, which further discourages FDI. Their FDI flows tend to be volatile and dependent on individual projects. For example, there is no record of any FDI inflow to Tuvalu during the past decade. Even relatively bigger countries, such as the Solomon Islands, have recorded fluctuating annual FDI flows ranging between \$19 million and \$238 million during the past decade.

Least developed countries in the region still rely heavily on natural resources for attracting FDI. However, the manufacturing and services sectors are making inroads, as they are attracting increasing amounts of FDI inflows (figure 3.19).

Figure 3.19. FDI inflows to Asia-Pacific least developed countries, by sector, 2005-2014



Source: ESCAP calculation based on fDi Intelligence data, 2015.

D CONCLUSION

The Asia-Pacific region has continued to be a major player in the global FDI scene. The region has not only received significant amounts of FDI despite the decline of FDI globally, it has also continued to grow as a major source of outward investment in the global FDI market. Economies in the region have been the key drivers of the increasing role that developing economies are playing globally.

In addition to the increasing share of the Asia-Pacific region in global FDI flows, the region is also experiencing structural changes in the types of investment it attracts. Globally, the services sector has become the biggest sector for FDI. In Asia and the Pacific, manufacturing is still strategically important for several economies, especially those in South-East Asia where increasing amounts of FDI have been invested in manufacturing as a result of increased labour costs in China. However, a number of economies have strategically strived to attract investment in services- and technology-related areas.

The mode of investment shows signs of shifting. The Asia-Pacific region has experienced an exceptionally sharp increase in M&A but only a rather modest increase in greenfield FDI. A direct comparison between these two modalities is not possible, given the different data collection methods. However, the importance of greenfield FDI in Asia and the Pacific is still high, although M&A are increasingly being favoured by investors.

Of all the subregions in Asia and the Pacific, East and North-East Asia as well as South-East Asia have outperformed the others, in terms of both FDI inflows and outflows. While some economies in the region have experienced a noticeable fall in FDI, in general the region as a whole has performed well for various reasons.

First, the investment environment in most economies has improved further, with national and regional investment measures addressing liberalization, facilitation and promotion of FDI. Among the least developed countries, Bangladesh has managed to attract a steady inflow of FDI for several decades as a result of its liberal investment policy and incentive regimes. Historically, the Asia-Pacific region has benefited from mostly non-coercive Governments as well as strong markets and private sector-driven economies.

Second, deeper levels of economic integration in Asia and the Pacific have helped to increase intraregional FDI flows as well as overall FDI flows to and from the region. In particular, South-East Asian countries are moving towards deeper levels of integration with the forthcoming establishment of the ASEAN Economic Community, which will facilitate intraregional trade and investment flows. China is also continuing to pursue investment in nearby countries, especially in ASEAN, Pakistan and Sri Lanka. In

addition, China has launched the “going global” strategy and the “One Belt One Road” initiative. Mega regional trade agreements such as RCEP and TPP will further promote intraregional and interregional investment flows. China has already invested heavily in infrastructure in the region, a strategy that has contributed to a better integrated market environment that attracts intraregional investors as well as investors from outside the region.

Despite the success of the region as a whole, uneven development between economies persists. The region has fast-developing star performers but is also home to countries where many live in extreme poverty. Least developed countries in the Asia-Pacific region have improved their capacities over time; however, they continue to rely on natural resources or labour-intensive industries and face a poor business climate, a lack of infrastructure and government resources, and other macroeconomic and political constraints that prevent them from attracting higher levels of value-added FDI flows. These small and vulnerable economies could benefit considerably from FDI, but they need enhanced regional cooperation to benefit from global and regional value chains.

Finally, the limitation on data availability prevent a more comprehensive intraregional analysis. In order to examine pressing issues, such as the impact of various modalities of FDI, improvements in the collection and availability of data in areas such as bilateral and sectoral FDI flows would further enhance the quality of analysis of international investment patterns and the determinates of their changes.

ENDNOTES

¹ All FDI data are from UNCTADStat and the UNCTAD World Investment Report 2015 with the exception of data on the value of announced greenfield FDI projects, which were collected from FDi Intelligence database.

