3 Cross-Border Investment

Riding the Pandemic Tide in Cross-Border Investment

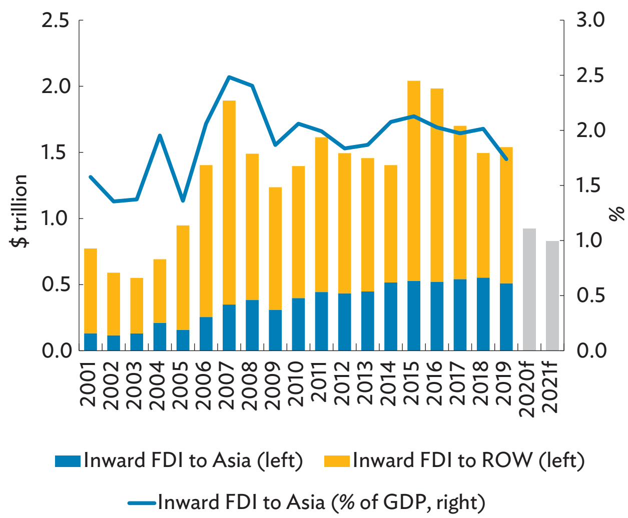
Updates on Foreign Direct Investment During the COVID-19 Pandemic

Although cross-border investment inched higher in 2019, global foreign direct investment is expected to decline in 2020 and 2021 as the COVID-19 pandemic could weaken corporate earnings, and investors might take a more cautious approach.

The coronavirus disease (COVID-19) pandemic has had a significant effect on the global economy. Efforts in containing the virus continue to weigh on economic activities, whether in the supply or demand side. The region's bleak growth outlook will negatively affect inward foreign direct investment (FDI) flows.

FDI edged up by 3.0% in 2019, after a 12.1% downturn in 2018. Global inward FDI rose to $1.54 trillion in 2019 from $1.50 trillion in 2018 (Figure 3.1).[18] Inward FDI to Asia slid by 7.7% from $553.3 billion in 2018 to $510.5 billion in 2019.[19] Despite the dip in inward levels, the region remained an important FDI destination, accounting for 33.1% of total global FDI. The drop in Asia's inward FDI in 2019 resulted mainly from weakening global demand for electronics and automotive products, as well as persistent trade tensions between the United States (US) and the People's Republic of China (PRC). Yet in 2019 Asia's intraregional FDI share remained stable at 51.7%.

Figure 3.1: Global Inward Foreign Direct Investment, by Destination ($ trillion)



f = forecast, FDI = foreign direct investment, GDP = gross domestic product, ROW = rest of the world.

Notes: Bars for 2020 and 2021 represent estimates from the United Nations Conference on Trade and Development's World Investment Report 2020. Estimate for 2020 is based on a forecasted 40% decline from 2019 levels, with 2021 based on a forecasted 5% decline from 2020 levels.

Source: ADB calculations using data from United Nations Conference on Trade and Development. World Investment Report 2020 Statistical Annex Tables. http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx (accessed June 2020).

Although FDI recovered slightly in 2019, inward investment has been trending down since peaking at $2.0 trillion in 2015. The decline is expected to continue into 2020 and 2021, exacerbated by the COVID-19 pandemic.

[18] The World Investment Report excludes the Caribbean financial centers from the total. These include Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Barbados, British Virgin Islands, the Cayman Islands, Curaçao, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Saint Maarten, and the Turks and Caicos Islands.

[19] Asia refers to the 49 members of the Asian Development Bank (ADB) within Asia and the Pacific, which includes Japan and Oceania (Australia and New Zealand) in addition to the 46 developing Asian economies.

According to the United Nations Conference on Trade and Development's 2020 World Investment Report, global FDI inflows for 2020 may decline by as much as 40.0% in 2020, bringing FDI below $1.0 trillion for the first time since 2005. Moreover, FDI may continue to decline in 2021 by about 5% to 10%. Even as investment is likely to recover in 2022, forecasts indicate that inflows for 2022 may still be below the $1.2 trillion trough seen during the global financial crisis.

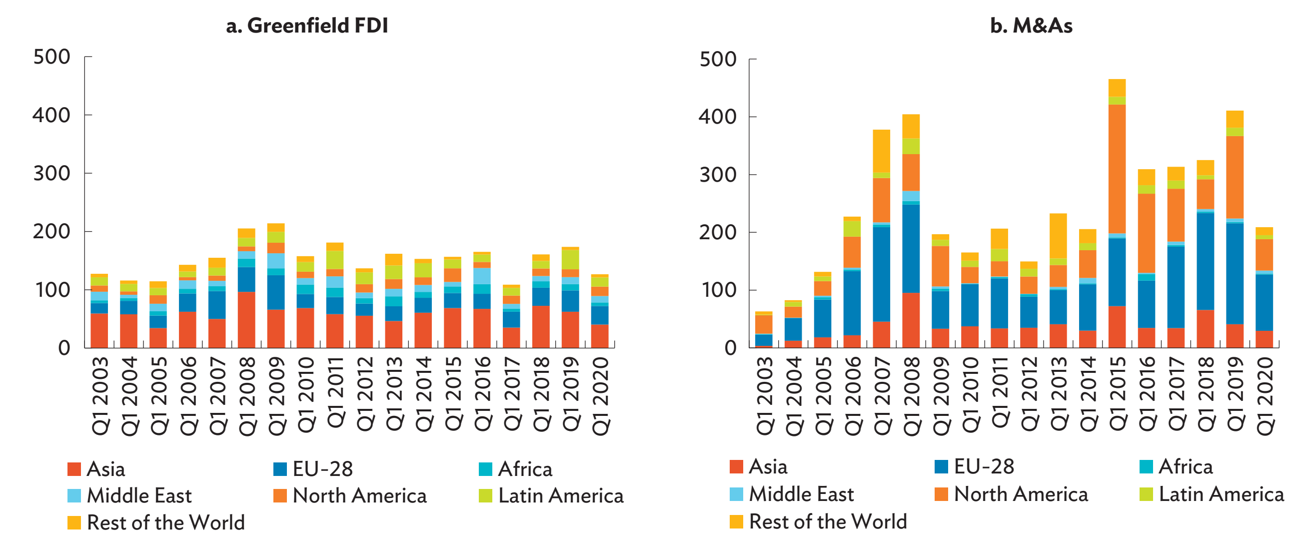
FDI flows are expected to fall in 2020, with immediate effects apparent within the first quarter of the year. A foreseen decline in reinvested earnings may bring about this fall in FDI inflows, according to the Organisation for Economic Co-operation and Development's (OECD) estimates. A fall in reinvested earnings during the pandemic is an expected outcome. During the financial crisis, reinvested earnings fell from almost 50% of earnings in 2007 to roughly a quarter over the succeeding couple of years. The share of reinvested earnings started to recover in 2010 and has been on the uptrend since 2013. However, enterprises are expected to respond in the same way they did in the global financial crisis, leading to the possible dip in reinvested earnings (OECD 2020a).

The first quarter of 2020 saw firm-level investment activity decline (Figures 3.2a and 3.2b). Greenfield investment from January to March of this year amounted to $126.8 billion globally, which is a 27.0% decline compared with the same period in 2019. Mergers and acquisitions (M&As) fared worse during the first quarter, with only $208.9 billion in deals pushing through. This level is less than half of that recorded in the first quarter of 2019. Delays and postponement of projects due to the COVID-19 pandemic negatively impacted greenfield investment, while cautionary measures due to an expected downturn in corporate earnings hampered M&As.

Asian economies were among the hardest hit globally in the first quarter of 2020. Greenfield investment in the PRC declined most in the first quarter of 2020, with FDI to the country dropping over $10.0 billion, due largely to the steep decline in investments in the coal, oil, and gas sector. The pandemic also damaged the Philippine economy during the quarter. Greenfield FDI to the Philippines slid by $6.6 billion, due to declines in travel-dependent sectors such as hotels and tourism. The United Kingdom (UK) saw the third-largest decline in greenfield FDI globally, with investment to the country slipping by $4.5 billion as investment in both renewable energy and electronic components fell.

Meanwhile, M&A deals suffered greatly in the US, as the value of deals in the first quarter (Q1) of 2020 declined by $87.5 billion. Substantial losses in deals in financial services, software and information technology (IT) services, and communications resulted in the steep drop

Figure 3.2: Global Inward FDI, First Quarter Estimates, 2003–2020—Greenfield and M&As ($ billion)



EU = European Union, FDI = foreign direct investment, M&A = merger and acquisition.

Sources: ADB calculations using data from Bureau van Dijk. Zephyr M&A Database; and Financial Times. fDi Markets (both accessed August 2020).

in the country's M&As in Q1 2020. Countries in Europe were also among the badly hit, with deals in the UK (down $58.3 billion) and Italy (down $13.8 billion) falling in the first quarter.

In Asia, M&As in the PRC dropped the most, from $12.6 billion in Q1 2019 to $8.3 billion in Q1 2020. Losses in deals in software and IT services, as well as in real estate, drove the decline. Deals in Indonesia also slid during the quarter (down $2.4 billion) because M&As in financial services and rubber sectors decreased.

Greenfield investment declined in almost all regions in the first quarter of 2020, barring North America (up 20.6%). Regions with the largest declines in greenfield investment were Latin America (down 52.3%), Africa (down 45.1%), and Asia (down 35.2%). In Latin America, four countries accounted for roughly three-fourths of the total decline in the region: Brazil, Bolivia, Cuba, and Peru. Meanwhile, two countries in Africa accounted for over 80% of the total decline in greenfield FDI in the region: Algeria and Kenya.

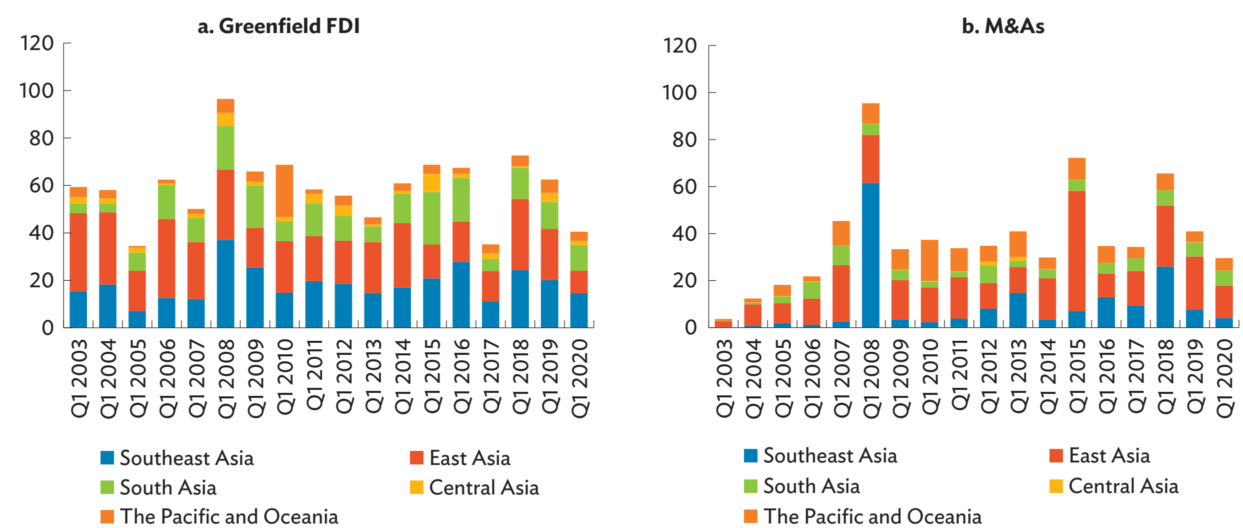
For M&As, all regions had been negatively impacted by the COVID-19 pandemic, with North America (down 61.8%) and Latin America (down 53.4%) among the hardest hit regions. The downturn in M&As in North America is due largely to the $87.5 billion decline in M&As in the US. In Latin America, decreased M&A volumes in Bermuda (51.9% of total), Brazil (30.9%), and Barbados (15.6%) accounted for almost all decline in the region.

