

CHAPTER 4

RECENT TRENDS IN FOREIGN DIRECT INVESTMENT IN THE REGION

A. FOREIGN DIRECT INVESTMENT INFLOWS

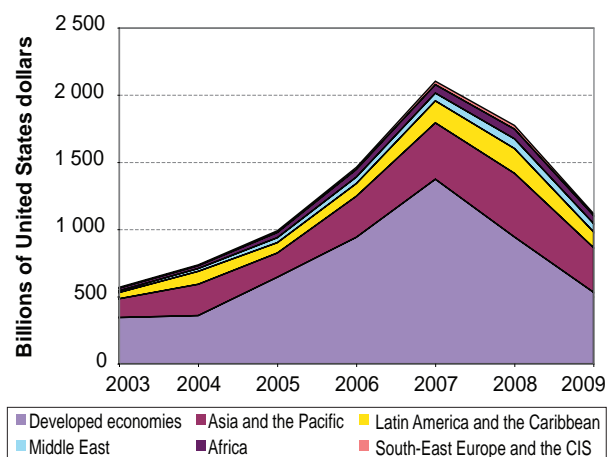
With the start of the global economic crisis, world foreign direct investment (FDI) inflows decreased by 16% in 2008, then dropped sharply by 37% in 2009 and gained a marginal 1% increase in 2010 (UNCTAD, 2011a). The decrease was relatively more pronounced in the developed countries. For the first time, developing countries are expected to have absorbed more than half of global FDI flows in 2010.

The Asian and Pacific region, and in particular China, was one of the top destinations for FDI during the 2000s. However, the global economic crisis had an impact on the dynamics of FDI inflows into the region, similar to the impact it had on trade in goods and services. FDI inflows into the region dropped by 30% to reach \$333 billion in 2009 (ESCAP, 2010). Figure 22 shows the trends in global FDI inflows and the regional breakdown for 2003-2009. ESCAP (2010) described these trends in some detail and this section provides an update based on the latest available data.³²

The principal factors driving the decrease in 2008 were the financial sector problems in the United States and elsewhere, and the liquidity crisis in the money and debt markets. The decline of FDI in 2009 was the result of a slump in mergers and acquisitions as well as in greenfield projects in the manufacturing sector

³² Because of limited availability of disaggregated data for 2010 from traditional sources (in particular, IMF and UNCTAD), the analysis in this section relies mainly on country data obtained from ADB, 2011; CEIC database, 2011; Economist Intelligence Unit, 2011; and UNCTAD, 2011a, none of which covers all economies from the Asia-Pacific region.

Figure 22. Foreign direct investment inflow, by region, 2003-2009



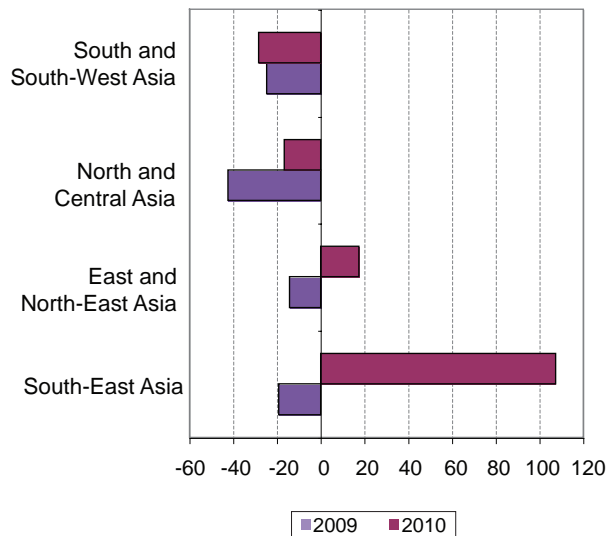
Source: ESCAP, based on data from UNCTAD (2010a).

Note: The regions shown in figure 22 are based on the *World Investment Report 2010* (UNCTAD, 2010a), with the exception of the three developed countries in the region, namely, Australia, Japan and New Zealand, which are included in Asia and the Pacific.

(UNCTAD, 2010b), coupled with the collapse of the capital-intensive mining and real estate sectors (fDI Intelligence, 2011). The changes in 2010 were driven by a geographically asymmetric recovery of production and trade, with Asia and the Pacific on the whole leading the recovery, although regional FDI inflows were predicted to have fallen short of the levels of 2007 and 2008.³³ As not all developing countries in the region experienced a similar resumption of growth, FDI inflows also reacted in very different ways from one subregion to another (figures 23 and 24).

