



**Asia-Pacific
Economic Cooperation**

IFAP Implementation in Facilitating Investment for the Asia Pacific Region

Part II: An Analysis of FDI Flows by Sector and Source Economy (2000-2010)

APEC Policy Support Unit
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Advancing Free Trade for Asia-Pacific **Prosperity**

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EXECUTIVE SUMMARY

This report analyzes foreign direct investment within the APEC region over the years 2000-2010. We focus on intra-APEC flows in order to judge the level of cooperation and integration which exists between APEC member economies. When data permits, the report analyzes those intra-regional investments by sector, looking at the industries of most interest to firms and how those investments impact other economic policy goals.

We examine the eight IFAP principles from a business perspective, looking at how each reduces either the costs or risks faced by foreign investors. Taken as a whole, IFAP helps improve an economy's business environment and facilitates the entry of foreign investment.

Special Highlight sections focus on Investment Promotion Agencies (IPAs) and International Investment Agreements (IIAs). All APEC economies have an active IPA; the insert discusses best practices and how IPAs can improve. 58% of bilateral APEC relationships are covered by IIAs, primarily in the form of bilateral investment treaties (BITs). BITs offer a promising area for progress on the international front.

US\$ 4.8 trillion of foreign direct investment flowed into APEC economies during the last decade, equivalent to an average of \$179 per person per year for each APEC citizen. However, only 40% of these funds were intra-APEC investments. Fifty-nine percent of that \$4.8 trillion flowed into industrialized economies, confirming the idea that firms invest where they can minimize cost and risk, validating IFAP's premise that simply improving the investment climate is not sufficient for attracting FDI and highlighting the importance of economy-wide competitiveness.

Intra-APEC FDI into developing economies showed a counter-cyclical trend as these economies maintained their regional support when firms from other areas showed interest, providing evidence of strong regional connections.

Our analysis showed positive correlations between per capita GDP and FDI, further demonstrating the importance of economy-wide improvements to better attract foreign funding.

Recent trends show that APEC firms are keen to invest within the region; over 5,000 intra-regional projects have been announced since the beginning of 2010. Many of these new projects are in services sector, surpassing manufacturing as the most common industry for international investors, with most citing the region's growing market size as their primary motivation to invest.

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INTRODUCTION

The Investment Facilitation Action Plan (IFAP) seeks to improve APEC's investment climate by providing a framework of actionable policy guidelines which can help economies understand where their current investment policies stand in relation to international best practices and acting as a tool to plan future policy implementation. This paper, in conjunction with a concurrent study analyzing the progress member economies have reported in meeting IFAP goals, hopes to offer a more nuanced picture of where international investment within the APEC region stands at the present moment and where it can go in the future.

Our report's primary contribution is a database compiled by the author which breaks down foreign direct investment within the APEC region by sector and source economy. With this data, we can better analyze which sectors within an economy are most open to international investment, which sectors can improve, how foreign investments have changed over time, and how deep investment cooperation runs between APEC members.

With the data already compiled and hopeful future contributions from members who have not yet submitted their reports, the Policy Support Unit will be able to run more sophisticated analyses to determine which policy actions have the largest impact on attracting foreign direct investment and what additional steps can be taken to strengthen intra-regional ties. Requests have been sent to each member's domestic agency responsible for compiling official FDI data – the central bank, finance ministry, or central statistics department. The statistics presented represent only those economies whose data was publicly available or who submitted responses to our formal requests. The Policy Support Unit appreciates the effort of those economies which shared their data.

The analysis will begin by describing IFAP goals in more detail and why implementation of the eight major themes is important as APEC members develop their future investment policies. Special highlighted sections on Investment Promotion Agencies and International Investment Agreements are included.

Following this introductory section, a description of the database will be presented including how it was constructed and which sources were used. An analysis portion follows including sections on the sectoral breakdown of foreign direct investment and volumes emanating from fellow APEC members. A final section on announced investment projects in 2011 and 2012 concludes.

IFAP GOALS

Many factors drive a firm's decision to invest abroad: the investment climate¹, size of the foreign market, access to export markets, stable political and economic systems, a skilled workforce, openness to trade, transparency and lack of corruption among others.² Firms will consider all of these dimensions before choosing where to place their investment, so economies hoping to attract more foreign investment would be wise to carefully analyze all these variables when formulating a wider economic policy.

IFAP's goals are more limited. Instead of attempting to address the comprehensive list of all these factors, it aims to address only one: the investment climate. IFAP provides eight principles to facilitate investment and make economies more attractive to FDI. Drawing from extensive stakeholder consultation on the impediments faced by firms operating in a foreign business environment, IFAP aims to mitigate two important factors:

- **Cost:** Time is one of the most important factors in a foreign firm's decision on where to invest their funds. An overly-onerous regulatory process that requires months of regulatory approval will discourage firms from even considering investment in a potential host economy. It is important for policymakers to balance the public interest with efforts to make the investment process more efficient and effective, primarily by encouraging transparency, consistency and accessibility in their business and investment regulations.
- **Risk:** Managing risk is an investor's primary business. Regulatory risk is the main area IFAP hopes to address, making the regulatory process clear and easily understood. These risks are particularly important since foreign investors may be unfamiliar with the domestic regulation environment.

To understand how these policy recommendations correct market failures, support the investment climate and help firms make more informed investment decisions, this section will examine each of the eight IFAP principles in turn and describe how they impact either cost or risk calculations.³

Principle 1: Promote accessibility and transparency in the formulation and administration of investment-related policies

Information relevant to potential investors should be readily available, easily accessible, and accurate. While this goal is a valuable target for all levels of government, it is especially important as firms decide whether or not to invest their resources in a long-term international

¹ The investment climate could be defined by three broad set of variables: macroeconomic policies such as fiscal, monetary and trade policies; governance institutions; and infrastructure. (OSCE 2006)

² Multilateral Investment Guarantee Agency (MIGA) 2012 Annual Report

³ This section draws from a previous PSU-sponsored report "Measuring Progress in Implementing APEC's IFAP" - prepared by the Centre for International Economics, October 2009

project. Inconsistent or unavailable information can cause investors to question the ability of a foreign economy to meet basic requirements and leave both cost and risk decisions unclear. The World Bank⁴ noted that over 70% of economies may miss out on investment opportunities because they are unable to provide the basic business information that companies need during the site selection process. Principle 1 is particularly important for investors deciding among competing investment destinations during the site selection process.

HIGHLIGHT: Investment Promotion Agencies

PSU research found that all APEC member economies have an investment promotion agency (IPA), the first point of contact for most firms conducting due diligence on potential hosts. These agencies reduce both cost and risk for investors by aggregating all necessary information in an accessible central source, reducing the time-cost spent searching for documents and, by enumerating the processes required to operate a business in the host economy, reducing the risk of unexpected impediments arising once operations have begun.