Greenfield FDI and M&As in Asia similarly declined in the first quarter of 2020 (Figures 3.3a and 3.3b). Greenfield investments in Asia declined by 35.2% in the quarter compared with the first quarter of 2019. Despite this decline, the region continues to be an attractive and important destination for foreign investment.

Among Asian subregions, greenfield investment fell most in East Asia (down 56.4%) and Central Asia (down 51.6%). In East Asian economies, declines were recorded in Hong Kong, China; the PRC; and Taipei,China. In Central Asia, losses in greenfield FDI in Kazakhstan, Tajikistan, and Uzbekistan affected the region most. Meanwhile, M&As in the region declined by 27.8%, with the largest in Central Asia (down 76.8%) and Southeast Asia (46.5%). In Southeast Asia, large declines in M&As were recorded in Indonesia (down 82.8%) and Myanmar (down 63.6%).

Outward investment also declined in the first quarter of 2020 (Figures 3.4a and 3.4b). Global outward greenfield investment amounted to $126.8 billion compared with the previous year's first quarter outward investment of $173.7 billion. This translates to a 27.0% year-on-year decline in the first quarter of 2020.

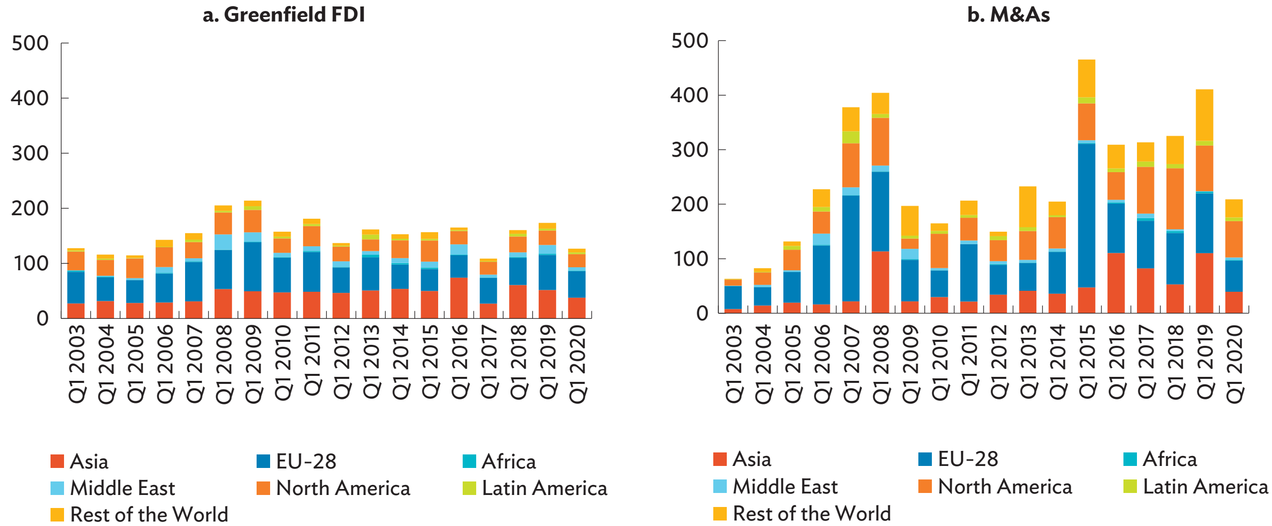
Figure 3.3: Asian Inward FDI, First Quarter Estimates, 2003–2020—Greenfield and M&As ($ billion)



FDI = foreign direct investment, M&A = merger and acquisition.

Sources: ADB calculations using data from Bureau van Dijk. Zephyr M&A Database; and Financial Times. fDi Markets (both accessed August 2020).

Figure 3.4: Global Outward FDI, First Quarter Estimates, 2003–2020—Greenfield and M&As ($ billion)



EU = European Union, FDI = foreign direct investment, M&A = merger and acquisition.

Sources: ADB calculations using data from Bureau van Dijk. Zephyr M&A Database; and Financial Times. fDi Markets (both accessed August 2020).

In terms of outward greenfield investment, FDI from the PRC, Saudi Arabia, and Germany recorded the largest declines. Greenfield FDI from the PRC fell by $8.4 billion in the first 3 months of 2020, as the country invested less in cross-border projects in transportation and warehousing, chemicals, and electronic components. Meanwhile, investment from Saudi Arabia fell by $8.3 billion as investment activities in coal, oil, and gas took a backseat in the first quarter. In Germany, steep falls in its outward investment in renewable energy; coal, oil, and gas; and plastics drove the $8.2 billion decline.

Deals from Japanese firms took a backseat in the first quarter of 2020, with M&As from the country declining by $59.3 billion. Most of the decline came with pharmaceutical activity being focused on developing treatments and vaccines for the virus, rather than consolidation. Deals from firms in Switzerland also recorded a $54.0 billon decrease, as deals in the communications, financial services, and software and IT services dipped. By region, in the first quarter of 2020, greenfield investment from the Middle East (down 65.0%) and Africa (down 36.8%) declined most.

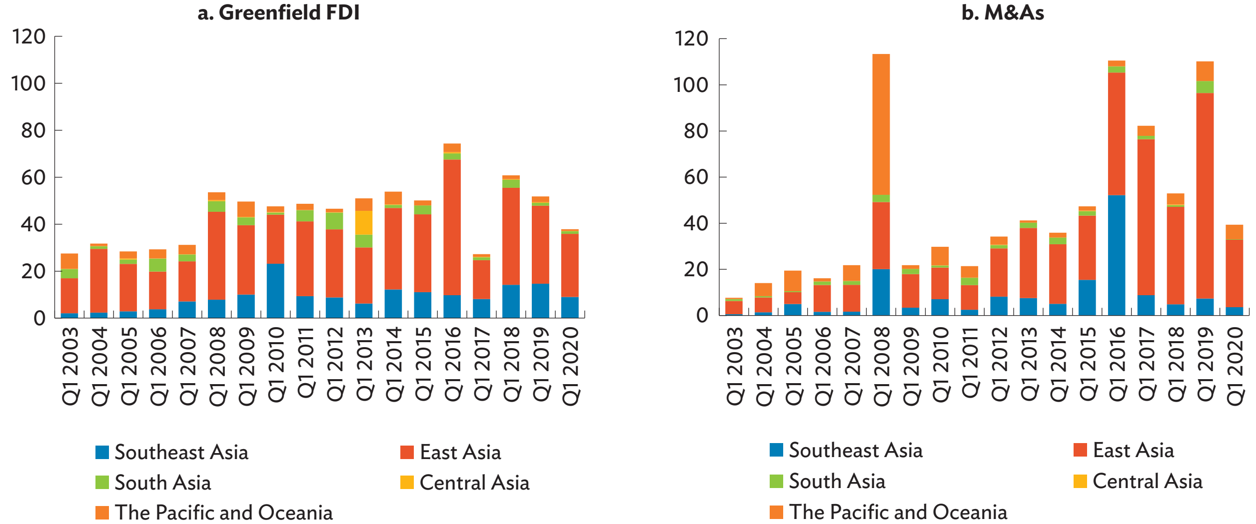
Meanwhile, outward M&As fell by almost half in the first quarter of 2020, from $410.8 billion in the first quarter of 2019 to $208.9 billion. Despite a significant increase in M&As from the Middle East (from $500 million in Q1 2019 to $4.4 billion in Q1 2020), downturns in other regions drove down M&As. M&As from Asia (down 64.3%) and Africa (down 60.6%) slid most. M&As from South Africa (down $2.4 billion) and Mauritius (down $619.9 million) took the biggest hit.

Greenfield investment from Asia amounted to $37.9 billion in the first quarter of 2020, a 27.0% decline from the first quarter of 2019 (Figures 3.5a and 3.5b). Greenfield investment from Oceania (down 69.9%) and Central Asia (down 53.7%) declined the most.

M&As from Asia in the first quarter of 2020 was only about a third of the level in the first quarter of 2019 (Figure 3.5). This amounted to $39.4 billion, compared with the previous M&A value of $110.2 billion. Apart from large declines in M&As from South Asia (down 97%), East Asia (down 67.1%), and Southeast Asia (down 51.6%), no M&As had been recorded for Central Asia and the Pacific in the first 3 months of 2020.

M&As from India suffered most in South Asia, with mergers amounting to only $157.2 million in Q1 2020 compared with $5.2 billion in the same quarter a year earlier. In East Asia, the value of M&As by Japan firms declined by $59.3 billion, accounting for 99.1% of

Figure 3.5: Asian Outward FDI, First Quarter Estimates, 2003–2020—Greenfield and M&As ($ billion)



FDI = foreign direct investment, M&A = merger and acquisition.

Sources: ADB calculations using data from Bureau van Dijk. Zephyr M&A Database; and Financial Times. fDi Markets (both accessed August 2020).

the total decline in the region. Meanwhile, losses of $3.0 billion in M&As from Singapore and $500 million from Thailand led the decreased M&As from Southeast Asia. Lower greenfield FDI and M&As from Asian investors hint at the more cautious stance as the region continues to battle the COVID-19 pandemic.

Sector-wise, the pandemic affected industries disproportionately. Early on, consumption in some activities such as travel, leisure, and entertainment took a hit, as minimum health standards such as physical distancing and cross-border policies such as travel bans were implemented.

Activity moved similarly in greenfield investment and M&As. Globally speaking, greenfield investment in the coal, oil, and gas sector plunged $13.6 billion year-on-year in the first quarter of 2020, due in part to slowing demand and earnings. Meanwhile, greenfield FDI in hotels and tourism in the first quarter of 2020 also fell, by $8.0 billion, followed by real estate (down $4.9 billion), leisure and entertainment (down $4.5 billion), and transportation and warehousing (down $3.5 billion). Lockdown measures impacted movement of people and goods greatly in these sectors, which led to sharp falls in foreign investment.

In Asia, the coal, oil, and gas sector was also among the largest decliners in Q1 2020. Greenfield investment to the sector fell $10.8 billion. Asia's hotels and tourism sector also took a big hit, with FDI in the sector declining by $8.1 billion that quarter. Investment in real estate also declined by $2.6 billion. Greenfield FDI in the automotive original equipment manufacturing sector also declined by $2.2 billion in Q1 2020, as production and demand slowed.

Meanwhile, global deals in pharmaceuticals declined by $62.4 billion in the first quarter of 2020. As the world started to grapple with the effects of the pandemic, pharmaceutical companies redirected resources to developing treatments and vaccines, taking attention away from M&As. As in greenfield investment, M&As in coal, oil, and gas also dropped by $18.0 billion year-on-year in Q1 2020. Deals in the financial services sector slipped by $17.4 billion in the first 3 months of 2020. M&As also declined in the first quarter of 2020 in the medical devices (down $16.8 billion) and software and IT services (down $16.6 billion) sectors.