³³ ESCAP estimate based on country data from ADB, 2011; Economist Intelligence Unit, 2011a; and UNCTAD, 2010a and 2011a.

Figure 23. Annual percentage changes in foreign direct investment inflows, by developing subregion, 2009 and 2010

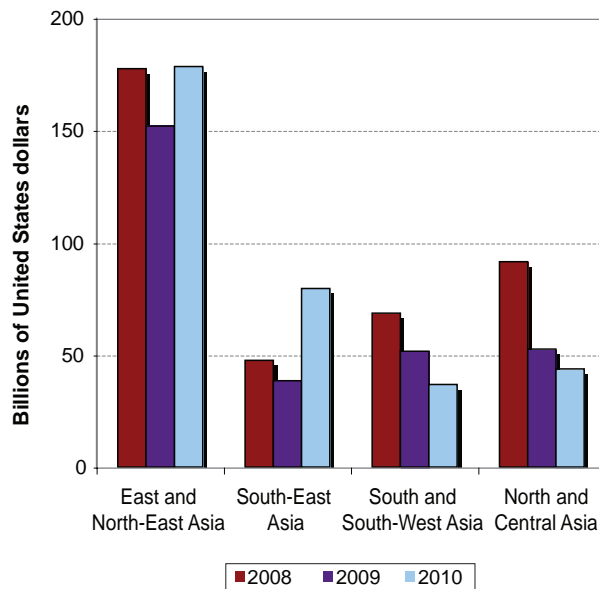


Sources: ADB (2011) and Economist Intelligence Unit (2011a).

Note: Here, North and Central Asia excludes Kyrgyzstan and Turkmenistan due to lack of data for 2010. Similarly, East and North-East Asia excludes the Democratic People's Republic of Korea and Macao, China, as well as Japan as a developed country, but includes Taiwan Province of China. South-East Asia excludes Brunei Darussalam and Timor-Leste. The Pacific was excluded from the analysis as the 2010 data for Pacific island States were not available. Data for India, the Islamic Republic of Iran, the Russian Federation, Tajikistan, Turkey and Viet Nam for 2010 are based on estimates.

While FDI inflows recovered in East and North-East Asia, and in South-East Asia in 2010 after a drop in 2009, the trend was the reverse in North and Central Asia, and in South and South-West Asia. Of all the developing subregions, South-East Asia witnessed the most remarkable recovery in FDI inflows after the global economic crisis. FDI in South-East Asia fell by around 19% in 2009, but registered a 107% annual growth in 2010 (figure 23). While East and North-East Asia regained inward FDI at the 2008 level, South and South-West Asia as well as North and Central Asia struggled to face continuous two-digit declines in FDI inflows in 2010. In particular, the FDI drop in South and South-West Asia was worse in 2010 than in 2009 due to the considerable slump of India, which is the region's leading FDI recipient.

Figure 24. Values of foreign direct investment inflows, by developing subregion, 2008-2010



Sources: ADB (2011) and Economist Intelligence Unit (2011a).

Note: Brunei Darussalam, Democratic People's Republic of Korea, Kyrgyzstan, Timor-Leste, Turkmenistan, the Pacific island States and Macao, China, were excluded due to the lack of data. Taiwan Province of China was included in East and North-East Asia. Data for India, the Islamic Republic of Iran, the Russian Federation, Tajikistan, Turkey and Viet Nam for 2010 are based on estimates.

“There is a divide in FDI performance between East and South-East Asia recovering and North and Central Asia and South Asia continuing a decline”

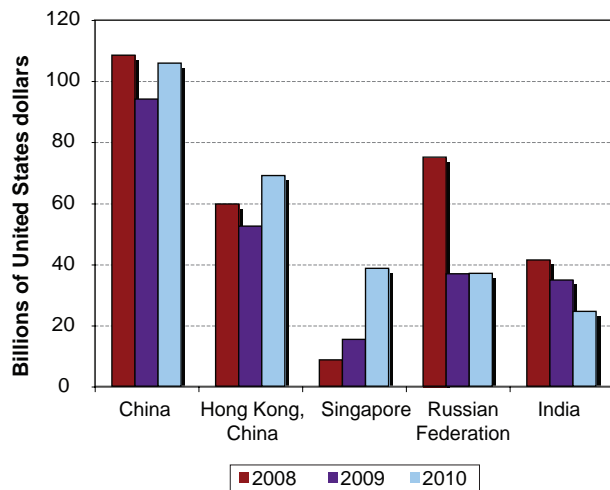
Total FDI inflows into the Asia-Pacific developing subregions (figure 24) can be disaggregated into two groups – one focused on the five regional "giants" (i.e. China; India, the Russian Federation, Singapore and Hong Kong, China)³⁴ in the context of FDI inflows, and the second comprising the remainder of the subregional economies. China, India, the Russian Federation, Singapore and Hong Kong, China, which