The World Bank's Global Investment Promotion Best Practices 2012 found that the best performing IPAs carry out two key roles:

- Maintain strong websites complete with all data investors need to perform their analyses
- Respond quickly, accurately, and professionally to investor outreach

Their report highlights Australia's Austrade website as a leading example of how IPAs can structure their internet presence to maximize data availability while retaining an inviting visual appeal.

Canada was noted as a leader in responsiveness. The evolution of Invest Canada from a reactive institution responding to company requests into a proactive body seeking out potential investors was highlighted as a demonstration of the potential IPAs can have in meeting wider economic goals.

Principle 2: Enhance stability of investment environments, security of property and protection of investors

Stable operating environments increase the likelihood that a firm's foreign investment will produce viable, long-term benefits for both the investor and the host economy. As such, implementing this IFAP principle can be seen as a risk-reduction step of an economy's investment policy especially after foreign firms have begun operating in the host economy.

Dispute resolution is an important demonstration of how stability affects a firm's investment decision. Disagreements will inevitably arise while doing business and foreign firms desire to know that the rule of law will be imposed fairly and uniformly. Bilateral investment treaties

⁴ World Bank Group, "Global Investment Promotion Benchmarking: Summary Report" 2009

(BITs) fill this role, ensuring that foreign firms have the right to settle disputes in binding international arbitration outside the host economy's judicial system. Evidence shows that having BITs in place increases the amount of FDI flowing between economy pairs.⁵

HIGHLIGHT: IIAs and BITs

International investment agreements are important tools an economy can use to improve its investment climate, specifically bilateral investment treaties (BITs). BITs seek to create a more welcoming environment for foreign investors by providing legal protections and freedom from expropriation, often by allowing disputes to be settled by an independent international arbiter such as the International Center for the Settlement of Investment Disputes. In this way, BITs can be viewed from the same business perspective as IFAP: acting to reduce an investor's cost and risk.

Within the APEC region, 120 international investment agreements have been agreed between member economies, covering 58% of bilateral pairings according to the World Bank's International Center for the Settlement of Investment Disputes.

Economies around the world have embraced BITs as a centerpiece of their investment policy: 2,833 are currently in force along with more than 300 preferential trade agreements (PTA) which generally contain clauses similar to those found in BITs.

Several studies (Kerner 2009, Neumayer and Spess 2005) have employed robust statistical techniques across global databases and concluded that BITs are effective in attracting foreign investment, especially for developing economies seeking investment from the industrialized world. In this light, BITs represent an area where rapid progress could be made on the regional front, encouraging investment through a demonstrable commitment to security and stability for investors.

Principle 3: Enhance predictability and consistency in investment-related policies

Investors are drawn to an environment where policies and laws are applied predictably and consistently, reducing the risk that they will encounter unforeseen hurdles. Arbitrary application of the law and other forms of corruption discourage investors with an existing presence from expanding their operations and sends a strong negative signal to potential investors that projected costs may increase, dissuading investment from ever entering the economy.

Transparency is the best way to ensure predictable, consistent policy application. IFAP guidelines remind economies of the importance of transparency in every step of the investment process, yet the impetus for ensuring that transparency is applied instead of implied ultimately rests with each domestic government.

⁵ Eric Neumayer and Laura Spess, "Do bilateral investment treaties increase foreign direct investment to developing countries?" May 2005.

Policymakers should keep in mind that foreign investors make their initial investment assessments from a distance unless they have previous operational experience in the targeted host economy. As such they often rely on media reports or analysis from trusted international organizations for their first impressions of the host's regulatory environment in addition to the information presented by IPAs. Once they have entered a host economy and gain more first-hand experience in dealing with the domestic regulation, predictable and consistent policy application becomes even more important. If these firms encounter too many challenges or the risk of unexpected policy changes becomes too high, they may decide to divest their positions and move operations to a new location.⁶ Actions such as this set a bad precedent and send negative signals to other potential investors about an economy's investment environment, providing further evidence of the importance of predictable, consistent policy application.

Principle 4: Improve the efficiency and effectiveness of investment procedures

Excessive burdens add additional cost to foreign investors. Multiple administrative forms, unnecessarily-long processing times, and burdensome procedures for connecting to infrastructure such as power and water place additional cost-layers on a firm's investment decision, reducing their incentive to invest in these overly-burdensome economies.

World Bank Ease of Doing Business indicators as well as the Investing Across Borders series highlight the costs associated with inefficient investment policies. The international best practice described by these agencies constitute much of the content in IFAP capacity building projects, so policymakers should familiarize themselves with the concepts to better understand the underlying rationale behind the IFAP principles.

Principle 5: Build constructive stakeholder relationships

By establishing a rapport with all players affected by investment policies – the business community, consumers, international organizations, and other branches of domestic government – policymakers open communication channels with all interested parties, ensuring that each has an opportunity to voice concerns and allowing government officials to effectively describe the benefits behind their changes.

Open communication between government and the business community lowers the risk that unexpected policy changes will negatively affect investors as well as acting as a valuable tool for governments to generate feedback from the business community. This can be seen as a commitment to transparency – in line with principle 3 – and a strong signal to potential investors that they will have the opportunity to voice their concerns and have those concerns incorporated into future policy decisions.

⁶ Imad Moosa, "Foreign Direct Investment: Theory, Evidence, and Practice", 2002

Principle 6: Utilize new technology to improve investment environments

Technology speeds up the investment process, making it easier and faster for foreign investors to enter new markets and thereby reducing opportunity cost.

For the government, the benefits of using technology come through simpler, more efficient processes, not in the technology itself. Economies need not invest in the most expensive or complicated technology to woo potential investors; rather they should focus on using technology to simplify their investment process and reducing the cost faced by investors.

The best-practices cited from the experience of successful IPAs show the usefulness of technology in terms of fostering transparency and accessibility of investment policies. The 2012 Ease of Doing Business report describes how economies are making business regulation and the regulatory process more accessible, helped in many cases by e-government initiatives.

Principle 7: Establish monitoring and review mechanisms for investment policies

Reviewing investment policies as a stand-alone action is unlikely to persuade firms to invest in any given economy. Instead, much like technology, the action of reviewing existing policies demonstrates a willingness by leaders to take a proactive approach to the policy environment. By ensuring that the existing rules are still appropriate for the current environment, policymakers reduce firms' perceived risk of overly-rigid or stagnant rules. Applying IFAP principles 5 and 6 would support an effective review of investment policies.