M&As in Asia declined the most in the communications industry, where deals dropped by $4.8 billion in Q1 2020. This is followed by software and IT services (down $2.7 billion), ceramics and glass (down $2.4 billion), business services (down $1.7 billion), and pharmaceuticals (down $1.7 billion).

Firm-level activity showed some signs of recovery in the second and third quarters, as countries started to reopen and ease some pandemic-related restrictions.

Despite the sharp drop in inward FDI during the first quarter, Q2 2020 showed some signs of recovery, especially for M&As (Table 3.1). While greenfield FDI decreased to $115.3 billion in Q2 2020 from $126.8 billion in Q1, capital expenditure for projects recovered in some regions. Greenfield investment in the European Union (EU)–28 countries increased by $3.7 billion in the second quarter, most notably in the UK (up $9.3 billion) and France (up $2.2 billion). Meanwhile, greenfield FDI in North America also recovered in the second quarter (up $6.3 billion) due to increased investment in the US (up $8.5 billion), which cushioned the decline in greenfield FDI in Canada in the same quarter. In the UK, much of the recovery was in renewable energy, along with transportation and warehousing, while FDI growth in the US was driven by investment in semiconductors and chemicals.

While greenfield FDI decreased overall in Asia, some countries saw increased FDI in the second quarter. Greenfield investment in Indonesia increased by almost $9.0 billion between the first and second quarter, largely in FDI to the country's chemicals and real estate sectors. Australia saw a $4.8 billion increase in FDI in the second quarter, due to projects in the coal, oil, and gas sector. Meanwhile, increased FDI in the real estate sector primarily drove Japan's growth in the second quarter.

M&As appear to have recovered in the second quarter. Attractive valuations due to lower equity prices and weakened currencies helped the recovery. Global M&As increased $152.2 billion over the first quarter. Large increases in M&A deals were seen in North America (up $74.9 billion), the EU-28 (up $40.5 billion), and Asia (up $28.9 billion). Second-quarter deals in the US more than doubled those in the first quarter ($50.8 billion to $120.2 billion). Meanwhile, deals in Ireland (up $63.7 billion) drove M&As up among EU-28 countries. In the US, deals in the communications, semiconductors, and automotive components sectors paved the way for FDI recovery. Meanwhile, pharmaceutical M&As drove recovery in Ireland.

In Asia, M&As recovered in India (up $15.6 billion) and Australia (up $9.6 billion). India recorded higher M&A values in the communications, food and beverages, and electronic components sectors. In Australia, M&As in food and beverages; paper, printing, and packaging; and real estate supported growth in the second quarter.

Among Asian subregions, overall firm-level investment activities picked up among countries in Oceania (up $15.1 billion), South Asia (up $7.0 billion), and Southeast Asia (up $5.1 billion), as shown in Table 3.2. Greenfield investment increased most in Oceania (up $5.6 billion) due to an uptick in Australia (up $4.8 billion). Large gains in greenfield FDI in Japan (up $2.1 billion) and other countries offset the sizable decline in FDI in the PRC (down $2.6 billion), resulting in an increased greenfield investment in East Asia (up $800 million). Meanwhile, M&As increased largely in South Asia (up $15.7 billion)

Table 3.1: Global Inward Investment by Destination Region, Q1 to Q3 2020—Greenfield FDI and M&As ($ billion)

	Greenfield FDI			M&As		
Region	**Q1 2020**	**Q2 2020**	**Q3 2020**	**Q1 2020**	**Q2 2020**	**Q3 2020**
Asia	40.5	38.5	18.1	29.6	58.4	42.8
EU-28	32.0	35.8	23.1	97.7	138.0	90.4
Africa	5.9	5.7	3.0	1.4	5.0	0.6
Middle East	11.1	1.8	10.3	5.3	9.4	11.7
North America	16.2	22.5	10.7	54.5	129.4	20.4
Latin America	15.7	8.3	7.1	6.7	8.9	2.8
Rest of the World	5.3	2.7	3.2	13.7	12.1	27.9
Total	**126.8**	**115.3**	**75.5**	**208.9**	**361.1**	**196.6**

EU = European Union, FDI = foreign direct investment, M&A = merger and acquisition.

Sources: ADB calculations using data from Bureau van Dijk. Zephyr M&A Database; and Financial Times. fDi Markets (both accessed November 2020).

because deals in India recovered significantly. Increased M&A deals in Australia brought about an increase in M&As in Oceania (up $9.4 billion), while gains in Indonesia (up $2.8 billion), Viet Nam (up $1.6 billion), and Singapore (up $1.3 billion) drove up M&As in Southeast Asia (up $4.9 billion).

While greenfield FDI continued to decline globally in the second quarter, some sectors saw increased activity. Global greenfield investment in semiconductors recovered, from $276.6 million in the first quarter to $12.7 billion. Renewable energy greenfield investment increased from $19.8 billion to $30.9 billion. Other sectors that posted recoveries between the first two quarters of 2020 were ceramics and glass, communications, and engines and turbines.

In Asia, second-quarter greenfield investment grew most in the chemicals sector, to $10.9 billion from $5.4 billion in the first quarter. Greenfield FDI also recovered in coal, oil, and gas (up $2.8 billion); real estate (up $1.9 billion); renewable energy (up $1.4 billion); and semiconductors (up $571.6 million).

M&As fared better in the second quarter of 2020 than in the first, largely because of gains in global pharmaceuticals deals (up $64.6 billion). Deals in communications also revived, with M&As growing by $51.0 billion globally. M&As increased in the food and services sector, from $6.0 billion in the first quarter to $19.1 billion in the second quarter. Increases in M&As were also recorded in electronic components (up $8.9 billion) and semiconductors (up $8.6 billion).

M&As in Asia in the food and beverages sector leapt in the second quarter compared with the first, from $1.3 billion to $15.6 billion. Communications also rebounded, from $3.0 billion to $11.5 billion. Deals in electronics components (up $3.5 billion), financial services (up $2.7 billion), and chemicals (up $2.6 billion) also increased in the second quarter.

Overall, outward FDI followed the same trend as inward FDI in the second quarter of 2020. Outward greenfield FDI slid further, by $11.5 billion, with the largest decline in outward greenfield investment from the EU-28 countries (down $9.7 billion), particularly in France (down $5.7 billion) and Spain (down $3.0 billion). This was followed by North America, as greenfield FDI from the region slid $5.1 billion between the first and second quarters. Meanwhile, Asia's outward greenfield FDI recovered, though modestly, by $1.3 billion. Large declines in financial hubs such as Japan, the PRC, and Singapore were offset by a $17.0 billion increase in greenfield investment from Taipei,China.

As greenfield FDI dove further in the second quarter, outward M&As recovered overall by $152.2 billion. The EU-28 and North America were at the forefront, as M&As from EU-28 countries increased by $96.1 billion, while those from North America increased by $61.6 billion. M&As from Asia also recovered in the second quarter, as deals from the region ticked upward by $8.9 billion.

Compared with Q2 2020, Q3 2020 indicated some steam lost in firm-level investment (see Table 3.1). Greenfield FDI continued a descent, globally pulling in only $75.5 billion in Q3 2020 compared with

Table 3.2: Asian Inward Investment by Destination Region, Q1 to Q3 2020—Greenfield FDI and M&As ($ billion)

	Greenfield FDI			M&As		
Asian Subregions	**Q1 2020**	**Q2 2020**	**Q3 2020**	**Q1 2020**	**Q2 2020**	**Q3 2020**
Southeast Asia	14.6	14.8	0.4	4.0	9.0	0.0
East Asia	9.5	10.3	8.8	13.7	11.1	27.6
South Asia	10.8	2.2	1.9	6.5	22.2	7.2
Central Asia	1.9	2.0	3.2	0.0	1.6	2.8
The Pacific and Oceania	3.8	9.3	3.9	5.3	14.7	5.2
Total	**40.5**	**38.5**	**18.1**	**29.6**	**58.4**	**42.8**

FDI = foreign direct investment; M&A = merger and acquisition.

Sources: ADB calculations using data from Bureau van Dijk. Zephyr M&A Database; and Financial Times. fDi Markets (both accessed November 2020).

$115.3 billion in Q2 2020. Greenfield investment declined in Asia (down $20.4 billion), totaling $18.1 billion in Q3 2020 compared with $38.5 billion in Q2 2020. Large declines were also recorded in the EU (down $12.7 billion) and North America (down $11.8 billion). Meanwhile, greenfield investment saw a bright spot in the Middle East during Q3 2020, as it increased to $10.3 billion from $1.8 billion in Q2 2020.

After a steep growth in Q2 2020, M&As retracted some of its recovery momentum in Q3, with the largest loss recorded in North America (down $109.0 billion). However, M&A trend was still quite robust in Asia. M&A deals in Asia also grew on year-on-year basis, recording $42.8 billion in Q3 2020 compared with $35.7 billion in Q3 2019 (see Table 3.1).

M&As in East Asia rebounded in Q3 2020. After dipping to only $11.1 billion in Q2 2020, M&As in the subregion totaled $27.6 billion in Q3 (see Table 3.2).

Despite uncertainties around the prolonged impact of the pandemic, FDI is expected to have continued its recovery trend in Q4 2020 in Asia, driven by the region's relatively better performance in containing the pandemic and resilience in industrial production capacities.

The COVID-19 pandemic is expected to continue weighing on foreign direct investment.

Some efforts to contain the coronavirus such as business and establishment closures—especially those of manufacturing plants and construction sites—have caused delays in the implementation of projects. While some fixed operational expenditures continued, other forms of capital expenditure were blocked. In addition, as governments rightly divert their attention to addressing the ongoing crisis, the approval of some planned mergers have been delayed.

Some countries have also tightened FDI screening measures to safeguard key establishments and sectors from possible predatory takeovers. While this policy response is not new in the time of the pandemic, measures such as these are expected to have a long-term effect on incoming FDI. In addition, shortages early in the pandemic also highlighted the need for supply chain resilience and autonomy, especially for critical supplies, such as medicine and personal protective equipment. In some cases, this has resulted in diversion, divestment, and reshoring.

Policy Updates: Regulatory Restrictions and Screening in Foreign Direct Investments

FDI regulatory restrictiveness across the world increased in recent years.

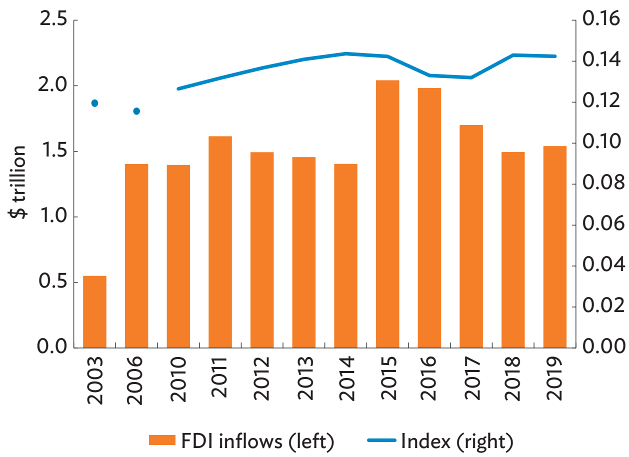
Countries regulate incoming investments in one way or another. More than assuring that investments are beneficial to their economy and meet best practices, some regulations are intended to address issues related to national security. Policies include entry and establishment regulations such as business permits, approval requirements, and, in some cases, limitations on foreign investment in some sectors. Restrictions play a role in how open a country is to FDI, and this degree of openness, in turn, affects its attractiveness as a destination for investment.