³⁴ Although it is the fifth largest FDI destination in Asia and the Pacific, Australia, a developed country, was excluded from this analysis focusing to developing countries (ADB, 2011; Economist Intelligence Unit, 2011a).

are characterized by either having a large domestic market or an advanced level of economic development, are the top FDI destinations among developing countries in Asia and the Pacific, and are estimated to have accounted for more than 70% of FDI inflows into the region in 2010.³⁵ It is, therefore, helpful to analyse the developments in those economies separately in order to gain a better understanding of the drivers of FDI flows as well as identify the potential for further FDI attraction (figures 25 and 26).

These five economies showed an improved but still mixed picture in 2010. China posted a 12% recovery of FDI inflows to approximately \$106 billion in 2010, almost regaining the level of 2008. FDI flows into Hong Kong, China, in 2010 also increased by 32% to \$66 billion, surpassing the 2008 level. FDI inflows to Singapore rose sharply by 153% to reach \$37 billion in 2010 after the slump in two consecutive years (2008 and 2009). However, FDI flows into the Russian Federation stagnated and those into India decreased by \$25 billion in 2010 (figure 25).

Figure 25. Foreign direct investment inflows to the five foreign direct investment "giants", 2008-2010

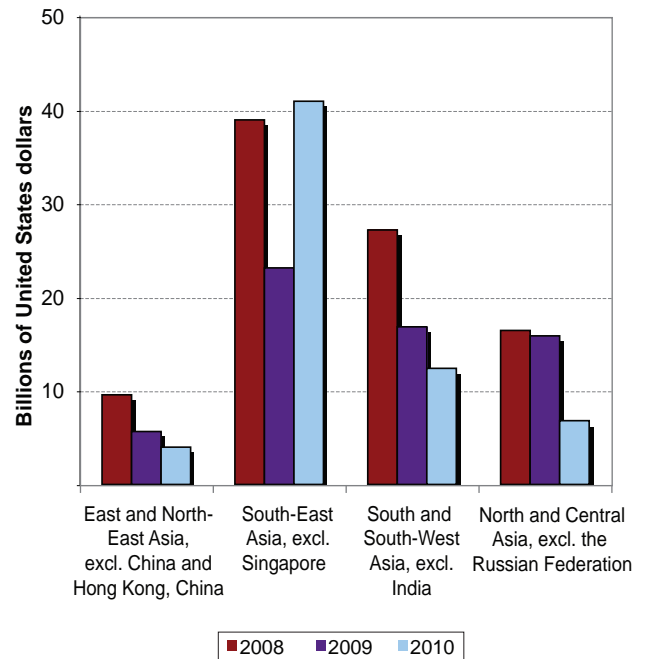


Sources: ADB (2011) and the Economist Intelligence Unit (2011a).

Note: Data for India and the Russian Federation for 2010 are based on estimates.

³⁵ Includes FDI to the developed countries in the region, i.e. Australia, Japan and New Zealand.

Figure 26. Foreign direct investment inflows to developing subregions, excluding the five "giants", 2008-2010



Sources: ADB (2011) and the Economist Intelligence Unit (2011a).

Note: Brunei Darussalam, Democratic People's Republic of Korea, Kyrgyzstan, Timor-Leste, Turkmenistan, the Pacific island States, Hong Kong, China, and Macao, China, were excluded due to lack of data. Taiwan Province of China was included in East and North-East Asia. Data for the Islamic Republic of Iran, Tajikistan, Turkey and Viet Nam for 2010 are based on estimates.