Principle 8: Enhance international cooperation

Another signaling device, being an active, responsible member of the international community demonstrates that economies are committed to international best practice and the rule of law and lowers the risk a firm takes in making their investment decision.

FDI DATA

Now that we better understand the reasoning behind IFAP and how it interacts with the investment environment, our analysis will shift toward examining the empirical evidence of FDI within APEC member economies. We begin by describing our project mandate and data.

The Policy Support Unit was tasked with analyzing the pattern and trends of foreign investment (mainly FDI), focusing on inter-regional and intra-regional FDI flows, and the sectoral composition of FDI flows.

This is an area of the FDI literature which has lacked extensive investigation in the past, mostly due to a lack of high-quality data. Taking the opportunity to fill a unique niche in the field and build on the cooperation inherent in APEC's mission, the PSU has built a proprietary database consisting of sectoral FDI flows within the APEC region over the years 2000-2010.

The PSU would like to note the importance of making investment data publicly available, a step toward meeting the key IFAP goal of transparency. All APEC member economies agreed that the PSU should proceed with this analysis and even then many failed to provide information on their international investment positions. A foreign firm looking for the same data would face large time costs searching for the sources and, if they failed to find even basic information on an economies' investment policy, may deem the risk too high to proceed. To avoid these potential problems in the future, the PSU strongly encourages all APEC members to be more forthcoming with their FDI data in line with the IFAP principles.

Our data are sourced directly from the domestic agencies responsible for aggregating and reporting FDI data – either central banks, finance ministries, or domestic statistical agencies, the same bodies used by UNCTAD to compile their foreign direct investment reports.⁷ By using these sources, we have done our best to ensure that the data have been assembled using international best practice and are of the same quality demanded by comparable international organizations. This includes using a minimum threshold of 10% foreign ownership of a company as well as calculating the reported figures on a balance-of-payments basis. Where possible, we have compared the total FDI flows reported to us with the figures published in UNCTAD's World Investment Report to ensure that the data we received matches that used by official United Nations sources.

Here we must note the difficulty of making accurate classifications of what constitutes foreign direct investment. It can be challenging for economies to know where foreign investors are based, which industry a newly-acquired company should be classified under, and what value to assign to a given asset. As such, FDI data are subject to large corrections once initial reports have been updated and amended.

⁷ For additional information on data compilation, please see the UNCTAD Training Manual on Statistics for FDI and the Operations of TNCs, Volume I

For this reason, the PSU chose to study the period 2000-2010. We were able to analyze a long time period which has already been subject to revisions, allowing a stable source of data that should not change with future corrections.

The sectoral and source-economy breakdowns were reported by each member based on their own internal classification system. This naturally raises concerns about how accurately we are able to draw conclusions across economies without a uniform system in place. As such, the PSU took a series of corrective actions to address these short-comings and ensure that our data are as accurate and reflective as possible.

First, we rely only on sources which use international best practice in their FDI compilation. By providing their reports in good-faith we believe these calculations represent an accurate representation of the FDI picture within each economy. Also, by comparing the sum total of FDI reported to us with internationally recognized figures reported in the UNCTAD World Investment Report, we are able to conclude that the data are in line with reports to other internationally-respected bodies.

Second, PSU researchers compiled each economy's response into 8 aggregate categories – total FDI, agriculture, construction, finance and investment⁸, manufacturing, mining, trade and logistics, and services. In this way, we were able to control the variation which existed between various reporting economies. For example, many economies reported foreign investment in their financial sector and insurance sector as separate classifications, while others did not report an insurance category. Though we were unable to determine the extent of overlap in those not reporting such a breakdown, by combining similar groupings into consistent, broader categories we ensured this non-uniform raw data did not alter our final results.

Finally, we did not attempt to draw conclusions from data which were not reported, choosing instead to leave those categories blank until additional inputs are shared. For example, Japan provided data from the years 2005-2010, not covering the earlier portion of our request, while many economies have yet to respond in any way to our requests. PSU researchers chose to leave those categories blank during this initial analysis and hope that a more detailed breakdown can be offered in the future.

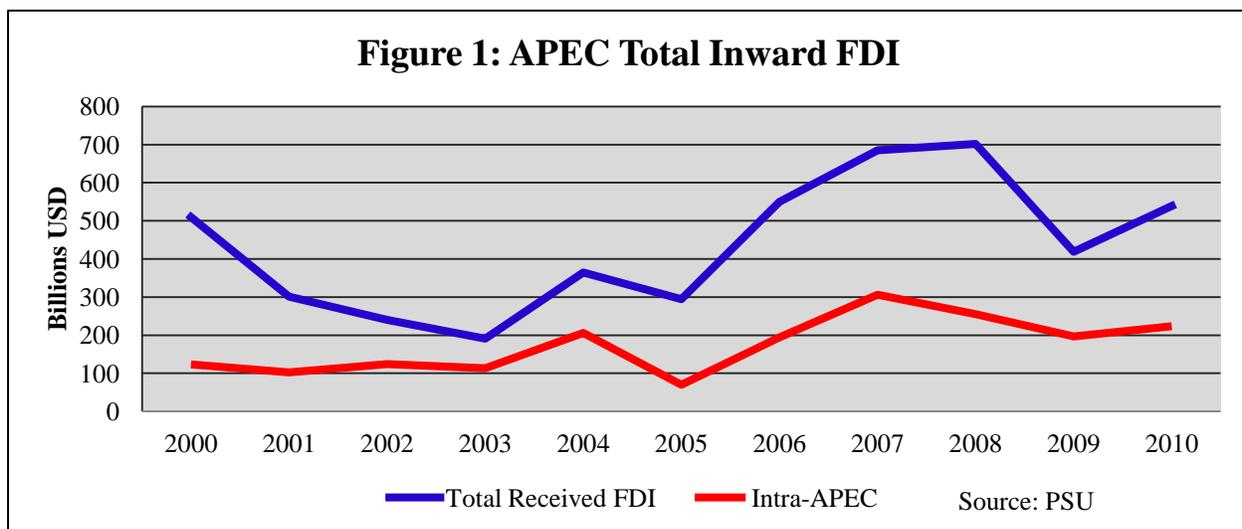
We acknowledge that this system is not perfect and leaves room for minor discrepancies across reporting economies. However, it is the most detailed breakdown of FDI data that our research has been able to uncover in the Asia-Pacific region and, since it was compiled from sources using international best practice and standardized by PSU researchers, we believe these data represent the most accurate reflection available of intra-APEC FDI flows.