An index from the OECD helps measure a country's regulatory restrictiveness. The index measures four regulatory areas: foreign equity limitations, discriminatory screening or approval mechanisms, foreign employment restrictions in key positions, and other operational restrictions. Values range between 0 and 1, with zero indicating openness (OECD 2010).

Globally, the FDI regulatory restrictiveness index had been rising since 2006, reaching its peak in 2014 at 0.144 (Figure 3.6).[20] It declined for several years, before increasing again and settling at 0.142 in 2019. The increase and eventual peak of the restrictiveness index coincided with a

[20] Economies included in the index were classified as Asia and non-Asia. Asia includes Armenia, Australia, Azerbaijan, Brunei Darussalam, Cambodia, Georgia, India, Indonesia, Japan, Kazakhstan, the Republic of Korea, the Kyrgyz Republic, the Lao People's Democratic Republic, Malaysia, Mongolia, Myanmar, New Zealand, the PRC, the Philippines, Singapore, Tajikistan, Thailand, Uzbekistan, and Viet Nam. Non-Asia includes Albania, Algeria, Argentina, Austria, Belarus, Belgium, Bosnia and Herzegovina, Brazil, Canada, Chile, Colombia, Costa Rica, Croatia, Czechia, Denmark, Egypt, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Jordan, Kosovo, Latvia, Lebanon, Libya, Lithuania, Luxembourg, Mexico, Moldova, Montenegro, Morocco, Netherlands, North Macedonia, Norway, Peru, Poland, Portugal, Romania, the Russian Federation, Saudi Arabia, Serbia, Slovakia, Slovenia, South Africa, Spain, State of Palestine, Sweden, Switzerland, Tunisia, Turkey, Ukraine, the UK, the US, and Uruguay.

Figure 3.6: FDI Regulatory Restrictiveness Index versus FDI—World



FDI = foreign direct investment.

Notes: The FDI Regulatory Restrictiveness Index measures statutory restrictions on FDI in 22 sectors. The index considers restrictions on four main areas: foreign equity limitations, discriminatory screening or approval mechanisms, foreign employment restrictions in key positions, and other operation restrictions. The index ranges in value from 0 to 1, with 0 being more open and 1 being more closed.

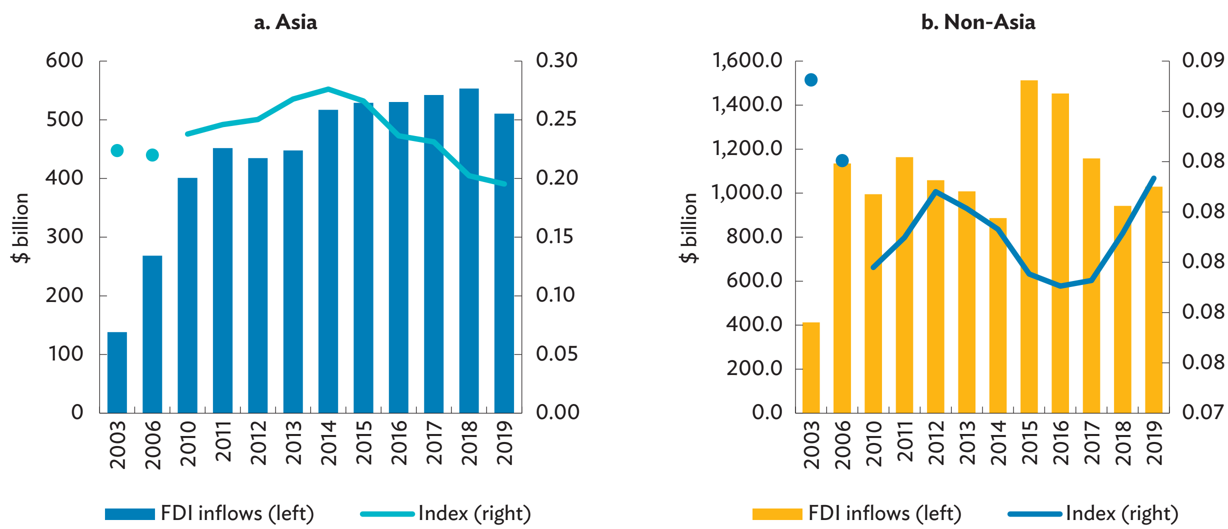
Sources: ADB calculations using data from Organisation for Economic Co-operation and Development. FDI Regulatory Restrictiveness Index. https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX# (accessed September 2020); and United Nations Conference on Trade and Development. World Investment Report 2020 Statistical Annex Tables. http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx (accessed June 2020).

trough in global inward FDI in 2014, valued at $1.4 trillion. Restrictions eased starting in 2015, and global FDI also recovered; however, global inward investments since seem to be on a downtrend, while restrictiveness is on an uptrend.

By region, FDI restrictiveness has been generally higher in Asian countries, also reaching a peak in 2014, at around 0.276 (Figure 3.7a). Regulatory restrictions have since eased, with the 2019 index valued at 0.195. A rise in FDI to Asia coincided with this ease.

Meanwhile, regulatory restrictions in countries outside of Asia seem to be lower, hovering along the 0.085 line across the years (Figure 3.7b). Available data indicate a peak in 2003 at 0.087, quickly reaching a trough in 2010 at 0.079. The Regulatory Restrictiveness Index reached another peak in 2012 and had declined until 2016. It has since picked up, with a value of 0.083 in 2019. While policy movements in non-Asian countries seem to be minimal, movement in inward FDI are more pronounced. Together with more lax restrictions came an influx of investment in 2015. Declines in FDI to non-Asian countries also coincide with an uptick in restrictiveness since 2017.

Figure 3.7: FDI Regulatory Restrictiveness Index versus FDI—Asia and Non-Asia



FDI = foreign direct investment.

Notes: The FDI Regulatory Restrictiveness Index measures statutory restrictions on FDI in 22 sectors. The index considers restrictions on four main areas: foreign equity limitations, discriminatory screening or approval mechanisms, foreign employment restrictions in key positions, and other operation restrictions. The index ranges in value from 0 to 1, with 0 being more open and 1 being more closed.

Sources: ADB calculations using data from Organisation for Economic Co-operation and Development. FDI Regulatory Restrictiveness Index. https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX# (accessed September 2020); and United Nations Conference on Trade and Development. World Investment Report 2020 Statistical Annex Tables. http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx (accessed June 2020).

Recent years have seen some screening mechanisms gain popularity worldwide. These mechanisms are aimed at screening foreign investments which may impede national security and other public interest.

Countries typically employ three types of screening mechanisms, usually in combination—cross-sector screening, sector-specific screening, or entity-specific mechanism. Cross-sector and sector-specific screening mechanisms are the most used, and typically employed in conjunction (UNCTAD 2019).

Sector-specific mechanisms initially regulated potential investments in the military and defense sectors, but these have since developed to protect other sectors deemed to be of domestic importance, with several countries specifying sectors of particular interest. These sectors include infrastructure such as energy supply and production, media, and telecommunications. Screening mechanisms may also include investments acquiring technology such as artificial intelligence, robotics, and aerospace technologies. In addition, the access of foreign investors to sensitive data on locals is also under consideration for screening in some countries.

Some countries have also implemented policies employing various FDI screening criteria (Table 3.3), with the majority focusing on defense, national security, public order, or public safety. These criteria and concerns have evolved into criteria besides national security. Some countries have included criteria on the possible effects of foreign investment on their respective economies, such as the economy's smooth operation, financial system stability, and steady economic growth, among others. Social costs, such as effects on the environment, health, and quality of life, are also of interest in some countries.

Mechanisms such as these are implemented across sectors and assessments are made whether potential investment impinge on specified criteria. However, even in the presence of cross-sector reviews, certain sectors or activities could be targeted through other restrictions such as lower relevant thresholds and other specific screening criteria.

Although legitimate from policy objective perspectives, some measures are expected to exert a negative impact on foreign investment.

For example, the US implemented tax reforms in 2017, which resulted in a repatriation of earnings of some multinational enterprises. Foreign investment from the US slumped to negative $90.6 billion in 2018 from $300.4 billion in 2017. Such measures continued to affect US outward investment in 2019. FDI to the US also declined by $194.5 billion in 2017, and continued to decline by $23.7 billion in 2018, and by $7.3 billion in 2019. On the inward FDI front, the US expanded the jurisdiction of the Committee on Foreign Investment in the United States through the Foreign Investment Risk Review Modernization Act of 2018. The implemented reforms were aimed at resolving "growing national security concerns over foreign exploitation of certain investment structures which traditionally have fallen outside of Committee's jurisdiction" (US Department of Treasury 2018).

In March 2019, the EU established a framework to screen inward FDI to shield the region from some predatory M&A practices and risks to security or public order (EU 2019). Early in 2020, the ongoing crisis saw the EU adding to its guidelines, enjoining member states to protect health-related companies and important assets. The COVID-19 pandemic has brought a fresh round of national security concerns, not only in the EU but in some Asian countries as well.

In April 2020, India moved to establish FDI rules to guard against opportunistic takeovers of companies hurt in the pandemic. Instead of being automatically approved, investors from border states must first seek government approval (BloombergQuint 2020). Australia also enacted some temporary measures in its FDI screening regime, lowering existing monetary review thresholds to $0, in effect subjecting all incoming foreign investment to review from March 29 onward (The Guardian 2020). The review schedule was also extended from 30 days to up to 6 months. The country implemented the temporary policy to "ensure appropriate oversight over all proposed foreign investment during [the pandemic]."

Table 3.3: FDI Screening Criteria—Select Economies

Economies	Screening Criteria
Australia	National interest
Austria	Public policy and public security, including services of public interest and crisis prevention, which affect a basic interest of society
Belgium (Flanders)	Strategic interests of the Flemish Community or the Flemish Region
Canada	Net benefit, national security
European Union	Security or public order
Finland	Key national interest: national defense, public order and security, fundamental interests of society
France	Public order, public security, or national defense
Germany	Public order or security, essential security interests
Hungary	Security interests
Iceland	National security, public order, public safety, or public health or in the event of serious economic, social, or environmental difficulties in particular economic sectors or particular areas
Italy	Defense interests, national security, essential interests of the State, public order
Japan	National security, public order, public safety; smooth operation of the economy
Latvia	National security
Lithuania	National security
New Zealand	Business experience and acumen, financial commitment, good character of an investor
Norway	National security
People's Republic of China (PRC)	National security, impact on the core key technological innovation development capabilities in important areas of the PRC, national steady economic growth, basic social living order, the research and development capacity of key technologies involving national security
Poland	Independence and territorial integrity, safeguarding human rights and freedoms, security and public order, environmental protection, ensuring the needs of the population to protect health and lives, prevention of activities and social and political phenomena disturbing international relations or impeding responsibilities of NATO membership
Portugal	Defense, national security, security of supply in services fundamental to the national interest
Republic of Korea	National security, national safety and public order, public hygiene, or the environmental preservation; Korean morals and customs
Romania	National security
Russian Federation	Defense, security
South Africa	National security
United Kingdom (UK)	Public interest, national security, stability of the UK financial system, accurate presentation of news, free expression of opinion
United States	National security

FDI = foreign direct investment, NATO = North Atlantic Treaty Organization, PRC = People's Republic of China, UK = United Kingdom.

Source: UNCTAD (2019).

The pandemic has also highlighted some downsides to increasing reliance on a more globalized supply chains and some countries may move to reshore or diversify their production. Such decisions will not only impact trade and production, they may also impact investment flows.