"China; Hong Kong, China; Singapore; the Russian Federation and India are the top FDI destinations in the Asia-Pacific region and have accounted for more than 70% of FDI inflows into the region"

The changes in FDI inflow into both South-East Asia and East and North-East Asia have followed a similar trend in trade in goods and services, and growth in general before and after the global economic crisis (figure 26). In 2010, South-East Asia quickly regained the pre-post crisis level of FDI inflows in 2007, relatively equally spread among the economies of the subregion. Malaysia experienced a record jump of more than 500%, thereby increasing its FDI inflows

from \$1.4 billion in 2009 to \$8.6 billion in 2010.³⁶ Indonesia also benefited from rising FDI inflows which grew by 160% from \$4.9 billion in 2009 to \$12.7 billion in 2010. However, Singapore was clearly the lead destination for FDI in the subregion. The country is ranked as the number one FDI destination in the world and had 300 registered projects in 2010 (fDi Intelligence, 2011). When Singapore is excluded, the subregion loses on average 35% of FDI inflows in the period 2008-2010. This means that Singapore has been contributing more than one third of the FDI inflows into South-East Asia. Indonesia accounts for 16% of the subregion's inflows, Malaysia for 10%, Thailand for 13% and Viet Nam for 17%. Indonesia outperformed both Thailand and Malaysia during 2008-2010. One explanation for this is perhaps that FDI in export-oriented manufacturing has expanded in Indonesia. Indonesia also has an advantage due to the existence of a relatively large domestic market as well as adequate supply of labour compared with tightening labour markets in neighbouring countries (Asian Development Bank, 2011).

In contrast, the recovery of FDI in East and North-East Asia was much more modest. In 2010, FDI inflows into East and North-East Asia increased by 17%, after witnessing a drop of 14% in 2009. When excluding China and Hong Kong, China, from FDI inflows into East and North-East Asia, the recovery in 2010 disappears and the slump for the remaining three economies (Mongolia, the Republic of Korea and Taiwan Province of China) continued in 2010 (a 29% drop) as 98% of total FDI inflows into this subregion went to China and Hong Kong, China.

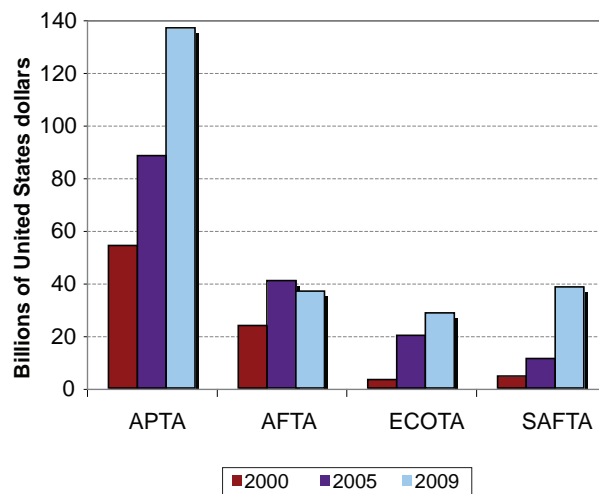
FDI inflows into South Asia and South-West Asia have been continuously declining since the start of the global economic crisis. In that subregion, FDI inflows reached a peak in 2008 (\$69 billion) and declined in

2009 (25%) and 2010 (28%). India accounted for 68% of subregional FDI inflows in 2009, and its FDI inflows considerably decreased in 2009 and 2010 by 16% and 29%, respectively. As shown in figure 26, when India is excluded, remaining South and South-West Asia still recorded a large contraction in FDI inflows in both 2009 and 2010.

In North and Central Asia, most FDI is in the natural resources sector, and is therefore long term and cannot be suddenly withdrawn (cf. UNCTAD, 2010a). This could partially explain why this subregion witnessed a delayed and resilient reaction to world trends. In 2009, while the Russian Federation, which accounted for 68% of subregional FDI inflows, experienced a quick drop of FDI inflows (51%), other countries in North and Central Asia only suffered mildly from the global crisis with FDI inflows falling by just 4%, to \$15.9 billion. Yet, in 2010, FDI inflows fell by 57% to \$6.8 billion, which is the worst result for any subregion in Asia and the Pacific. This large drop was mainly because of a fall in FDI inflows into Kazakhstan at almost 400% in 2010 relative to 2009; Kazakhstan accounted for 67% of the subregion's FDI inflows in 2009 (excluding the Russian Federation).

Finally, figure 27 shows FDI inflows to major trade groupings in Asia and the Pacific, i.e. the Asia-Pacific Trade Agreement (APTA), ASEAN Free

Figure 27. Foreign direct investment inflows, by regional trade agreement



Source: ESCAP based on UNCTAD (2010a).