⁸ This grouping includes investment categorized under 'real estate' by reporting economies. Roughly half of those reporting included real estate as a separate component and half did not. Rather than omitting this data, PSU decided to include real estate under the finance and investment heading which includes more traditional areas such as banking and insurance. Though the PSU was unable to determine the intended usage of those land investments, we assumed they were used for investment purposes and not another usage such as purchasing land to build a factory. If this assumption holds, then the value-added motivation of the foreign firm is to earn investment profits from their land acquisition which is consistent with inclusion under the financial heading.

FOREIGN DIRECT INVESTMENT IN APEC

US\$ 4.8 trillion in foreign direct investment flowed into APEC economies during the last decade, equal to 1.83% of total GDP or an average of \$179 per person per year. These headline numbers match up well with global averages but conceal extensive regional variability. Our analysis will explore each APEC economy's investment portfolio in as much detail as possible, revealing a more nuanced story of how connections, investment, development and policy intermingle in the broader economic context.

Our initial findings were surprising but perfectly in line with the IFAP guidelines and economic theory: APEC members with a high per-capita GDP and large developing economies received a majority of FDI flows. Examining these flows at the sectoral level allowed the PSU to explore the areas foreign investors found promising and where policymakers attempted to channel these investments. We found that not all sectors are created equal, with wide discrepancies in funding levels to various sectors reported around the region. Further, only 40% of those funds were intra-APEC - originating in one APEC economy and destined for another - leaving additional room for further regional investment initiatives. All figures are in nominal US dollars following UNCTAD practice.



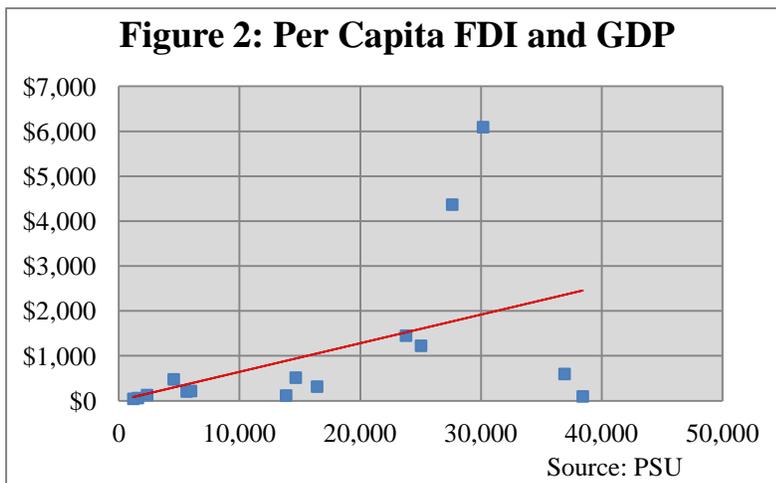
Industrialized APEC Economies

The five industrialized APEC economies – Australia; Canada; Japan; New Zealand; and the United States – are both the primary sources and destinations of foreign investment in the Asia-Pacific region. Combined they received a total of \$ 2.78 trillion in foreign investment from 2000-2010, 59% of total APEC inflows for that period.

Most of these funds were sourced from outside APEC: only 31% or \$866 billion came from other APEC members. Even within this intra-APEC flow, we begin to see a hierarchy: 77% or \$759 billion originated in one of the other industrialized APEC members. This figure means that

65% of all investment flowing out of industrialized APEC economies went to other industrialized economies.

These results confirm the idea that firms invest abroad for a wide range of issues and seriously examine both the cost and risk factors involved. Instead of the classic notion of foreign companies investing in less-developed economies to take advantage of cheaper factors of production and developing economies benefitting from the hoped-for technological spillover effects, we instead see firms from developed economies choosing to operate in other developed economies. This seems to validate IFAP's premise that simply improving the investment climate is not sufficient for attracting FDI and highlights the importance that economy-wide improvements in competitiveness can bring.



We also begin to see the correlation between per capita GDP and per capita FDI. Richer economies attract more FDI on average than less affluent economies. While it's difficult to determine whether more FDI causes higher per capita GDP or vice versa, there exists a clear association between the two factors, specifically for developing economies. Using a global dataset of developing economies, a World Bank analysis⁹ found that for every

1% increase in per capita GDP, FDI increased by 1.27%, showing the strong positive association between the two variables. Our analysis looks at this variable for many APEC economies and finds a similar trend. Unfortunately, due to our data limitations the empirical evidence in our analysis is rather weak even though our result shows a similar, positive trend. Econometric regression analysis which includes more economies would allow us to make more accurate assessment of the importance of this and other key variables.

Australia received US\$304 billion during the last decade, equivalent to \$1,449 per capita each year or 4.22% of total GDP. Of this, 53% or \$160 billion came from other APEC members. Australia was an active investor in APEC as well with their firms investing \$62 billion in other APEC economies. A strong majority of these funds, 83%, flowed to other industrialized APEC economies.

Canada received \$436 billion in total foreign investment from 2000-2010, 46% coming from other APEC members. This number highlights the close relationship Canada shares with the United States: 97% of these intra-APEC flows came from American firms. Annual per capita FDI averaged \$1,225 for every Canadian, equal to 3.62% of total GDP.

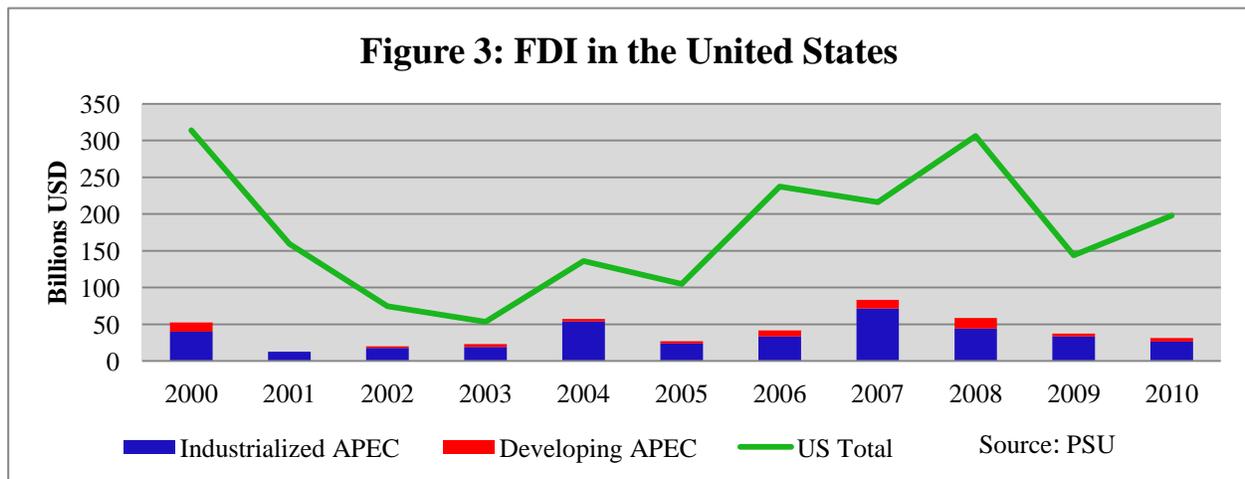
⁹ Mansoor Dailami, "Mobilizing International Resources for Development: Foreign Direct Investment and Other Private Flows", 2008.

