International
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Foreign Direct Investment Regimes 2020

A practical cross-border insight into FDI screening regimes

First Edition

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Recent FDI Trends in the APEC Region

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1 Overview of the Global Foreign Direct Investment (FDI) Market

According to the UNCTAD World Investment Report 2019 (UNCTAD (2019), World Investment Report 2019, New York and Geneva: United Nations), Foreign Direct Investment ("**FDI**") flows around the world have been decreasing for three years in a row. The FDI flow was USD 1.5 trillion in 2017 and it decreased to USD 1.3 trillion in 2018. Analysed by region, FDI inflows in Europe decreased by 55%, by 4% in North America, and by 6% in Latin America and the Caribbean. However, contrary to these regions, the FDI inflows to the Asia-Pacific Economic Cooperation ("**APEC**") region increased by 1% to USD 839 billion (Asia as a whole increased by 4% to USD 512 billion). Looking at more specific areas in the APEC region, FDI inflows in the South East Asian countries (i.e. ASEAN countries) have increased for three consecutive years. FDI inflows in Singapore, Indonesia, Vietnam and Thailand have increased and are still showing an upward trend. In addition to South East Asia, FDI in South Asia increased by 4%, by 4% in East Asia and by 3% in West Asia. It is clear from these figures that the Asian market is still very attractive to investors from other regions of the world. Asia is the leading FDI market in the world and about 39% of global inflows were received by Asian markets (APEC received about 65% of global inflows).

What are the causes of these fluctuations in FDI flows? The FDI market can be affected by many factors, including the economic, tax and political environments. However, the specific FDI regulations and policies in force in each country play a fundamental role. In 2018, 112 changes were made worldwide to regulations governing or affecting FDI. Amongst these 112 changes, 65 changes (58.04%) were aiming at relaxing the regulations to ease and encourage FDI flows and spur the economy. Conversely, 31 changes (27.68%) were made to tighten regulations with the rest being neutral. Comparing relaxation vs. tightening trends, it seems like the world is still intent on liberalising FDI rules. However, this can be compared with the 2017 figures with 144 changes including 98 changes (68.06%) to relax regulations and 23 changes (15.97%) to tighten regulations. The percentage of changes bringing about restrictions increased by 11.71% from 2017. Moreover, the number of amendments aiming at tightening FDI regulations has been growing for four consecutive years. Therefore, in recent years, there has been conflicting trends reflecting diverse national policies and strategies, including within the APEC region.

Key amendments to the FDI regimes of major APEC countries are explained below.

2 Recent Amendments in China, South East Asia and South Asia

Developing and emerging countries in the APEC region, especially China and South East Asia, have attracted high inbound investments by foreign investors, not just from Asia but also Europe and North America. Many factors can explain this continuous trend, including the relaxation of FDI regulations. Investors are very active in the region across almost all industries.

China

Since 2018, the trade war between China and the United States has been intensifying. The news reports daily on the complex relationship between the two countries. However, even though bilateral ties are not on the mend and the political situation between the two countries remains confrontational, FDI inflows to China increased by 4% in 2018 and FDI channelled to the manufacturing industry increased by 20% from 2017. Moreover, about 60,000 new companies have been established by foreign investors in China during 2018. Countries investing in China are not just developing countries or local players like Hong Kong, South Korea and Singapore; FDI inflows from more developed economies in Europe like the United Kingdom, France and Germany have also increased.

In the past, China was one of countries which was typically trying to strictly limit and control FDI flows. A foreign investor trying to establish a company in China had to obtain prior clearance from the Ministry of Commerce (MOFCOM). Such policy was reversed following drastic amendments in 2016. The PRC has adopted a new regime which significantly reduces costs and procedures to be followed by a foreign investor establishing a company in China. The 2016 reform replaced the approval requirement with a notification requirement, except in some sensitive sectors which are still subject to the approval of the relevant authority (these exceptions are listed in a "**Negative List**").

The Negative List was revised in 2018 with effect in July 2018. The number of prohibited, restricted or regulated sectors (including agriculture, infrastructure, finance, and the automotive sector) has been reduced from 63 to 48. After the entry into force of the 2018 Negative List, BMW, a German car manufacturer, invested USD 4 billion to acquire additional shares in its PRC joint venture to increase the shareholding. Such an example shows that relaxing regulation led to the growth of FDI inflows heading to China.

In June 2019, the Chinese authorities announced the implementation of the 2019 Negative List (the Special Administrative Measures on Access to Foreign Investment (2019 edition)) and the Free Trade Zone Special Administrative Measures on Access to Foreign Investment (2019 edition), which further relax FDI regulations and replace their respective 2018 editions. Besides the 2019 Negative List, the new Encouraged Catalogue, or the Catalogue of Encouraged Industries for Foreign Investment (2019 edition), lists industries where foreign know-how and investment is welcome. The 2019 Negative List has further lifted prohibitions or eased restrictions in sectors such as the oil and natural gas industries, mining and transportation. This move will likely enhance FDI in the PRC.