Bilateral Investment Treaties and Foreign Direct Investment

International investment agreements (IIAs) are an important policy tool to attract FDI by safeguarding the economic interests of both the recipient economies and international investors. Investment treaties govern a set of circumstances that includes the scope of investment, treatment received by foreign investors, and dispute settlement and compensation mechanisms. Investment treaties grant international legal protection to foreign investors from adverse actions by governments of host states. States, on the other hand, often support investment treaties for their perceived role in attracting investment flows. Investment agreements can signal a stable and predictable environment for investment. In addition, they are believed to play a role in promoting good governance standards and, by making host states liable, encourage administrative and judicial reforms.

In recent years, however, some concerns arose that IIAs impose costs to states and do not always fully deliver their objectives. Increasing cross-border investment flows in the past 15 years have been followed by a rise in the number of investor–state disputes (ISD), more concentrated in middle-income economies. Strategies by multinationals to structure investments by resorting to investment treaties have exacerbated this trend.[21]

While the design and negotiation of IIAs can be complex, new approaches are emerging to compare the design, structure, and economic impact of these agreements (Bergstrand and Egger 2013, Konrad 2017). Among these efforts is ADB's development of a comprehensive database of IIAs in Asia, including both bilateral investment treaties (BITs) and investment chapters of free trade agreements, to create a granular classification of provisions enforced by Asian economies.[22]

The purpose of this section is threefold: first, to characterize the existent bilateral investment treaties in Asia, with a focus on existing and new investment provisions. Second, to present a more granular analysis on the impact of BIT provisions in Asia's investment flows, emphasizing differences by entry mode and sector allocation. Third, to present a taxonomy of policy responses where countries resort to investment treaties to mitigate the effects of COVID-19 on FDI, and to assess their past and their potential role after the pandemic.

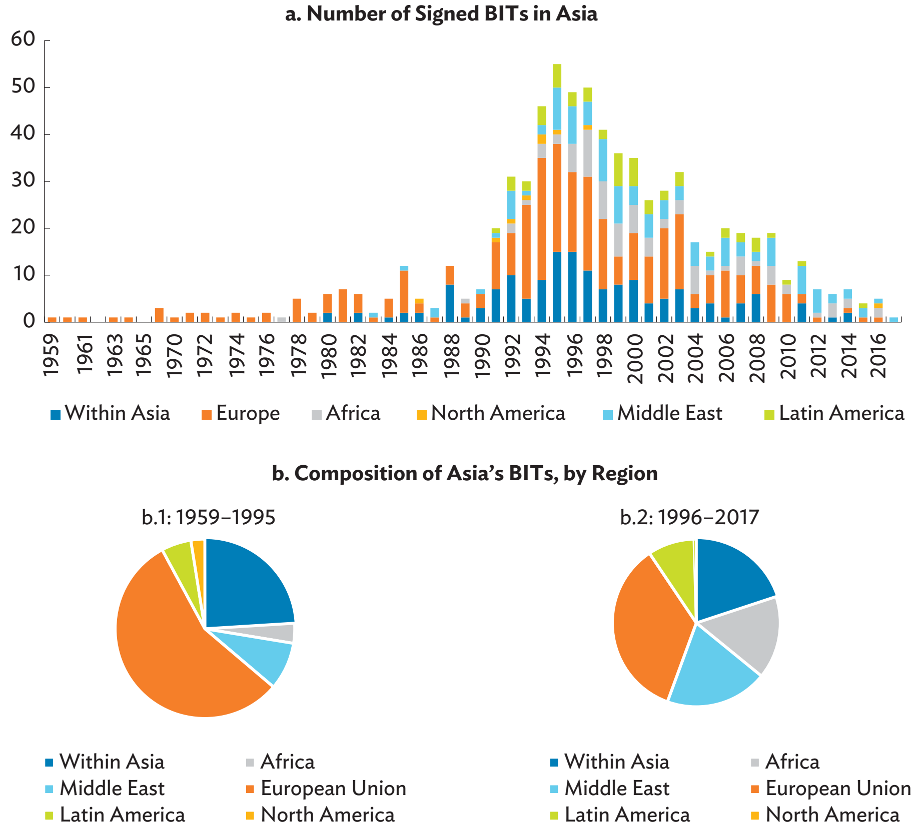
Trends in BITs and Investor–State Dispute Cases in Asia

As of 2020, nearly 3,000 IIAs, including BITs and preferential trade agreements, had been signed globally —of which around one-third involve Asian economies. Since the early 1990s, Asia started to engage more actively in bilateral investment treaties, both within and outside the region, with the number of agreements decreasing in the last decade (Figure 3.8a). The regional composition of Asian BITs has also evolved, with emerging regions (Africa, Latin America, and the Middle East) becoming more present from the mid-1990s (Figure 3.8b.2).

21 A number of multinationals have adopted a "treaty shopping" strategy allowing investors from a home state to incorporate a subsidiary in a third state, use that subsidiary as corporate vehicle to make investments in the host state, and claim the protection of an investment treaty between the third state and the home state. This type of triangulation poses challenges for identifying the jurisdiction in investment disputes and exposes host states to arbitration claims.

22 The database codifies into 15 provisions, as follows: (i) definition of investment, (ii) admission versus establishment, (iii) national treatment, (iv) most-favored nation clause, (v) fair and equitable treatment, (vi) direct and indirect expropriation, (vii) free transfer of investment-related funds, (viii) noneconomic standards, (ix) investor–state dispute mechanism, (x) umbrella clause, (xi) temporal scope of application, (xii) performance requirements (xiii) transparency mechanisms, (xiv) public interest obligations, and (xv) exception clause.

Figure 3.8: Number of Enforced Asian BITs and Regional Distribution, by Year



BIT = bilateral investment treaty.

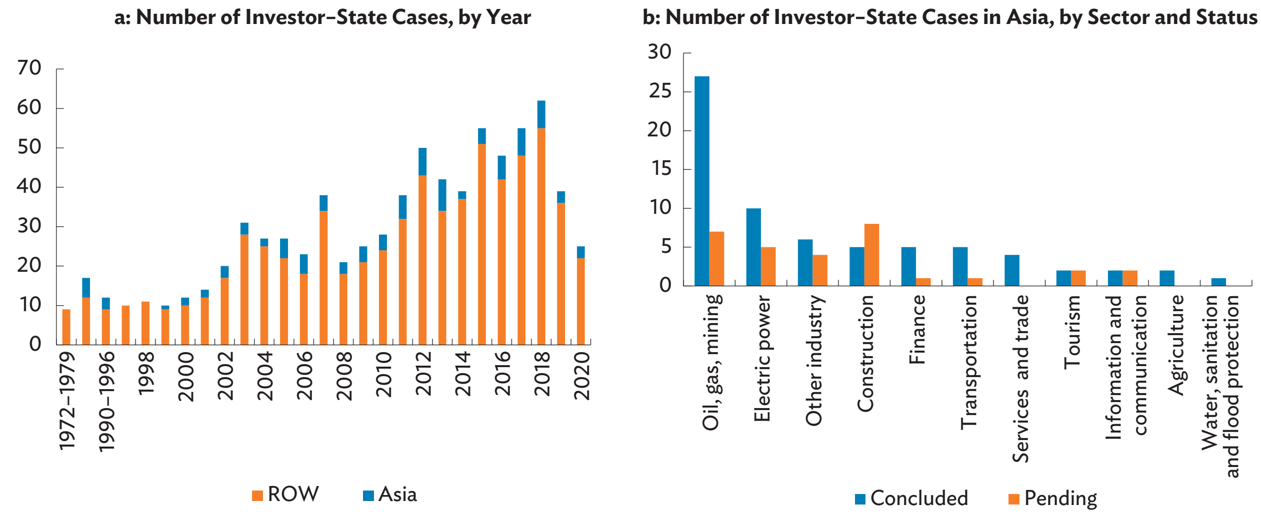
Source: ADB (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department). International Investment Agreement Database.

ISDs have increased steadily in number over the past 2 decades, both globally and in Asia. Whereas before 2000 Asian economies were involved in very few cases, the caseload has gradually increased. The World Bank's International Center for Settlement of International Disputes database, which covers a significant portion of ISDs worldwide (both conciliation and arbitration), reports 673 cases globally (both ongoing and concluded) since 2003, of which 83 concern Asian economies (Figure 3.9a). Disputes involving Asian states increased by 57% between 2000–2010 and 2011–2020. Sector concentration is high. Most cases are concentrated in the oil, gas and mining, and electricity sectors (Figure 3.9b). About 60% of the cases worldwide have invoked BITs as the basis of consent to establish taking action (ICSID 2020).

Characterization of BIT Provisions in Asian Treaties

The ADB BIT database characterizes 15 provisions across 1,012 investment treaties in Asia. It allows firms to compare IIAs directly across countries where they may locate affiliates, and for policy makers to identify provisions that could be incorporated in other treaties or multilateralized. Building on an existent database for BITs in Asia (Chaisse and Bellak 2015), five new provisions are included in the new database: public interest obligation, exception clause, performance requirements, access to arbitration, and transparency in investor–state arbitration (Figure 3.10).

Figure 3.9: Trends in Investor–State Disputes in Asia



ROW = rest of the world.

Source: ADB calculations using data from World Bank. International Center for Settlement of International Disputes (ICSID). ICSID Cases Database. https://icsid.worldbank.org/cases/case-database (accessed July 2020).

Figure 3.10: Description of New BIT Provisions in ADB Database

Public interest obligations

Labor, health, and environmental standards to avoid disputes post-establishment

Performance requirements

Designed to protect or support certain industries or regional development policies

Exception clause

National security or general exceptions to protect strategic industries in times of economic crises/shocks

Access to arbitration

General provisions on investor–state dispute settlement, defining the type of disputes to which the mechanisms apply

Transparency in ISA

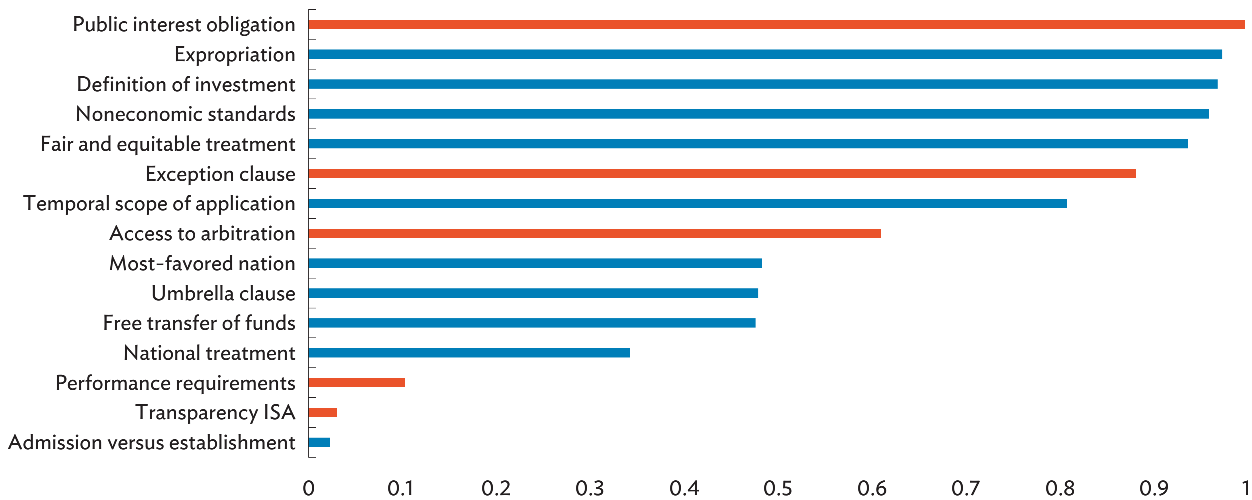
Procedures for appointing arbitrators, arbitration venues available, obligation to consider the arbitration award as final and binding

BIT = bilateral investment treaty, ISA = investor–state arbitration.