³⁶ The Malaysian Industrial Development Authority approved a much larger number of investment projects (more than 910) in 2010 compared with earlier years as reported on 8 March 2011 at Malaysiadigest.com <www.malaysiadigest.com/news/18498-mustapa-malaysias-fdi-totaled-us9bil-in-2010.html>. In 2010, Malaysia improved its rank in the World Competitiveness Yearbook from eighteenth to tenth place (IMD, 2011) and also was ranked twenty-first in the World Bank Doing Business Report (World Bank, 2010a), particularly with regard to easy access to finance and a high level of investor protection.

**“APTA had the highest FDI inflows
of any trade grouping”**

Trade Agreement (AFTA), Economic Cooperation Organization Trade Agreement (ECOTA) and SAFTA in 2000, 2005 and 2009.³⁷ In combining the four regional trade groups, 28 countries participate in one or two trade agreements. Unsurprisingly, APTA had the highest FDI inflows of any trade grouping, as it comprises some of the region's major FDI destinations, including China and India. Despite the global economic crisis, aggregate FDI inflows to all regional trade groups – except for a slight decline in AFTA in 2009 – showed positive trends throughout the 2000s. This could be evidence of positive associations between broadening and deepening trade liberalization as well as increasing and diversifying FDI flows within the region.

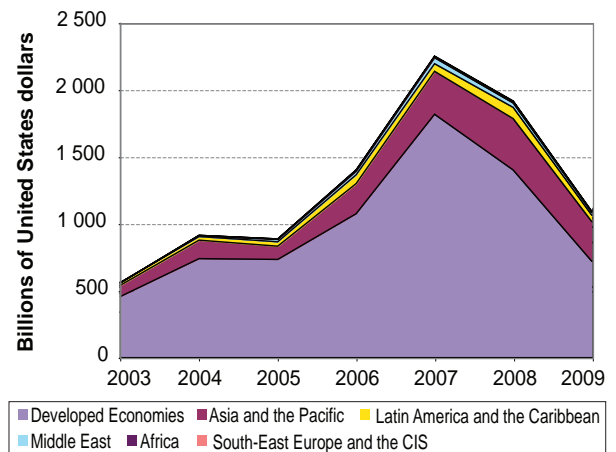
B. FOREIGN DIRECT INVESTMENT OUTFLOWS

While global FDI outflows in 2010 increased by 13% to reach just over \$1.3 trillion, this amount was still some 10% below the pre-crisis average (2005-2007), and 40% below the 2007 peak. Developing countries are becoming increasingly important investors with their share in global outflows increasing to 28% in 2010. As developed countries are still confronting the effects of the crisis, many transnational corporations (TNCs) in developing countries are investing in other emerging markets, where recovery is strong and the economic outlook better. In 2010, 70% of investment by developing countries was directed towards other developing countries compared with FDI from developed countries in developing countries, which was about 50% of their total FDI.

³⁷ APTA has six member countries, i.e. Bangladesh, China, India, Republic of Korea, Lao People's Democratic Republic and Sri Lanka. AFTA covers all 10 ASEAN member countries. ECOTA has 10 member countries – both from North and Central Asia and from South and South-West Asia, i.e. Afghanistan, Azerbaijan, Islamic Republic of Iran, Kazakhstan, Pakistan, Tajikistan, Turkey, Turkmenistan, Uzbekistan and Kyrgyzstan. SAFTA was signed by all eight South Asian countries. See APTIAD for more details of regional free trade agreements at www.unescap.org/tid/aptiad/agg_db.aspx.

Developed economies continued to account for the biggest share of global FDI outflows, which reached 81% in 2007, similar to the pre-crisis peak, followed by the Asia-Pacific region, which accounted for 14% (figure 28).³⁸ Nonetheless, FDI outflows from the Asia-Pacific region increased by 20% in 2008 and 23% in 2009. At the same time, the share of FDI outflows from developed economies fell to 66%, while the share of Asia-Pacific FDI outflows almost doubled to 27% in 2009. Japan; Hong Kong, China; China; Singapore; Australia; and India were the top six Asia-Pacific FDI outflow sources in 2009 (UNCTAD, 2011b). This strong success was partly due to the dynamism of TNCs from emerging developing economies and their increasing aspiration to compete in new markets (ESCAP, 2009b).