South East Asia and South Asia

As mentioned in the overview, FDI in South East Asia and South Asia is constantly on the increase and 2018 was an all-time high for South East Asia. In the South East Asia region, the main ASEAN countries, namely Singapore, Indonesia, Vietnam and Thailand are leading the pack. With regard to South Asia, Bangladesh is experiencing significant growth and is one of the fastest-growing economies in the world, while India is still absorbing 70% of the FDI heading towards South Asia.

Indonesia

FDI inflows to Indonesia have increased by 7% compared to 2017, reaching USD 22 billion. More than half of the investments are from Singapore, followed by China and Japan. Many multinational companies invest in Indonesia through a regional headquarters established in Singapore. Foreign investors have been especially interested in manufacturing, infrastructure, real estate and the digital economy.

Back in 2016, there was a relaxation of FDI regulations, and the number of regulated sectors decreased from 664 to 515. The reform of the FDI regulation policy has slowed down since 2018; however, the Indonesian government has set a goal to be ranked in the top 10 economic powers by 2030. To boost FDI, the Indonesian government has announced that it will actively pursue policies aiming towards the relaxation of FDI regulations.

In August 2019, to enhance investment by foreign banks, the Indonesian authorities started considering a reform of bank ownership rules which had been preventing foreign banks from investing into Indonesian banks.

Singapore and Thailand

In 2018, FDI inflows to Singapore increased to USD 78 billion from USD 76 billion, which constituted about half of FDI inflows to South East Asia. Cross-border inbound M&A was the main reason for the growth. There were no major amendments made to the FDI regulations and policy in 2018; however, Singapore is already known as an open country regarding FDI.

FDI inflows to Thailand increased sharply in 2018. FDI reached USD 10 billion which is a 62% increase from the previous year, and such investments are led by Japan and Singapore. The manufacturing, financial and insurance sectors have attracted many foreign investors.

India

FDI in India increased by 6% to USD 42 million in 2018. Investments in manufacturing, communications and financial services were relatively stable.

Since 2017, India has been liberalising its FDI policy to enhance FDI inflows. In January 2018, India liberalised its FDI regulations in certain industries, including single-brand retail trading and airlines. In addition, in August 2019, the Indian government announced a new regulation which allowed single-brand retailers, like Apple, to open online stores before opening retail outlets in India.

The background of the position taken by the Indian government is that although India is still economically growing, the rate of growth has decreased compared with past decades. To boost economic growth, the Indian government believes that FDI growth is essential and they are contemplating further relaxation of their regulatory framework to liberalise foreign insurance intermediation and sourcing regulations.

Notwithstanding this, the Indian government is still conservative in many respects. It approved new policies on e-commerce to protect local offline and online retailers that came into effect on 1 February 2019. The new policies banned the offering of large discounts by online marketplaces. This change in policy had a significant impact on foreign e-commerce companies operating in India, such as Walmart and Amazon. Walmart acquired India's biggest e-commerce platform in 2018, a year before these changes, which boosted the amount of inbound cross-border Indian M&A to USD 33 billion in 2018.

3 Amendments in APEC Developed Countries

Unlike developing countries in the APEC region, developed countries such as Japan and Australia (excluding developed ASEAN members), have taken opposite steps regarding FDI regulations. Japan and Australia have introduced stricter FDI regulations over recent years, following the trend prevailing in many developed countries around the world. The restrictions in Japan and Australia are meant to align their rules with those of the United States and the EU. For example, in the United States, the Committee on Foreign Investment in the United States (CFIUS) implemented a pilot programme in November 2018. Under the programme, a foreign investor is required to file a mandatory notification to invest in certain critical technology and the President of the United States has the authority to block investments. In the EU, the European Council has approved new FDI screening regulations which came into force in April 2019 and which allow Member States to request information and give their opinion regarding FDI in the EU. These stricter FDI policies in developed countries aim to protect national security from foreign investors. As a result, for example, the number of outbound mergers and acquisitions by Chinese companies increased sharply from 2015, but the number has been decreasing from 2017 for two consecutive years.

Japan

FDI in Japan in 2018 amounted to USD 26 billion, which means an increase of 26.7% compared to 2017. Half the investments in Japan were in the manufacturing sector, which increased by 32% to USD 13.2 billion. By industry type, electrical equipment, transportation equipment, chemicals and the healthcare industry were driving growth in the Japanese market. This has resulted from a number of large transactions (e.g. the acquisition of Toshiba Memory by the consortium led by Bain Capital and completed in 2018).