Source: ADB (forthcoming).

A first glance at the distribution of BIT provisions in Asian investment treaties (Figure 3.11) confirms the heterogeneity among treaties, and that certain provisions (i.e., expropriation, definition of investment, exception clause) are more common than others (i.e., national treatment, performance requirements, transparency in investor–state arbitrations). While certain provisions are fundamental to any bilateral treaty, many are not part of Asian treaties in force today.

Figure 3.11: Average Score for BIT Provisions in Asia's Bilateral Investment Treaties



BIT = bilateral investment treaty, ISA = investor–state arbitration.

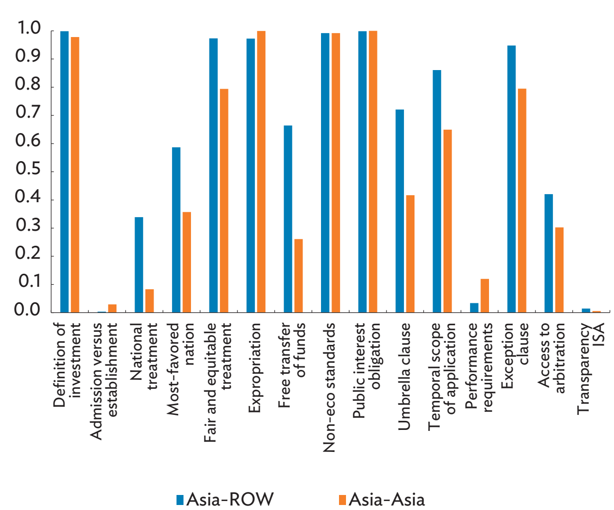
Notes: Bars in red denote additional provisions included in the ADB International Investment Agreement Database. For all provisions, the higher the value the more likely will the treaty foster foreign direct investment.

Source: ADB (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department). International Investment Agreement Database.

Provisions in intra-Asian bilateral investment treaties tend to differ from those between Asia and the rest of the world (ROW), with possible implications for foreign investment.

Comparison of intra-Asian (Asia–Asia) and extra-Asian (Asia–ROW) agreements shows that certain provisions are standard (e.g., definition of investment, expropriation, fair and equal treatment), while others differ between intra and extraregional Asian BITs (Figure 3.12). Examples include the free transfer of funds and the umbrella clause. Clauses on transfer payments are particularly important for investors, and about half of Asia's BITs stipulate that a wide range of payments and other investment-related funds can be transferred out of the host state in a freely convertible currency. The umbrella clause extends the scope of the application of a BIT to any dispute relating to investments and offers more protection to the investor. The template or model of an investment treaty can have implications for both investors and states. In the case of free transfer of funds and umbrella clause, Asian investors tend to be less protected than investors from outside the region. Having less access to arbitration mechanisms could also deter intra-Asian investors. In general, extra-Asian agreements tend to include more favorable provisions for investors.

Figure 3.12: BIT Provisions for Intraregional (Asia–Asia) and Extraregional (Asia–ROW) Agreements



BIT = bilateral investment treaty, ISA = investor-state arbitration, MFN = most-favored nation, ROW = rest of the world.

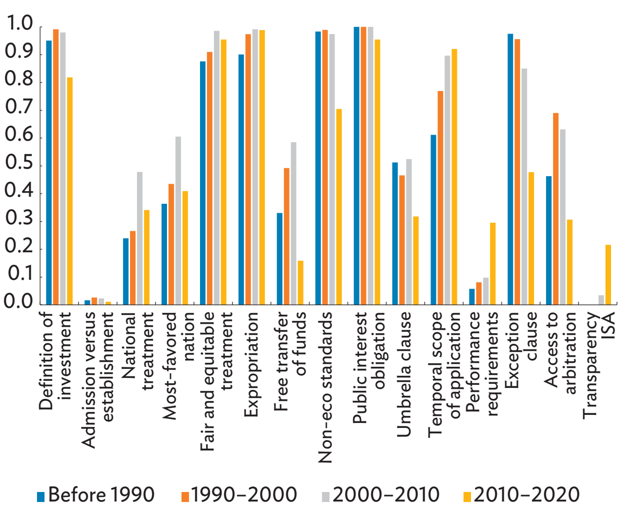
Note: For all provisions, the higher the value the more likely is the treaty to foster FDI.

Source: ADB (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department). International Investment Agreement Database.

Incorporation of certain BIT provisions in Asian treaties has also increased over time, highlighting new priorities for investors and host economies.

A mapping of the incorporation of BIT provisions over time shows a small group of provisions constitutes the backbone of most agreements: definition of investment, fair and equal treatment, expropriation (Figure 3.13). Other provisions have become more prominent; in particular, performance requirements and transparency in investor–state arbitration. Performance requirements have been used as an instrument of regional development policy or to protect certain industries, but their use has been more limited in recent years as they challenge World Trade Organization obligations. Transparency rules in ISD mechanisms, on the other hand, have become more common, with some treaties stipulating public arbitration. Noticeably, the number of agreements including provisions on free transfer of funds and the umbrella clause has decreased. The change in composition of provisions stresses the need for considering the interrelations among investment provisions, as studied in the following section.

Figure 3.13: Average BIT Provisions by Year of Signature or Enforcement



BIT = bilateral investment treaty, ISA = investor–state arbitration, MFN = most-favored nation.

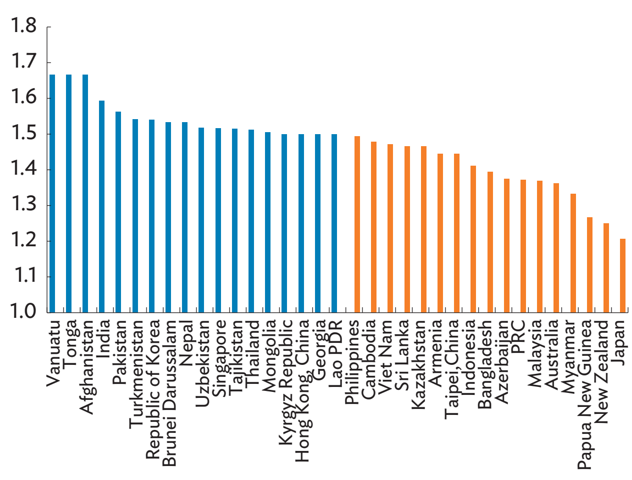
Note: For all provisions, the higher the value the more likely will the treaty foster foreign direct investment.

Source: ADB (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department). International Investment Agreement Database.

Liberalization and Antidiscrimination Indicators

Two original indicators are estimated at the country level from the ADB database to assess Asian economies' stance on BIT provisions. The Liberalization Quality Indicator captures the openness of an economy to foreign investment, or, conversely, the degree of control maintained by a state over foreign investment. The indicator is based on the coding of three provisions related to entry: the regulation of foreign investment entry (admission clause), the regulation of transfer of investment-related funds out of the host state, and the presence of noneconomic standards.[23] The index provides a proxy for an economy's stance on FDI capital transfers (equity, reinvested earnings, or profit shifting) and long-term capital movements. Results suggest that economies with a low score (i.e., Myanmar, the PRC, and Viet Nam) tend to have a more restrictive approach toward foreign investors, whereas economies with a high score (e.g., Vanuatu, India, and Pakistan) are more open to foreign investment (Figure 3.14). Some scores are also explained by treaties having been signed before the expansion of cross-border investments in the 1990s.

Figure 3.14: Liberalization Quality Indicator



Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.

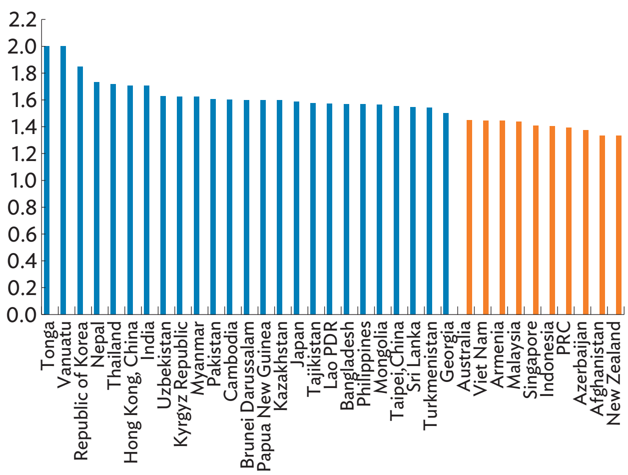
Note: The Liberalization Quality Indicator measures the degree of openness of an economy to foreign investment, or alternatively, the degree of control still maintained by a state over foreign investment.

Source: ADB (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department). International Investment Agreement Database.

[23] For more information, see ADB IIA Toolkit for a Comparative Analysis of Concluded IIAs (ADB forthcoming).

The Antidiscrimination Quality Indicator measures the level of equal treatment and absence of discrimination between domestic and foreign investment and how provisions bring about equal treatment for investors (Figure 3.15). The indicator is based on the most-favored nation and national treatment provisions. Economies with a high Antidiscrimination Quality Indicator score indicate that they protect foreign investors from discriminatory practices. On the flip side, these economies can be more vulnerable to facing investment disputes by investors.

Figure 3.15: Antidiscrimination Indicator



Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.

Note: The Antidiscrimination Indicator measures the degree to which international investment agreements ensure a certain degree of equality for foreigners (among themselves and/or relative to nationals).

Source: ADB (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department). International Investment Agreement Database.

Assessing the Impact of BIT Provisions on Foreign Investment Flows

To assess the role of BIT provisions on foreign investment, an empirical analysis is proposed, building on ADB's previous work and the relevant literature. The following econometric specification is estimated using a global investment data set of FDI (M&As and Greenfield) over 2003–2019 in a Poisson Pseudo-Maximum Likelihood gravity setting:

$$FDI_{ijk} = exp[\alpha + \beta \boldsymbol{BIT\_prov}_{ij} + \theta \boldsymbol{Grav}_{ij} + \delta_i + \delta_j + \delta_k]\varepsilon_{ijk}$$

where FDI_{ijk} denotes investment flows from country *i* to country *j* in subsector *k*, $\boldsymbol{BIT\_prov}_{ij}$ is a vector with the BIT provisions between countries *i* and *j*, $\boldsymbol{Grav}_{ij}$ is a vector of dyadic control variables in a standard gravity model (distance, gross domestic product origin and destination, common language, contiguity, colonial relationship, governance quality), and δ are fixed-effects for countries and sector. The dependent variable is defined by different measures of FDI flow: M&As (number of deals and deal value in millions of US dollars) and greenfield (number of projects and capital investment in millions of US dollars). The use of Poisson Pseudo-Maximum Likelihood in the estimation has several advantages in this context: it takes into account the heteroskedasticity of errors; it is relatively robust to different variance process scenarios; and it performs well when the proportion of zeros is large, as in this study.