Figure 28. Foreign direct investment outflows, by region, 2003-2009



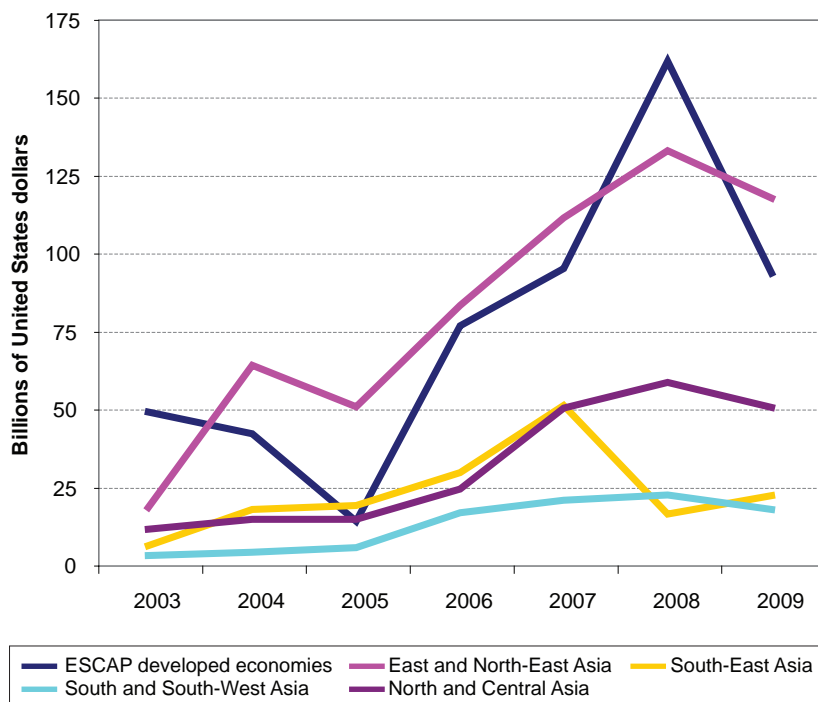
Source: ESCAP, based on data from UNCTAD (2010a).

Note: Regions are based on World Investment Report 2010 (UNCTAD, 2010a), with the exception of the three developed countries in the region, i.e. Australia, Japan and New Zealand, which are included in Asia and the Pacific.

All six subregions in the Asian and Pacific region recorded growth in FDI outflows during the 2000s, although that growth varied across subregions (figure 29).³⁹ While developed economies (i.e. Australia, Japan and New Zealand) in the region recorded the highest rise in FDI outflows in 2008, they

³⁸ The Asia-Pacific region includes the three developed countries in the region, i.e. Australia, Japan and New Zealand.

³⁹ The Pacific island States registered minimal FDI outflows (average of less than 0.1% of the region's total) and have thus been excluded from figure 29.

Figure 29. Foreign direct investment outflows, by Asia-Pacific subregion, 2003-2009

Source: ESCAP, based on data from UNCTADstat.

also recorded the sharpest drop in 2009. In contrast, FDI outflows from East and North-East Asia fell only slightly in 2009, gaining the largest share of regional FDI outflows (39%), followed by Asia-Pacific developed economies and North and Central Asia, accounting for 31% and 17%, respectively. South-East Asia and South and South-West Asia had shares of 7% and 6%, respectively.

India has also emerged as a leading foreign investor.⁴⁰ For example, in 2010, when most economies reduced their investment in Western Europe due to the economic crisis, India increased its investment by 37%. India also increased its FDI in Africa by 74% in 2010, making it the joint third-leading source country of FDI together with France. The main sectors receiving Indian FDI are financial services and communications (fDi Intelligence, 2011). The Russian Federation has also gained ground as a source of FDI in recent years. The Russian Federation is estimated to have

increased its FDI outflows by 18% to approximately \$52 billion in 2010. Outflows from these emerging economies are expected to continue growing in 2011, as the result of their rapid economic growth as well as the strong drive by global and regional TNCs to acquire mineral resources and strategic assets abroad (UNCTAD, 2011b).

C. INTRAREGIONAL FOREIGN DIRECT INVESTMENT FLOWS

Developing economies of Asia and the Pacific are gaining importance as sources of FDI in the region, complementing FDI from those developed countries that have been the traditional sources. For example, low-income ASEAN members (i.e. Cambodia, Lao People's Democratic Republic, Myanmar and Viet Nam – often called CLMV countries), have experienced increasing intra-ASEAN FDI inflows compared with the more industrialized and higher income ASEAN member countries such as the Philippines, Singapore and Thailand. This is an indication that the CLMV countries have received South-South FDI from the

⁴⁰ However, it is estimated that India decreased its overall outward FDI by 17% in 2010 (UNCTAD, 2011b).

more advanced ASEAN countries.⁴¹ In South Asia, Indian enterprises have become the main investor in smaller-sized neighbouring markets, such as those of Nepal and Sri Lanka (ESCAP, 2011b).