The Japanese government has imposed FDI restrictions on national security grounds. One of the major changes in Japan was the amendment of the Foreign Exchange and Foreign Trade Act of Japan (Act No. 228 of 1949) ("**FEFTA**") in 2017. The amendment permits the Ministry of Finance to order a foreign investor, which has obtained shares in a Japanese company without filing a mandatory notification to the Bank of Japan, to sell such acquired or allotted shares.

Moreover, Japan further amended the FEFTA in May 2019 to expand the scope of sectors which require a prior notification to the Bank of Japan in case of foreign investment, including the manufacturing of data processing software, and computer and telecommunications equipment. The same reason mentioned for the policy changes in the United States and the EU underpins this amendment, introduced to prevent the leakage of important technology and to protect manufacturing or technological infrastructure relating to national security from being damaged or sabotaged.

In August 2019, the Japanese government started planning new amendments to the FEFTA to further tighten up FDI regulations. Now the Japanese government is seeking to amend the current 10% threshold rule. The 10% threshold rule triggers a prior notification filing requirement with the Bank of Japan if a foreign investor acquires more than 10% of the shares in a Japanese company in specific sectors. Under the current FEFTA, sectors subject to the 10% threshold rule are fairly diverse: gas, electricity, weapons, broadcasting, etc. The Japanese government is planning to reduce the threshold to 1%. The reason for the proposed amendment can be found in the Companies Act of Japan, under which a shareholder holding more than 1% of the issued shares has the right to propose a new agenda to be the subject of a shareholders' meeting. Therefore, such shareholder may be involved in the decision-making of the company on material issues through a shareholder's proposal. By introducing the 1% threshold, the Japanese government may obtain information on foreign investors having such "power" in companies engaged in sectors that are generally deemed sensitive and may block the acquisition, if necessary.

In practice, the Japanese government has only very rarely interfered with the acquisition of shares by foreign investors. However, in 2008, a British hedge fund, The Children's Investment Fund, had planned to acquire additional shares in Electric Power Development Co., Ltd., a Japanese electricity company, to increase its share ownership percentage to 20%. In this case, after the filing of a prior notification with the Bank of Japan, the Japanese government rejected their proposal on the ground of the possibility of jeopardising public order. It was the first time the Japanese government had ordered a halt to the acquisition of additional shares.

As part of a difficult balancing act, at the same time the Japanese government will introduce the 1% threshold rule, it is planning to introduce easier procedures for foreign investors in areas unlikely to affect national security to boost FDI in Japan.

These amendments are expected to become effective sometime in 2020. It will be the first comprehensive reform of the FEFTA since FDI in Japan became free in principle in 1980.

Australia

In 2018, FDI inflows to Australia increased by 43% to USD 60 billion from USD 42 billion.

Similar to Japan and other developed countries, to manage national security risk, the Australian government adopted a new regime, the Security of Critical Infrastructure Act 2018, to restrict investment in certain important and strategic sectors including electricity, gas, water and ports. Under this act, (i) a "responsible entity" (e.g. for critical electricity or gas assets, the entity that holds the licence, approval or authorisation to operate the asset to provide the relevant service) is required to report "operational information" (e.g. the location of the asset, etc.), and (ii) a "direct interest holder" (e.g. together with any associate of the entity that holds an interest of at least 10% in the asset, etc.) is required to report "interest and control information" (e.g. details of the entity, etc.). A foreign investor who is caught by the regulation is required to report a large amount of information and a penalty may be imposed in case of non-compliance.

In addition, on 1 February 2018, the Australian government announced that a foreign investor intending to acquire agricultural land is required to demonstrate to the Foreign Investment Review Board that Australians had the same opportunity to acquire the land (the sale was widely advertised).

4 Future Prospects

Historically, developing countries in the APEC region have favoured a strict oversight of inbound investments and FDI restrictions to protect their own market and industries. However, they are now at a stage which requires more FDI to fuel further economic growth. In addition to the good location, a generally skilled labour force and low labour costs, especially in South East Asia, FDI policy reform is an effective tool to attract foreign investors. The liberalisation of local FDI regimes is likely to continue in developing APEC countries and emerging markets. It is also important to note that these countries are competing between themselves and investors are playing hard-to-get.

In contrast, developed countries like Japan and Australia are now getting more restrictive: national security, trade secrets, access to cyberspace, big data and new technologies need more scrutiny, oversight and legal protection from a mature and sophisticated market perspective. However, the tightening of FDI regulations in developed countries does not take us back to the past, at a time when FDI was very strictly regulated. The thrust behind the restrictions is not to protect their industries against foreign competition. Markets in developed countries are generally open compared to those in developing countries; the concern is with national security.

Changes in FDI regulations and policies are very active in the APEC countries, both developed and developing. Such changes may drastically change the FDI market in the APEC countries and may adversely affect foreign investors' current or proposed projects, such as in Walmart's case. Thus, it is essential for foreign investors to keep an eye on the latest developments in the region.

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