Preliminary results (Table 3.4) for individual provisions confirm the association between BIT provisions and FDI inflows. A comparison of the extensive margin (number of deals and projects) by entry mode (M&As versus greenfield) indicates that most provisions tend to have a positive impact on greenfield investments than for M&A investments. Overall, results are more significant for the extensive margin variables (number of deals and projects) than intensive margin (deal value and investment). The results suggest that investment provisions could capture long-term factors and established attributes of the origin and recipient countries, to which greenfield investments are more sensitive, whereas M&As could be more dependent on short-term fluctuations, including macroeconomic and financial risks (Davies and Desbordes 2018).

As some BIT provisions cover similar areas of investment policy, provisions can be analyzed individually or aggregated in five broad families, as defined in Annex Table 3a.1. Preliminary results for the model above using the broad families of BIT provisions for the full sample and by sector (primary, manufacturing, and services) are presented in Table 3.5. Results suggest that *entry* provision rules (which describe entry rules for foreign investors in domestic markets) and

Table 3.4: M&A and Greenfield Variables, and BIT Provisions

	Dependent Variable			
	M&A		Greenfield	
	Number of Deals	Deal Allocated	Projects	Investment
BIT	0.098	0.221	0.412***	0.227**
	(0.146)	(0.179)	(0.090)	(0.104)
Definition of investment	-0.015	0.062	0.153***	0.053
	(0.068)	(0.084)	(0.043)	(0.048)
Admission versus establishment	0.036	0.113	0.248***	0.064
	(0.126)	(0.151)	(0.085)	(0.086)
National treatment	-0.039	0.127	0.240***	0.107
	(0.086)	(0.130)	(0.053)	(0.065)
Most–favored nation	0.004	0.120	0.215***	0.092
	(0.083)	(0.108)	(0.047)	(0.057)
Fair and equitable treatment	0.027	0.075	0.204***	0.096**
	(0.059)	(0.082)	(0.037)	(0.048)
Expropriation	-0.018	0.068	0.160***	0.067
	(0.069)	(0.085)	(0.044)	(0.049)
Free transfer	0.040	0.087	0.212***	0.072
	(0.095)	(0.101)	(0.045)	(0.057)
Noneconomic standards	-0.026	0.064	0.159***	0.069
	(0.070)	(0.085)	(0.044)	(0.049)
Public interest	-0.020	0.155	0.294***	0.119
	(0.143)	(0.175)	(0.088)	(0.097)
Umbrella clause	0.016	0.139	0.218***	0.087
	(0.073)	(0.098)	(0.042)	(0.053)
Temporal scope	0.014	0.022	0.194***	0.090*
	(0.062)	(0.081)	(0.039)	(0.048)
Performance requirements	0.340	-0.623**	0.033	-0.207
	(0.218)	(0.302)	(0.260)	(0.227)
Exception	-0.036	0.070	0.140***	0.059
	(0.077)	(0.090)	(0.047)	(0.050)
Arbitration	0.144	0.235	0.280***	-0.036
	(0.158)	(0.189)	(0.076)	(0.094)
ISA	0.637	-0.299	-0.479	-0.490
	(0.443)	(0.628)	(0.454)	(0.468)
Observations	2,715	2,715	2,715	2,715

*** Significant at 1%, **Significant at 5%, *Significant at 10%. Standard errors in parentheses.

BIT = bilateral investment treaty, ISA = investor–state arbitration, M&A = merger and acquisition.

Notes: Poisson Pseudo-Maximum Likelihood estimates. Robust standard errors clustered by country pair. Baseline control variables (average from 2004–2019) include log(distance), log(gross domestic product [GDP] origin country), log(GDP destination country), contiguity, common language, colonial relationship, common colonizer, and governance indicators. Dependent variable is taken as the total from 2004–2019.

Sources: ADB calculations using data from Bureau van Dijk. Zephyr M&A Database; Financial Times. fDi Markets; Centre d'Études Prospectives et d'Informations Internationales (the French Research Center in International Economics). GeoDist Database. http://www.cepii.fr/CEPII/en/cepii/cepii.asp (all accessed June 2020); and ADB (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department). International Investment Agreement Database.

expropriation provisions could be more favorable to greenfield investments in the manufacturing sector (the base sector in Table 3.5). The effects of *treatment* and investor–state dispute mechanism provisions are less conclusive. These results point to an heterogeneous effect of BIT provisions in explaining M&A and greenfield investment flows, so as among economic sectors, which is coherent with a strand of the literature (Berger et al. 2010, Urata 2015, and Desbordes 2016). They also call for further analysis of ADB's IIA database to understand the role of provisions in explaining FDI recent trends in developing Asia.

Policy Implications under COVID-19

Asian economies have taken different steps to mitigate the disruptive effects of the COVID-19 pandemic on foreign investment.

Measures toward investment facilitation, enlarged services of investment promotion agencies related to COVID-19, and incentives for investment in essential sectors have been introduced. Examples of policy measures in the region include alleviating administrative

Table 3.5: M&A and Greenfield (Number of Deals/Projects), by BIT Family and Sector

Dependent Variable = Number of M&A deals	Independent Variables = BIT and BIT Families					
	BIT	ENTRY	TREAT	SCOPE	EXPR	ISDM
BIT	-0.077	-0.043	-0.071	-0.063	-0.057	-0.077
	(0.177)	(0.123)	(0.107)	(0.104)	(0.089)	(0.132)
Prov x Primary	-0.253	-0.182	-0.131	-0.144	-0.094	-0.142
	(0.334)	(0.213)	(0.196)	(0.188)	(0.164)	(0.241)
Prov x Services	-0.365***	-0.247***	-0.214***	-0.212***	-0.177***	-0.238***
	(0.110)	(0.074)	(0.067)	(0.064)	(0.053)	(0.081)
Observations	5,027	5,027	5,027	5,027	5,027	5,027
Pseudo R2	0.610	0.610	0.610	0.610	0.610	0.609
Dependent Variable = Greenfield Investments	**Independent Variables = BIT and BIT Families**					
	BIT	**ENTRY**	**TREAT**	**SCOPE**	**EXPR**	**ISDM**
BIT	0.291*	0.175*	0.159	0.149	0.137*	0.080
	(0.157)	(0.106)	(0.097)	(0.092)	(0.078)	(0.098)
Prov x Primary	-0.266	-0.165	-0.109	-0.122	-0.075	-0.081
	(0.285)	(0.187)	(0.176)	(0.165)	(0.141)	(0.194)
Prov x Services	-0.442***	-0.286***	-0.256***	-0.240***	-0.206***	-0.244**
	(0.142)	(0.093)	(0.091)	(0.084)	(0.072)	(0.101)
Observations	5,027	5,027	5,027	5,027	5,027	5,027
Pseudo R2	0.579	0.579	0.579	0.579	0.579	0.577

*** Significant at 1%, **Significant at 5%, *Significant at 10%. Standard errors in parentheses.

BIT = bilateral investment treaty, EXPR = expropriation, ISDM = investor–state dispute mechanism, M&A = merger and acquisition, TREAT = treatment.

Notes: Poisson Pseudo-Maximum Likelihood estimates. Robust standard errors clustered by country pair. Baseline control variables (average from 2004–2019) include log(distance), log(gross domestic product [GDP] origin country), log(GDP destination country), contiguity, common language, colonial relationship, common colonizer, and governance indicators. Dependent variable is taken as the total from 2004–2019. Includes main effects of the variables in the interaction.

Sources: ADB calculations using data from Bureau van Dijk. Zephyr M&A Database; Centre d'Etudes Prospectives et d'Informations Internationales (the French Research Center in International Economics). GeoDist database. http://www.cepii.fr/CEPII/en/cepii/cepii.asp; and Financial Times. fDi Markets. (all accessed June 2020); ADB (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department). International Investment Agreement Database.

burdens for firms to speed up production during the pandemic (e.g., Myanmar, the PRC, and Thailand) and the use of online and e-government services. Countries have also strengthened partnerships between domestic and foreign investors (e.g., Indonesia). Investment incentives have also been introduced in Asia during the crisis, including, for example, support for the rapid development of medical equipment (e.g., the Republic of Korea) and the conversion of production lines toward essential sectors (e.g., India) (UNCTAD 2020b).

At the international level, there is a fear that governments' response to the COVID-19 crisis could trigger an upsurge of investor–states disputes.

International investment tribunals might have to play a role in the review of states' measures to tackle the COVID-19 pandemic, and calls for a moratorium on all treaty-based ISD arbitration for COVID-19-related measures have emerged (CCSI 2020). From the perspective of IIAs, policy measures by governments can be grouped in four broad areas: (i) foreign investors operating conditions; (ii) market access, transparency, and fairness in global trade; (iii) due process issues; and (iv) other indirect measures (Table 3.6) (Chaisse 2020). A possible increase in the number of ISDs does not mean these claims will be successful; the general perception is that most breaches of investment treaties could be justified, particularly given the emergency situation caused by the COVID-19 pandemic.

Should investment claims increase, some BIT provisions will become important for the recovery.

States and investors have been confronted with economic downturns, political crises, disasters, and other major events. Recent examples in the region include investor claims in cases of expropriation of mining leases and nationalization in the banking sector. Certain BIT provisions have been and will be particularly important in the context of post-COVID-19 investment claims. A critical provision is Fair and Equitable Treatment, which could represent the main entry point for investors against states after the pandemic. Also, provisions on expropriation could play a role in future COVID-19 disputes. Expropriation occurs when an investor can prove that the legal system has been changed in breach of a legitimate expectation the investor had at the time of making an investment. To better respond to a crisis such as COVID-19, Asian governments should continue strenghtening provisions in their BITs to ensure that they are flexible and balanced (Table 3.7).

Table 3.6: International Investment Agreements and Types of COVID-19 Measures

Type of Measures	Measures
Foreign investors operating conditions	Suspension of utility payments
	Compelling production/supply
	Deliveries/supplies limitation
Market access, transparency, and fairness in global trade	Price controls
	Export controls
	Other potentially WTO-inconsistent measures
Due process issues and procedural irregularities	Private property seizure
	Courts closure
	Extraordinary powers to government
Other measures with indirect impact	Other measures with indirect impacts
	COVID-19 tax measures
	Arbitral institutions

COVID-19 = coronavirus disease, WTO = World Trade Organization.

Sources: ADB compilation based on Chaisse (2020) and UNCTAD (2020a).

