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Enhancing foreign direct investment in APEC

By Ken Waller – Director, The Australian APEC Study Centre

APEC has developed policy frameworks to encourage member economies to liberalise investment flows, including the Investment Facilitation Action Plan (IFAP) which sets out the principles of a welcoming foreign direct investment policy and a menu of options to attain them. Of course, it is for individual economies to determine whether and how they will respond to implementing IFAP.

Reliable data on investment inflows and outflows shows a mixed picture on the region's investment performance. UNCTAD's World Investment Report, shows foreign direct investment (FDI) flows to developing Asia reached \$541 billion in 2015, a 16% increase over 2014; the region was the largest regional recipient of flows, driven mainly by increased FDI in East and South Asian economies. In East Asia, FDI inflows increased by 25% in 2015 - due to corporate restructuring in Hong Kong, China and flows into China's services sectors.

However, the inflow figures for 2016 are expected to show a decline as a consequence of slower world growth and a reduction in cross-border mergers and acquisitions.

FDI outflows from developing Asia declined in 2015. Even so, outflows from the region were the third highest ever and outflows from China and Thailand increased. China remains the third largest investing country after the US and Japan.

The region is relatively more attractive than other developing regions, though less attractive than Europe and the United States as investment destinations.

The World Bank, the OECD, UNCTAD, ADB and the APEC Policy Support Unit provide solid inputs into building the capacities of regional investment policy agencies and investment promotion authorities. This Centre at RMIT University is the secretariat for the Regional Investment Analytical Group (RIAG) which provides analysis on investment developments within a framework outlined by the World Bank.

RIAG provides inputs to the ABAC Business Advisory Council in support of the Council's role in advising APEC Ministers and officials on ways to increase investment flows. And the Centre plays an important capacity building role in hosting training programs for regional officials involved in investment policy formulation and



implementation, particularly relating to investment in infrastructure financing through Public Private Partnerships.

There is no shortage of advice in supporting enhanced capacities to encourage FDI inflows to the region. But the reality of recent flow trends is that they are greatly dependent on foreign investor perceptions of the state of the global and regional economies and the outlook for global growth over the life of an investment cycle.

Recent developments in anti-globalisation sentiments and in threats of protectionism are likely to negatively impact FDI investment flows, regionally and globally. Thus, there is a call to governments and policy makers in APEC and to the key affected communities (businesses, trade unions, NGOs and the broad swathes of consumers in their various groupings – service providers, students, tourists, health care, universities) to actively promote open and liberal investment policies.

There are some important lessons to be drawn from most recent analysis on FDI flows.

Analysis by the OECD and UNCTAD in the Sixteenth Report on G20 Investment Measures (19 November 2016)ⁱ notes, importantly, that the overall direction of investment policy specific measures taken by G20 countries remains solidly oriented toward further liberalization and easing of conditions for international capital flows. This stance has been maintained since commitments to those objectives were made at the first G20 Washington meeting in 2008, as measured by a broad set of economic indicators.

The same report, however, notes that restrictions to international investment remain in many key sectors of G20 members; explicitly in rules or less explicitly in the application of discretionary policies. “Reviewing whether the stock of restrictions to foreign investment can be further reduced remains a priority task for G20 governments to put their pledge to build an open world economy, reject protectionism, and promote global investment into action”ⁱ. The report notes further that “policies with discretionary elements – especially those related to national security concerns – as well as concerns about unequal competition among companies that [benefit from] different degrees of government backing or funding require attention and dialogue to reconcile views and approaches resulting from different economic models and traditions in the common interest of openness and fairness in the area of international investment” (p3).



On a positive note, UNCTAD (Global Investment Trends) advises that economies in emerging Asia were most active in investment liberalization across a broad range of industries. While new restrictions were introduced, these mainly reflected concerns about foreign ownership of strategic industries.

National security interests are an increasingly important factor and countries take into account key economic interests in the investment screening process. As UNCTAD notes, Governments' space for applying national security regulations needs to be balanced with investors' need for transparent and predictable outcomes.

UNCTAD also notes that the number of international investment agreements (IIAs) continues to grow. In 2015, 31 new IIAs were concluded, bringing the number to 3,300 treaties by end 2015 and by end May 2016 close to 150 economies were engaged in negotiating at least 57 new IIAs. The number of new treaty-based Investor State arbitrations reached 70 in 2015 with 40% brought against developed countries. Publicly available arbitral decisions in 2015 had a variety of outcomes. UNCTAD's Investment Policy Framework includes a Road Map for IIA reform and these have been used by 100 countries – 60 have used them to design treaty clauses.

UNCTAD cautions that while many countries have set up schemes to promote and facilitate investment, most of them relate to promotion, marketing and incentives, rather than facilitating - making it easier for investors to invest. ***In IIAs concrete facilitation measures are rare.***

Much like APEC's Investment Facilitation Action Plan, UNCTAD and the OECD provide policy options to improve transparency and information for investors, ensure efficient and effective administration procedures and enhanced predictability of the policy environment. UNCTAD notes that countries can implement measures unilaterally and it provides options that can guide international collaboration or that can be incorporated in IIAs.

UNCTAD highlights increasingly complex ownership structures of multinational enterprises, posing new challenges for investment policy makers in considering ownership-based measures as an aspect of FDI policy.

More than 40% of foreign affiliates worldwide have multiple "passports". The affiliates are part of complex ownership chains with multiple cross-border links involving an average of three jurisdictions. These are much more common in the largest MNEs; 60% of foreign affiliates of the largest MNEs have multiple cross-border links to the parent company. UNCTAD found that the top 100 MNEs in its



Transnationality Index have an average of 500 affiliates each, across more than 50 countries, with multiple hierarchical levels across up to 6 bordersⁱⁱ. “They have about 20 holding companies owning affiliates across multiple jurisdictions, and they have almost 70 entities in offshore investment hubs.” (pxiii)

As a consequence, the nationality of investors in and owners of foreign affiliates is becoming increasingly blurred.

The challenge for policy makers is that ownership investment policies will have to be rethought to safeguard the effectiveness of ownership rules. Policy makers should test the “fitness for purpose” of ownership rules compared to mechanisms in investment-related policy areas such as competition, tax and industry development.

Alternatively, policy makers can strengthen the assessment of ownership chains and ultimate ownership and improve disclosure requirements. UNCTAD notes however, the administrative burden that this could place on institutions/ agencies and on investors, highlighting the importance of finding a balance between liberalisation and regulation.

As APEC considers proposals to advance investment openness in the region, policy makers need to consider practical ways to respond to the issues raised by UNCTAD, OECD and the G20 discussed above. The following matters could be part of a forward looking agenda:

- Ways to improve understanding between public agencies and investors on perceptions of national interest in investment screening (or equivalent mechanisms which have broadly the same purpose). The aim would be to increase clarity on the varied forms of national interest and the reasons for them, thereby providing a common base which could inform investor decision making. APEC is well suited to organize public private dialogues to facilitate this work
- Review IFAP and compare with UNCTAD and OECD principles to refine explicit policies aimed at making the investment facilitation processes easier and more transparent
- Noting the growing complexity of multiple “passports” and ownership structures, economies could promote policy dialogues involving public agencies and private groups to see if ways can be found to simplify disclosure on ownership structures, the reasons for such structures and ways to achieve efficiencies in achieving transparent disclosure



APEC economies could consider development of a “fit for purpose” to demonstrate the balance of advantage to economies, weighing the burden of administration against the gains from ownership disclosure in foreign investment policy making.

¹ OECD & UNCTAD (2016), Sixteenth Report on G20 Investment Measures

² UNCTAD (2016), Will Investment Report 2016