Enterprises in developing countries in Asia and the Pacific tend to invest in neighbouring but less developed countries that offer similar socio-economic conditions. These businesses have an advantage over enterprises from developed countries, because their technologies and knowledge are often a more appropriate fit for the factor endowments and market characteristics of the recipient less developed countries. For example, a smaller technology gap may put these firms in a good position to transfer and diffuse technology and knowledge (ESCAP, 2010 and 2011a).

Although there are company-based case studies, data on intraregional FDI flows – in particular South-South investment flows – are still rare. In this case, anecdotal evidence further provides an idea of the extent and nature of those investments. Intraregional FDI flows for China, the Republic of Korea and India are reviewed here for this purpose.

Close to one third of investment projects in the Asia-Pacific region in 2010 were implemented by companies that have headquarters in the region, with most projects located in China (fDi Intelligence, 2011). As China is by far the largest FDI destination in the region, it is interesting to note that most FDI in China was sourced from other East and North-East Asian economies, mainly Hong Kong, China.⁴² More precisely, Hong Kong, China, accounted for 42% of

FDI inflows into China in 2009, followed by Japan (13%), the Republic of Korea (10%) and Taiwan Province of China (7%). These economies accounted for more than 80% of total FDI inflows into China in 2009. In contrast, South-East Asia provided 7% of FDI inflows into China in 2009. FDI from ASEAN was relatively weaker but is expected to increase with the increasing integration of ASEAN with China.

“Most FDI in China was sourced from East and North-East Asian economies”

The Boao Forum for Asia (Beijing University of International Business and Economics, 2011) introduced interdependence indices for FDI inflows and outflows⁴³ for the Republic of Korea to help measure the degree of regional integration of the country through FDI flows (table 11). The country's FDI inflows exhibited a high degree of interdependence with many Asian economies and showed the diversified FDI relationships of the Republic of Korea with various other countries of the region, in particular with both East and North-East Asian countries (e.g. China and Japan) and South-East Asian countries (e.g. Malaysia, the Philippines and Singapore). In terms of FDI outflows, the Republic of Korea also exhibits a high degree of interdependence with a number of Asian economies, mostly in South-East Asia as well as East and North-East Asia; this picture supports the rapid development of global value chains in the region. It is noteworthy that the Republic of Korea has developed a relatively strong level of FDI interdependence with India as an FDI destination.

⁴¹ See a detailed analysis in the *Asia-Pacific Trade and Investment Report 2010* (ESCAP, 2010), pp. 41-42, available from www.unescap.org/tid/publication/aptir2590.asp.

⁴² The high level of FDI flows from Hong Kong, China to China could be at least partly explained by traditional indirect investment made by TNCs from third countries to China through Hong Kong, China (e.g. corporate investments from Taiwan Province of China). Compared with the 2000 share of 45%, Hong Kong, China's share in FDI inflows to China in 2009 dropped slightly. With regard to inflows to Hong Kong, China, on average 27% of FDI came from China in 2008 (Economist Intelligence Unit, 2011a), which accounted for 69% of China's aggregate FDI outflows (China, 2009).

⁴³ The construction of these indices is similar to that of trade interdependence indices. One index reflects the degree of investment integration, while another measures investment intensity. For a detailed explanation, see Beijing University of International Business and Economics, 2011, p. 28, footnote 1.

**Table 11. Foreign direct investment interdependence index
for the Republic of Korea**

FDI Inflows	Integration/Intensity	FDI Outflows	Integration/Intensity
Malaysia	40.9	Philippines	14.9
Singapore	4.5	Indonesia	4.6
Japan	4.3	China	4.1
China	4.2	Malaysia	2.2
United States	2.4	Hong Kong, China	1.8
Germany	1.9	Singapore	1.7
Philippines	1.4	Japan	1.6
Sweden	1.1	United States	1.4
United Kingdom	1.1	Taiwan Province of China	1.3
Australia	0.9	Thailand	1.2
Saudi Arabia	0.7	Netherlands	0.9
France	0.7	India	0.9
Taiwan Province of China	0.7	Australia	0.6
Hong Kong, China	0.7	United Arab Emirates	0.6
Switzerland	0.6	Brazil	0.5
India	0.3	Russian Federation	0.4
United Arab Emirates	0.2	South Africa	0.4
Canada	0.2	United Kingdom	0.3
Thailand	0.2	Italy	0.1

Source: Modified from Beijing University of International Business and Economics (2011).