Table 3.7: Recommendations for Improving BIT Provisions in the Post-COVID-19

<table>
<tr><th>BIT Provision</th><th>Definition</th><th>Post COVID-19 Recommendation</th></tr>
<tr><td>National treatment</td><td>Provision describes the obligation to grant foreign investors treatment no less favorable than domestic investors.</td><td>Maintain a degree of flexibility with regard to national treatment. Exempt specific policy areas and vital economic sectors to meet both current and future regulatory or public policy needs.</td></tr>
<tr><td>Fair and equitable treatment (FET)</td><td>Provision describes if an IIA stipulates equal treatment between foreign/domestic investment for accessing national courts and agencies, imposing taxes, and dealing with domestic regulation.</td><td>Clarify scope and obligations of FET standards; FET does not preclude states from adopting good-faith regulatory measures that pursue legitimate policy objectives.</td></tr>
<tr><td>Expropriation</td><td>Provision describes arrangements for host government to take over foreign assets. It can be direct (asset appropriation) or indirect (no economic benefit for foreign investors due to loss of management, depreciation, and so on.)</td><td>Set out criteria that should not be considered an expropriation, e.g., legitimate regulation taken in exceptional circumstances for the public interest.</td></tr>
<tr><td>Most-favored nation clause</td><td>Provision describes the nondiscrimination of foreign investment. The more favorable treatment provided to previous agreements is applied to current agreement.</td><td>Maintain a degree of flexibility with regard to MFN. Exclude specific areas and vital economic sectors to meet regulatory or public policy needs.</td></tr>
<tr><td>Free transfer of investment-related funds</td><td>Provision describes modalities for repatriation of investment (including profits, benefits, capital gain), proceeds from liquidation or sale, payments.</td><td>Provide list of covered payments or transfers and include exceptions in case of serious balance-of-payments difficulties or serious economic crisis.</td></tr>
<tr><td>Non-economic standards</td><td>Provision describes protection to investors that covers non purely economic issues, including labor regulations, environmental standards, health, and human rights.</td><td>Set out investor obligations by raising the obligation to comply with domestic laws and corporate social responsibility clauses.</td></tr>
<tr><td>Access to arbitration</td><td>Provision describes access to arbitration mechanisms, including the International Centre for Settlement of Investment Dispute or others. Existence can be an incentive to invest by providing access to a neutral jurisdiction.</td><td rowspan="2">Consider ISD reform: a standing ISDS tribunal replacing the ad hoc investor–state arbitration, limited ISDS, more state control over ISDS, opening proceedings to the public and third parties, enhancing the suitability and impartiality of arbitrators, and replacing ISDS by settling disputes in domestic courts or state–state dispute settlement.</td></tr>
<tr><td>Transparency in ISA</td><td>Provision describes existence of ISDM-specification transparent mechanisms (more transparent) or ISDM provisions for the appointment of arbitrators, obligations of parties, and enforcement (more restrictive).</td></tr>
</table>

BIT = bilateral investment treaty, COVID-19 = coronavirus disease, FET = fair and equitable treatment, IIA = international investment agreement, ISDM = Investor–State Dispute Mechanism, ISDS = investor–state dispute settlement, MFN = most-favored nation.

Sources: ADB compilation based on Chaisse (2020) and UNCTAD (2020b).

In the long-term, a balance between adopting policy measures that prioritize national interest while keeping treaty compliance will be important.

Some reforms to the international investment regime have been implemented gradually to allow states to respond to crisis episodes. In recent years, countries have been more aware of investor–state dispute mechanisms, in particular regarding transparency of settlement procedures, the suitability and selection of arbitrators, and possible resolutions through state–state dispute settlement. Early warning systems for potential disputes are also being developed (UNCTAD 2020b, 2020c). Finally, an important effort in capacity development of government officials responsible for investment policy is needed. Investment treaties could lead to losses—both in the policy space and pecuniary—where host countries lack legal capacity to ensure implementation. Government capacity will play an important role in mediating the impact of investment treaties' disputes in the aftermath of the COVID-19 crisis.

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Annex 3a: Supplementary Charts and Table on BITs and the Liberalization and Antidiscrimination Indicators

Annex Table 3a.1: BIT Provisions by Category

Dimension	Definition	BIT Provisions Included
Entry	Describes entry rules for foreign investors	• Admission versus establishment • Noneconomic standards • Investment-related funds
Treatment	Describes treatment given to foreign investors against domestic ones	• National treatment • Most-favored nation • Public interest obligation*
Scope	Describes definition of investment, jurisdiction, and duration of treaty	• Definition of investment • Umbrella clause • Temporal scope of application • Exception clause* • Performance requirements*
Expropriation	Arrangements for host states to take over foreign assets	• Fair and equitable treatment • Direct and indirect expropriation
Dispute mechanism		• Access to arbitration* • ISA transparency*

BIT = bilateral investment treaty, ISA = investor–state arbitration.

*New available provisions in ADB's (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department) International Investment Agreement Database, not covered in Chaisse and Bellak (2015).

Sources: ADB compilation based on Desbordes (2016) and Chaisse (2020).

Annex Figure 3a.1: Liberalization and Antidiscrimination Indicators in Asia

GDP per Capita

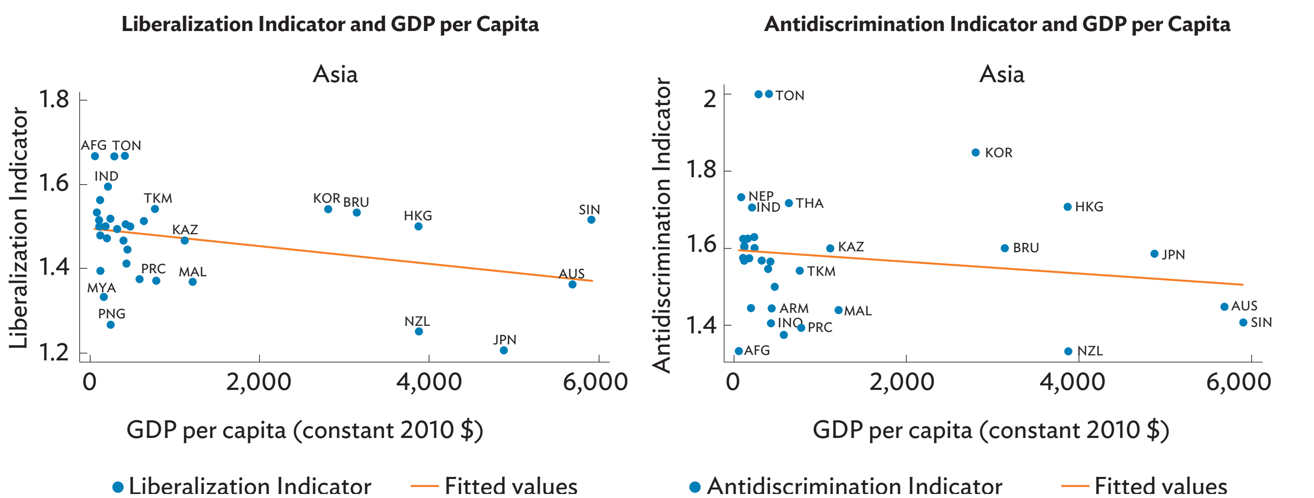

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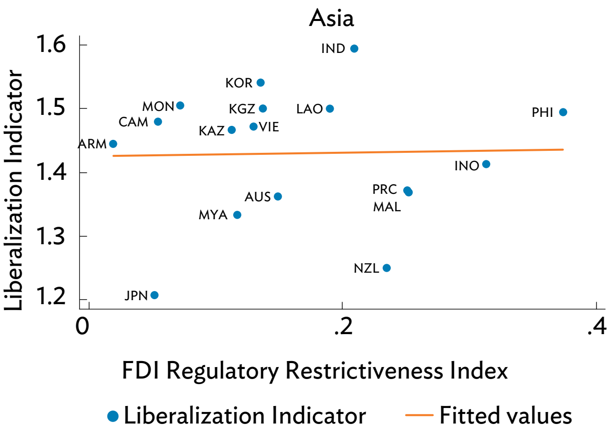
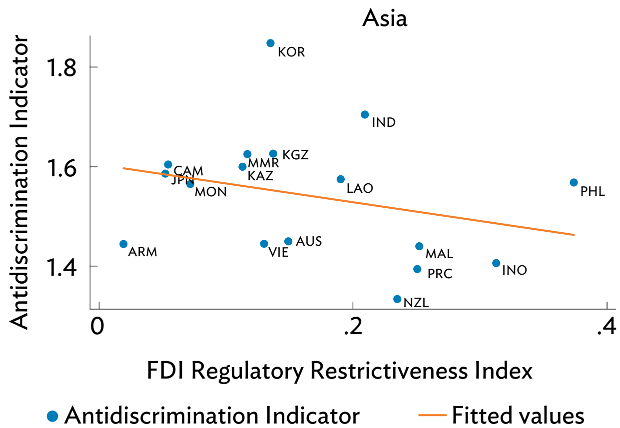
Figure continued

FDI Regulatory Restrictiveness Index

Liberalization Indicator and FDI Regulatory Restrictiveness Index

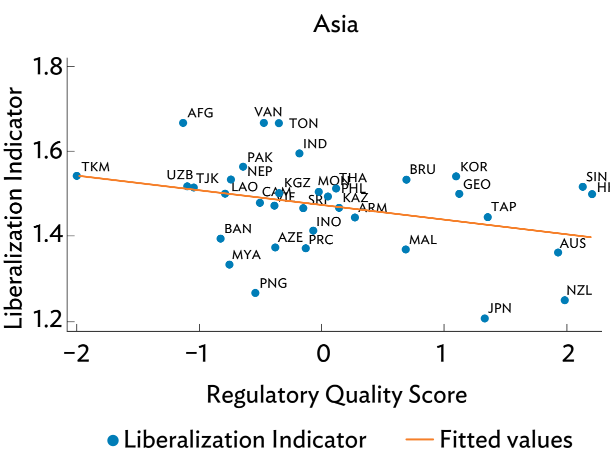


Antidiscrimination Indicator and FDI Regulatory Restrictiveness Index

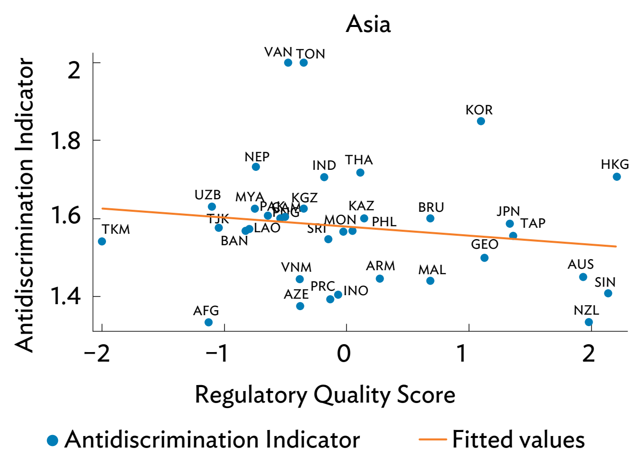


World Governance Indicator (Regulatory Quality)

Liberalization Indicator and Regulatory Quality



Antidiscrimination Indicator and Regulatory Quality



AFG = Afghanistan; ARM = Armenia; AUS = Australia; AZE = Azerbaijan; BAN = Bangladesh; BRU = Brunei Darussalam; CAM = Cambodia; FDI = foreign direct investment; GDP = gross domestic product; GEO = Georgia; HKG = Hong Kong, China; IND = India; INO = Indonesia; JPN = Japan; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; KOR = Republic of Korea; LAO = Lao People's Democratic Republic; MAL = Malaysia; MON = Mongolia; MYA = Myanmar; NEP = Nepal; NZL = New Zealand; OECD = Organisation for Economic Co-operation and Development; PAK = Pakistan; PHI = Philippines; PNG = Papua New Guinea; PRC = People's Republic of China; SIN = Singapore; SRI = Sri Lanka; TAJ = Tajikistan; TAP = Taipei,China; THA = Thailand; TKM = Turkmenistan; TON = Tonga; UZB = Uzbekistan; VAN = Vanuatu; and VIE = Viet Nam.

Sources: ADB calculations using data from Organisation for Economic Co-operation and Development. FDI Regulatory Restrictiveness Index. https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX#; World Bank. World Development Indicators. https://databank.worldbank.org/source/world-development-indicators; World Bank. World Governance Indicators. http://info.worldbank.org/governance/wgi (all accessed July 2020); and ADB (Regional Cooperation and Integration Division, Economic Research and Regional Cooperation Department). International Investment Agreement Database.