Canadian firms were active investors primarily in the United States, sending \$207 billion or 84.5% of their total \$245 billion in intra-APEC funds to their southern neighbors. Intra-APEC funding accounted for 53% of Canada's total outward FDI of \$465 billion.

The PSU received Japanese data for the 2005-2010 period, so our analysis will focus only on these 6 years. During that time, Japan received nearly \$74 billion in foreign investment, of which over \$40 billion or 55% came from other APEC members. We can see less openness to outside investors when examining these numbers on a per capita and percentage of GDP basis: annual FDI was only \$97 per person or 0.26% of GDP from 2005-2010.

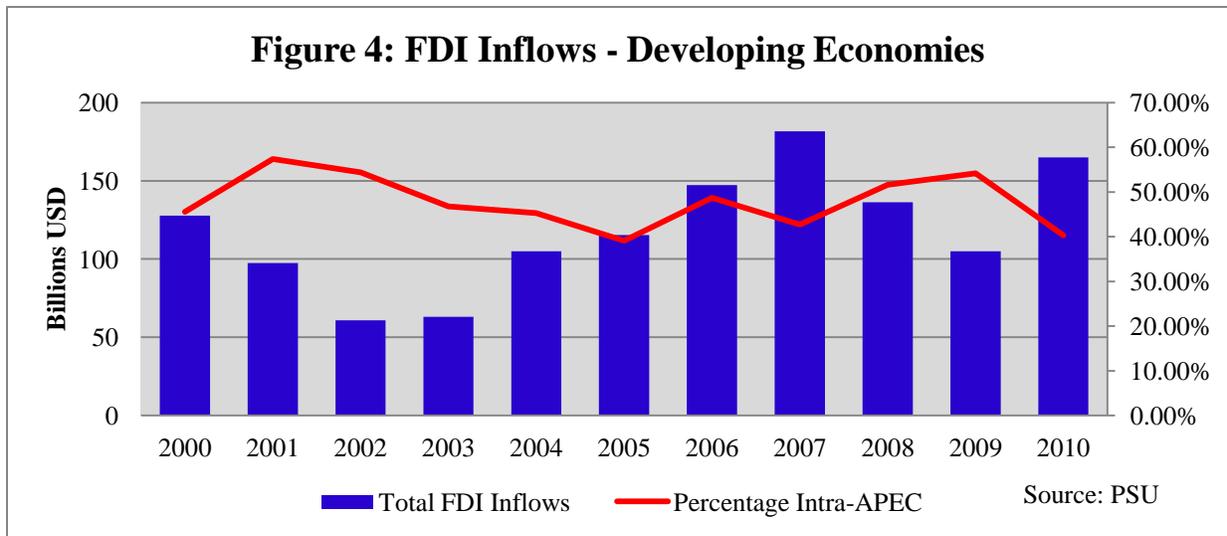
Japanese firms were much more active in the region, investing \$319 billion in other APEC economies. This was equivalent to 54% of their total external investment of \$590 billion. The United States received the largest share of these funds, absorbing \$135 billion or 41% of Japan's total intra-APEC investment followed by China with \$41 billion.

The strong bilateral relationship New Zealand shares with Australia can be seen in New Zealand's FDI numbers: of the \$23 billion in outside investment received over the last decade, nearly \$20 billion or 86% came from Australian firms. 46.5% of New Zealand's outward investments within the APEC region flowed to Australia as well.



Coming to the United States, we find the real engine of investment in APEC. The US received over \$1.9 trillion in outside investment in the years 2000-2010, equivalent to 40% of total FDI entering APEC. While APEC firms were active investors in the US market, we see that the United States appealed to global firms: only 22% of these funds came from other APEC members. Within that 22%, the numbers are skewed heavily toward just a handful of economies: Australia; Canada; Japan; Korea; Mexico; and Singapore accounted for over 97% of the total \$440 billion APEC investment in the United States.

US companies were also active in APEC, entering deals worth \$538 billion or 28% of total intra-APEC FDI.



Developing APEC Economies

Examining the investment position of all developing APEC economies is a difficult task. The Policy Support Unit was able to secure data on total FDI broken down by APEC member economy for only 10 of the 16 developing economies. Of these 10, only 5 – Chile; Mexico; the Philippines; Singapore; and Thailand – followed through on PSU requests for data on sectoral investment. Our analysis covers only those economies who submitted data or whose official statistical agencies publicly provided the necessary breakdowns.

Developing APEC economies recorded over \$2 trillion in foreign investment in the decade ending 2010, 42% of APEC's total; approximately \$1 trillion was sourced from other APEC members. Interestingly, 61% of this intra-APEC investment came from other developing APEC members which highlight strong regional connections.

Intra-APEC FDI has shown a counter-cyclical trend as demonstrated in Figure 4 above. The percentage of intra-regional flows into developing APEC economies are at their lowest when foreign investment flows are at their peak. Conversely, when investors from other regions reduce their funding, intra-APEC flows reach their highest level in percentage terms, demonstrating APEC's resilient connections and commitment toward regional development. While this finding is positive for the region as a whole, the benefits of FDI are not uniformly spread.

The differences between developing APEC economies can be rather stark. Average per capita FDI among all 10 reporting economies is \$1,361. If Singapore and Hong Kong, China are removed along with their average per capita FDI of \$5,229, the total for all remaining developing APEC members falls to \$211. Clearly, understanding the intricacies of foreign investment in these economies requires a more detailed breakdown.

China experienced the most dynamic investment growth of any APEC member that reported data during the last decade. Starting in 2002, China received FDI flows that more than doubled in volume on an annual basis, increasing from \$52 billion to \$114 billion in 2010. This represented

the largest percentage and actual increase among APEC members and made China APEC's second largest destination for international investment after the United States. Yet on a per capita basis, China lags behind other APEC economies in attracting foreign investment, averaging only \$60 per person. These measures show both the size and dynamism of the Chinese economy and how extensive reforms need to be in the future in order to fully meet IFAP goals of openness and transparency.