Note: Indices greater than 1.0 suggest that the level of FDI interdependence between two countries is relatively high. The table shows the average of the two indices – FDI integration and intensity. Asia-Pacific economies are highlighted in bold.

Figure 30 highlights the growing share of FDI inflows from Asia-Pacific economies into India. While Mauritius, an offshore financial centre, has dominated FDI inflows to India (34% of total FDI inflows in 2010),⁴⁴ the share of FDI from Asia-Pacific economies in India's total FDI inflows increased from 11% in 2003 to 22% in 2010. At the same time, Europe and the United States (two traditional sources of FDI in India) saw their shares considerably reduced in 2003-2010, although both increased FDI in India in terms of value. Among the subregions in Asia and the Pacific, South-East Asia, East, as well as North-East Asia dominated FDI inflows into India, accounting for approximately

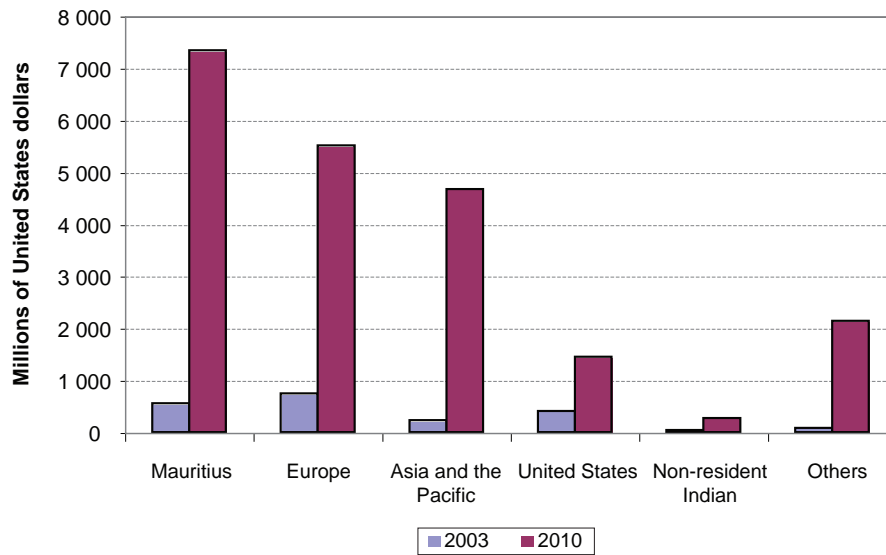
⁴⁴ Mauritius, which has a double tax avoidance treaty with India, is used by a number of foreign investors as an intermediary to reach the Indian market to capitalize on the tax rebates that the country as an offshore financial centre offers. Moreover, some parts of FDI inflows from Mauritius to India could also be round-tripping back to India for domestic investors to avoid capital gains tax in India. In order to understand the trend of FDI inflows to India well, company-level FDI data can be examined although such an exercise would be very costly (Gopalan and Rajan, 2010).

“Economic integration of the Asian and Pacific region not only depends on the extent of intraregional trade but also on the extent of intraregional FDI”

94% of total FDI from Asia-Pacific economies to India (57% for South-East Asia⁴⁵ and 37% for East and North-East Asia). India's South Asian neighbours accounted for less than 1% of FDI inflows to India.⁴⁶ These results indicate a growing trend of FDI inflows into India from other economies in Asia and the Pacific, particularly South-East Asia, and East and North-East Asia.

⁴⁵ Singapore has dominated South-East Asia's FDI to India, e.g. accounting for 81% in 2010.

⁴⁶ This issue may be revisited to examine if India's neighbouring countries may also use Mauritius as an intermediary to facilitate their investment to India. In addition to India, Mauritius holds the double tax treaties with four South Asian countries, i.e. Bangladesh, Nepal, Pakistan and Sri Lanka (LOWTAX, 2011).

Figure 30. Foreign direct investment inflows into India, 2003 and 2010

Source: ESCAP, based on data from the CEIC database (2011) and International Monetary Fund (2011b).

It is apparent that economic integration of the Asian and Pacific region not only depends on the extent of intraregional trade flows but also on the extent of intraregional FDI flows, which is in line with the emergence of global value chains in the region.

Statistical evidence also reveals that among developing countries, China, India and the Republic of Korea exhibit various degrees of integration with the rest of Asia and the Pacific through increasing FDI flows.