² The data on greenfield FDI are from fDi Intelligence, which tracks greenfield FDI project announcements on a global basis. The data are based on information available at the time of the project announcement and, therefore, differ from official FDI flows that are based on balance of payments and international investment position (IIP) statistics. Discrepancies may arise from the timing of the investment, as the database does not take any phasing of the investment into account. In addition, fDi Intelligence also uses its own estimates of capital investment if such data are not given in the project announcement. Additionally, some of the announced investment capital may be raised locally, meaning that only a part of the capital invested may manifest itself as actual FDI flows.

Due to different data collection methods, the direct comparison between announced greenfield FDI projects and

value of cross-border M&As is not possible. However, this report attempts to provide some insights by observing the trends and changes over time.

³ The values of greenfield FDI projects were collected from fDi Intelligence, except for the world total figure which is from the UNCTAD World Investment Report 2015 and which excludes the financial centres in the Caribbean.

⁴ Due to the limited access to data on cross-border M&As at the country level, intraregional and country level analyses as well as a sectoral analysis mainly depend on greenfield FDI data.

⁵ Data are retrieved from the Asia-Pacific Trade and Investment Agreements Database (APTAD) at www.unescap.org/resources/asia-pacific-trade-and-investment-agreements-database-aptiad.

⁶ Sectoral FDI trends are further examined in later sections under subregions and highlights of selected countries.

⁷ FDI inflows to developing Pacific countries are too small for meaningful subregional interpretation. Instead, they are discussed in section C.3. on least developed countries.

⁸ Individual ASEAN countries will have to make many adaptations in order to enable the implementation of the ASEAN Economic Community. In Thailand, for example, the National Reform Council has identified 106 Thai laws that need to be amended in order to fully implement the action plans outlined in the AEC Blueprint.

⁹ The World Bank’s Ease of doing business index ranks economies according to how conducive the regulatory environment is to business operations. The index averages the country’s percentile rankings on 10 topics covered in the World Bank’s Doing Business report. The ranking of each topic is the simple average of the percentile rankings of its component indicators. The index is available from <http://data.worldbank.org/indicator/IC.BUS.EASE.XQ>.

¹⁰ The high increase in Hong Kong, China, could be explained by its role as a connector and a conduit for investment. It is argued that foreign investors use Hong Kong, China as a base from which to invest in the rest of China and the region, and that Chinese companies increasingly use Hong Kong, China as a platform to make global investment and acquisitions. It is likely that round-tripping between Hong Kong, China and mainland China are included in the figure, however, as it has been a continuous problem and would not be the only reason for the high increase in 2014.

¹¹ The “Going Global” strategy was adopted by the Government of China in 2001, under which Chinese firms are encouraged to look for opportunities overseas. This

strategy took another step forward in 2013 with adjustments in the regulatory framework for outward FDI in order to help Chinese firms to be competitive abroad.

¹² The “One Belt One Road” initiative is aimed at jointly building a “Silk Road Economic Belt” and “21st Century Maritime Silk Road”, strongly advocated by China. Discussions on the implications and benefits are discussed among the associated countries and the Asia-Pacific region as a whole. Some experts claim it could potentially bring in opportunities for Chinese investments in infrastructure as well as lead to a potential increase in bilateral trade.

¹³ “Make in India” is a long-term strategy aimed at increasing the share of manufacturing in GDP (from 16% to 25%) in a decade as well as the creation of 100 million jobs, according to Prime Minister Narendra Modi. It is hoped that this strategy will boost the country’s automotive industry and provide the opportunities for new FDI in this sector. However, some hurdles exist that cannot be ignored, such as whether: (a) the focus on the manufacturing sector is really appropriate for India; (b) the demand constraints and excess capacity domestically and globally has been examined properly; and (c) the import substitution strategy will be helpful for import-dependent India.

¹⁴ Small island developing States are recognized by the United Nations Conference on Environment and Development (UNCED) as a distinct group of developing countries facing specific social, economic and environmental vulnerabilities. For more information, refer to the UN-OHRLLS website at <http://unohrlls.org/about-sids/>.

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