Externally Chinese firms have become much more active, increasing their outward FDI flows from \$6 billion in 2000 to over \$68 billion in 2010. A majority of these funds, 71%, have stayed within the APEC region.

Hong Kong, China attracted

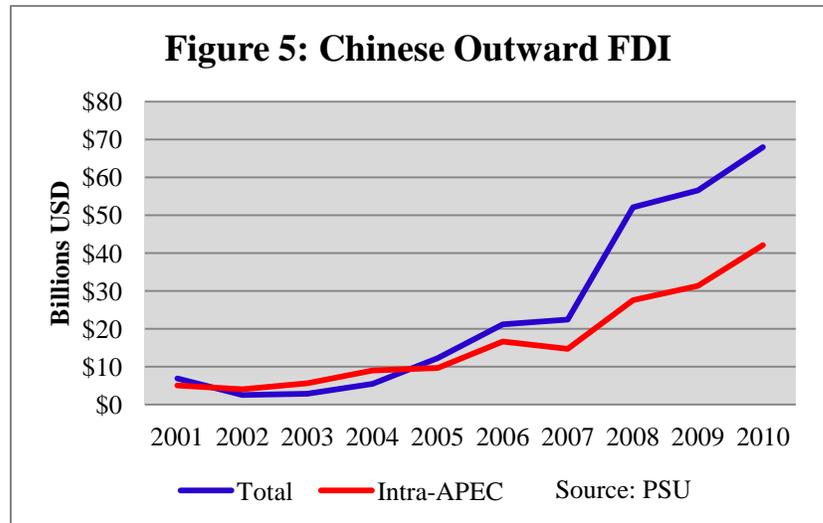
US\$453 billion of FDI inflows, equivalent to 22% of its total GDP (one of APEC's highest) or an average of US\$5,994 per capita during this period. 44% of these FDI inflows came from within the APEC region. In particular, HKC showed a strong investment relationship with China: US\$161 billion or 36% of its total FDI came from Chinese firms, which is equivalent to 80% of HKC's cumulated FDI inflows from the APEC region.

Hong Kong, China also played a predominant part in facilitating intra-regional FDI flows. For the years 2000-2010, FDI outflows amounted to US\$483 billion, equivalent to 23% of its total GDP during this period, 63% of which went to the APEC region. Eighty-six percent of these FDI outflows to the APEC region went to China, once again reflecting the close investment relationship between HKC and China. Such outflows amounted to US\$257 billion, equivalent to 55% of HKC's total FDI outflows.

Chinese Taipei recorded over US\$73 billion in FDI inflows during the years 2000-2010 with 39% coming from other APEC economies. We were able to gather data on investment from the People's Republic of China for the years 2009 and 2010. During those two years, Chinese firms invested US\$131 million in Chinese Taipei, nearly as much as Australia recorded in the entire decade. With more complete data on Chinese FDI, it's likely that APEC's share of total FDI within the Chinese Taipei economy would increase. The United States and Japan were the most active reported APEC economies with their firms investing \$12 billion and \$8 billion respectively.

Externally, firms from Chinese Taipei invested US\$ 36 billion in the APEC region.

Korean firms were more active investors than recipients in the APEC region during the last decade, receiving \$35 billion in FDI while investing \$62 billion. These numbers also show a



higher degree of progress still available in meeting IFAP goals as FDI accounted for only 0.76% of GDP, one of the lowest totals in APEC.

Southeast Asian economies submitted at the lowest rate of all APEC members, with only Malaysia; the Philippines; Singapore; and Thailand responding to PSU requests for data. However, the Philippines; Singapore; and Thailand all provided detailed breakdowns by source economy and sector as requested. Their assistance is greatly appreciated by PSU staff.

These four economies reported \$425 billion in total FDI during the years 2000-2010, 44% of which came from other APEC members. Of the \$179 billion in intra-APEC investment, the Southeast Asian economies were the most well-balanced between industrialized and developing APEC investment with 52% coming from industrialized economies and 48% from developing members. These headline numbers mask deep differences, however, which we will explore in more detail in the economy-specific breakout below.

Malaysia received \$135 billion in FDI from around the world during the last decade, most of which came from outside APEC. Japan; Singapore; and the United States accounted for a combined \$45 billion of foreign investment in Malaysia, 81% of total APEC funds flowing in to the economy. Total FDI accounted for an average of 9.2% of GDP, however, showing that Malaysia has made considerable progress opening their market to foreign investment even if regional firms are less active investors.

The global outlook shows in Malaysia's external investment as well with only 30% of its \$64 billion in outward FDI invested in the APEC region.

The Philippines reported data for the years 2005-2010. In that period, they received a total of \$23 billion in foreign investment for an average of \$3.8 billion per year. APEC economies were quite active, accounting for over 70% of that total. Japan; Korea; Singapore; and the United States combined for \$14 billion of FDI, good for 61% of total investment and 88% of APEC funding. The Philippines lags other economies as an FDI destination, receiving an average of only \$43 per capita or 1.29% of total GDP.

Singapore is a global destination for foreign funding, attracting over \$215 billion during that last decade or an average of \$4,366 per capita. Singapore's openness to foreign investment is reflected in the percentage of FDI to GDP, second to HKC at 14.5%. However, this openness to the global marketplace also leaves Singapore open to global fluctuations and their FDI numbers reflect this, rising during the boom years before the recession in the early 2000s, and showing the same pattern in the run-up to the Global Financial Crisis in 2008. Still, Singapore did not experience a net withdrawal of funding at any point during our period of analysis, showing that their commitment to the IFAP goals and broader economic stability were rewarded with higher levels of foreign investment.

Thailand, like the Philippines, reported data for the years 2005-2010. During this period they received over \$51 billion in foreign investment, 63% of which came from other APEC economies. Thailand was relatively open to foreign investment with FDI averaging over 3.6% of

GDP for the period as a whole and nearly 4% if data from 2009 and the dip related to the Global Financial Crisis are removed.

We will examine the sectoral breakdowns of the Philippines; Singapore; and Thailand in the next section.

Chile and Mexico were the Latin American economies reporting data and each offered a complete sectoral breakdown along with their headline numbers. These numbers will be analyzed more closely in this section with additional sectoral reporting to follow in the next section.

Chile reported nearly \$37 billion in FDI during the 2000s, equaling an average of \$206 per capita or 3.13% of GDP. Intra-APEC investment is dominated by the industrialized economies, led by Canada and the United States each with over \$7 billion invested.

Nearly one-third of total foreign investment went to the mining industry with APEC economies providing over 70% of that total. Canadian firms led this sector with over \$4.5 billion invested in mining alone. Both Australia and Japan accounted for roughly \$1 billion in Chilean mining investment as well. The construction industry and trade and logistics sectors were also receptive to foreign investment, accounting for a combined 50% of total FDI in Chile. The agricultural and financial sectors were the most closed, combining for only approximately 10% of total FDI.

Mexico received over \$255 billion in foreign investment in the last decade, equal to \$218 per capita or 2.9% of GDP, roughly similar with Chile's reported figures. The United States is easily the largest source of international funding flows into Mexico, with 50% of total FDI and 89% of intra-APEC flows during the last decade. Of these intra-APEC flows, a majority went to the financial and manufacturing sectors which combined for nearly \$100 billion in foreign investment.

SECTORAL BREAKDOWN

This section will explore sector-specific investment outcomes, how they differ across the region, and variations between economies at various levels of development. With this data, we will be able to examine the level of intra-APEC cooperation in more detail and analyze how open specific sectors within each member's economy are to international capital markets. We begin with the industrialized APEC economies that provided data for our report, the United States and Japan.

The United States offered breakdowns into four sectors that we analyzed: finance, manufacturing, services, and trade. They did not have a breakdown into agriculture, construction, or mining, making it impossible for the PSU to analyze these sectors. From the data available we can tell that the United States is rather open to investment from APEC member economies in the trade, manufacturing, and financial sectors with \$90 billion, \$102 billion, and \$103 billion in each respective category during the years 2000-2010. Canada and Japan dominate the manufacturing sector with their firms investing a combined \$87 billion or 85% of total APEC funding into American firms. These two economies see their share rise to 93% or \$84 billion in the trade, logistics, and communication sector. Canada alone shines through in the finance, real estate, and insurance sectors with over \$77 billion invested in the United States over this period, 75% of total intra-APEC investment.

In the service sector, though, America receives considerably less investment from APEC members. Again Japanese and Canadian firms supply a majority of the investment with 96% of total intra-APEC funding, but the total volume is only slightly more than \$12 billion over the decade to 2010, significantly less than the other reported categories. From our data it is not possible to determine if this reduction is due to high barriers to entry or that other APEC firms are less simply competitive than their American counterparts.

FDI into Japan was a more nuanced picture with many foreign firms divesting their holdings in Japanese companies over the last decade. The financial sector received over \$33 billion from APEC members, though American firms invested \$35 billion in total. Many other firms from APEC economies reversed their positions and moved out of the Japanese market. In the manufacturing sector we see an absolute removal of \$2.8 billion from APEC economies, while in the service sector and trade and logistics, a majority of economies show little net growth or outright reversals in the investment holdings. Both sectors show gains amongst other APEC members but those are heavily bolstered by Singaporean and US firms, responsible for a combined 74% and 78% of each respective sector.

In the agriculture, construction, and mining sectors, Japan reported minimal investment from any APEC members. Primary resource extraction is not a major component of the Japanese economy and many Japanese construction firms are world-leaders who seek out and win contracts abroad, so low numbers in the mining and construction sectors are in line with expectations. However, our research found few economically-efficient causes for limited investment in the agricultural sector. Reforms which ease investment into agriculture could offer strong gains for the Japanese economy.

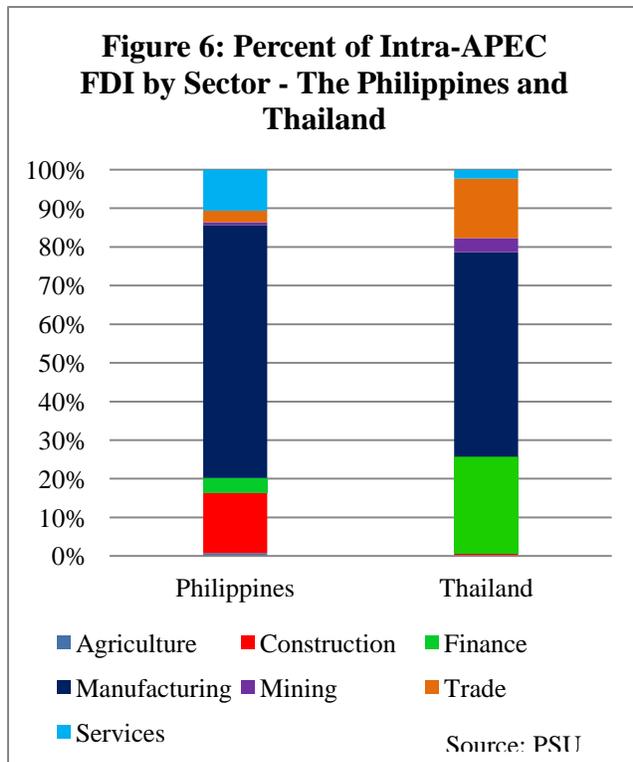
Singapore attracted more FDI from other APEC member economies during the years 2000-2010 than Japan drew globally, notching up over \$74 billion from the region. 64% of APEC funding came into the financial sector, demonstrating Singapore's push to become a financial center and its position as a safe haven in the region. For example, Indonesia and Chile combined to invest over \$11 billion in the sector, more than Australia; Canada; Japan; and New Zealand combined. Trade and logistics also showed strong gains of over \$15 billion, highlighting Singapore's strength as a global trading hub.

Singapore showed their openness to regional investment in other areas as well, with services and manufacturing showing strong gains and even mining and agriculture, not major drivers of the Singaporean economy, ending the decade with a positive investment. The only sector showing declines over our period of examination was the construction sector. Again, our data does not allow us to determine if this occurred due to few investment opportunities arising because of Singapore's competitive domestic firms or if other barriers to investment hinder regional entry. If barriers are the main culprit, welfare gains could stand to be gained by their removal.

The most interesting sectoral analysis available from our current data comes in examining FDI entering the Philippines and Thailand. Both are developing Southeast Asian economies which draw approximately 58% of their intra-APEC FDI from industrialized economies and 42% from other developing APEC members. Also, each reported sector-level data for the years 2005-2010, allowing us to make robust comparisons of their results. By examining the way each economy accepts and utilizes foreign investment, we will attempt to analyze the benefits FDI can have on developing economies' growth strategy.

Before examining the FDI numbers, however, we will begin by analyzing each economy's nominal per capita GDP. The Philippines per capita GDP rose from \$2,697¹⁰ in 2000 to \$3,560 in 2010, equivalent to 2.6% annual growth. Thailand, by contrast, enjoyed an 8.2% annual growth rate in per capita GDP as the average wage rose from \$1,943 in 2000 to \$4,614 in 2010. Thailand's economic development model has been more effective in raising average wages during the 2000s. Building on the earlier premise that FDI increases along with per capita GDP, we'll now explore the differences between each economy's FDI bundle to examine in more detail how foreign investors impact economic development.

¹⁰ All data in this paragraph are drawn from the World Bank's World Development Indicators via StatsAPEC. Nominal GDP is used so that measurement units are consistent for both FDI and GDP statistics.



Thailand has attracted the most FDI into its manufacturing, finance, and trade and logistics sectors, drawing \$28 billion, \$13 billion, and \$8 billion in respective intra-APEC investment. Their agriculture, construction and service industries have received relatively little attention from Asia-Pacific investors, drawing in only \$61 million, \$255 million, and \$1.2 billion over the last decade.

Investment in the Philippines, by contrast, has followed an opposite path. Manufacturing, construction, and services are the largest recipients of international investment, drawing in \$10.5 billion, \$2.5 billion, and \$1.7 billion respectively. The financial sector and trade and logistics industry drew in only \$606 million and \$475 million in intra-APEC investment over the same period.

In their World Investment Report, UNCTAD lists one of the primary challenges when integrating investment policy into a larger development strategy as “channeling investment to areas key for the build-up of productive capacity and international competitiveness.”¹¹ Economies seek out foreign investment in hopes of achieving knowledge spillovers in industries they would like to develop into productive drivers of growth. In this light, it would seem that both Thailand and the Philippines view manufacturing as an area where they can be competitive on the international stage. Both have attracted the largest share of intra-APEC FDI into their manufacturing sectors.

Other sectors, however, show a clear divergence in FDI growth. Thailand has received investment into the trade and logistics sector as well as finance, high value-added industries which appear poised to grow in importance in a globalized world. The Philippines have received investment in their construction industry along with the service sector, areas which are generally more focused on domestic consumption. Finance and trade lag behind other industries.

This divergence could arise because of many factors:

- Different growth strategies: export-led vs. domestic consumption
- Difficulty channeling FDI toward desirable industries
- High barriers to entry for foreign firms

¹¹ UNCTAD World Investment Report 2012.

Regardless of the reasons why, it is clear that Thailand and the Philippines appeal to foreign investors for very different reasons, though they share common economic development goals and a similar mix of inflows from both industrialized and developing APEC economies.

PROJECTS ANNOUNCED SINCE 2011

5,218 intra-APEC investments totaling \$330 billion have been announced since the beginning of January 2011, according to the Financial Times fDi Markets database.¹² Firms from industrialized APEC economies have sourced a majority of these foreign ventures with American, Japanese, and Canadian firms pledging to invest in a combined 3,728 projects, 71% of total intra-APEC activity.

China has been the largest destination for pledged intra-APEC investment in the last two years, followed by the United States, Indonesia, Canada, and Mexico. Over \$214 billion in investment has been announced in these five economies, corresponding to 65% of the total intra-APEC value.

The services sector has seen the largest number of announced projects in the last two years, led by the sales, marketing and support segment. Manufacturing was the second most common recipient of foreign investment, followed by trade led by the logistics, distribution, and transportation segment.

48% of firms announced that the destination economy's growth potential was a prime motivating factor in their investment decision, while 34% noted proximity to markets of customers as a reason to invest.

The two preceding points – which sectors of the economy are receiving the most attention and the motivating factor behind a firm's decision to invest abroad – are important to consider when shaping an economy's investment policy. No matter what strategy policymakers implement to attract FDI, they will not be successful unless foreign firms believe that their investment will be viable and profitable.

A strong plurality of firms noted that the growth potential of the Asia-Pacific region was a factor in their decision to invest in the region. Their actions reflect that belief with the services and trade sectors growing in importance as foreign firms seek to position themselves to sell to host-economy consumers instead of simply relying on them for low-cost inputs or factors of production. Policymakers who incorporate these facts into a more comprehensive investment policy will be best positioned to take advantage of the gains foreign investment can offer in the future.

¹² The fDi Markets database records announced foreign investment projects, not necessarily projects that are implemented in any given time period. These numbers should be used for illustrative purposes only and as a signal of which markets are active sources and destinations of intra-APEC FDI.

CONCLUSION

APEC economies were magnets for foreign investment over the last decade, attracting over \$4.8 trillion from global firms. These trends show no sign of reversing or slowing. Foreign firms remain positive on the APEC region, announcing over \$330 billion in new investment in the last 2 years and cite growing markets and close proximity as their primary motives. Foreign firms believe that the benefits of investing in the Asia-Pacific region outweigh both the cost and risk of doing so, decisions made easier by a more transparent, accessible investment climate facilitated by the eight principles laid out in the IFAP agenda.

However, these gains were not spread equally. Six APEC economies – Canada; China; Hong Kong, China; Mexico; Singapore; and the United States – garnered 84% of those flows with the United States alone receiving over 40% of total APEC FDI. A majority of internal flows were sourced in a handful of APEC economies as well, indicating that the gains from these investments are going to a small number of economies, but also signaling that many APEC members have substantial opportunity to advance their own positions within the regional investment field.

We also found evidence of positive counter-cyclical resilience in intra-APEC FDI flows, specifically for developing APEC economies. When others retrench and reduce their investments, APEC members maintain their support and continue to invest in the region, a demonstration of the commitment and strong connections which exist between member economies.

Another trend we were able to identify is the positive correlation between per capita GDP and per capita FDI. On trend, those economies with higher per capita GDP also attract more foreign investment per capita. Assigning causation to this trend is difficult without more complete data and, even then, sophisticated statistical techniques would be needed to properly account for strong endogeneity bias. Despite these short-comings, there is evidence that richer economies attract more foreign investment.

Economies also face difficult challenges directing those funds toward sectors in line with their broader economic agendas and adapting the policy environment to match. Yet opportunities exist for nimble, proactive economies that recruit foreign investors and understand the changing dynamics of firm demand. Service sector investment has moved past manufacturing as the area where foreign firms seek to channel their investments, offering recipient economies the opportunity to rise up the global value chain as international connectivity increases.

As a cooperative body, APEC offers substantial room to grow in the investment arena. Only 40% of international funds invested in the region came from other APEC member economies and only 58% of the region is covered by bilateral investment treaties or other international investment agreements. As an established forum seeking common understanding and progress on international economic issues, APEC offers a strong starting position for economies seeking to strengthen their position in the international investment field. IFAP offers a solid policy foundation to enhance an economy's investment climate.

Areas where future APEC cooperation could provide further benefits in facilitating international investment are in access to export markets, openness to trade, and transparency, areas which firms have identified as important factors as they analyze international investment positions and the core focus and strength of APEC. Directing future effort toward these issues could help further enhance APEC economies as a choice destination for foreign investment.

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