INVESTMENT TRENDS MONITOR

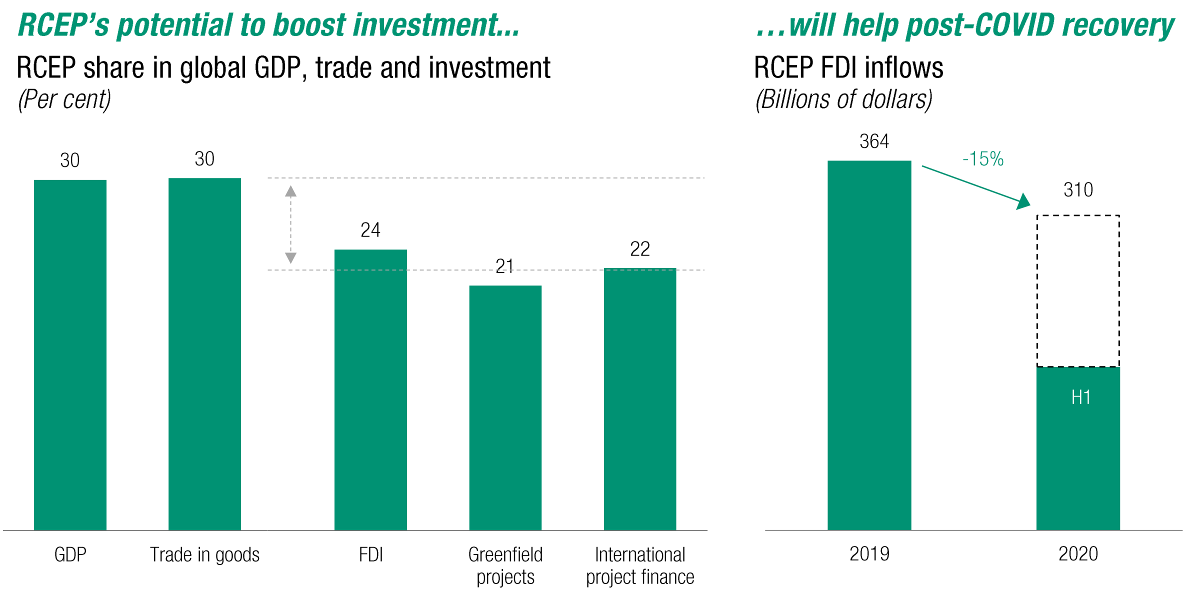
UNITED NATIONS
UNCTAD

RCEP AGREEMENT A POTENTIAL BOOST FOR INVESTMENT IN SUSTAINABLE POST-COVID RECOVERY

HIGHLIGHTS

- *The Regional Comprehensive Economic Partnership (RCEP) agreement, signed on 15 November 2020, is one of the world's largest trade and investment pacts. It could give a significant boost to foreign direct investment (FDI) in the region (figure 1).*
- *The investment provisions in the agreement mostly consolidate existing market access as contained in myriad bilateral agreements. However, the provisions related to market access and disciplines in trade, services and e-commerce are highly relevant for regional value chains and market-seeking investment.*
- *RCEP is already an important FDI destination. It accounts for 16% of global FDI stock and more than 24% of flows. While global FDI has been stagnant for the last decade, the RCEP group has shown a consistent upward trend until last year.*
- *The agreement comes at a time of major upheaval caused by COVID-19. The pandemic will lead to a drop in FDI in the region of about 15%. However, this compares favourably to a fall of 30-40% in global FDI, and the region looks set to lead the FDI recovery.*

Figure 1. Key indicators of investment potential



Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics); greenfield data based on information from the Financial Times Ltd, fDi markets; project finance data based on Refinitiv.

- *A key challenge for RCEP will be to follow through on economic integration efforts at a time of global and intra-regional geopolitical and trade tensions. The global economic recession caused by the pandemic will also limit the potential of RCEP to expand trade, investment GVCs in the short term.*
- *A key opportunity lies in the diversity within RCEP, which can lift investment prospects through complementary locational advantages and catch-up development potential. Among the members, FDI stock relative to the size of the economy ranges from less than 5% to a multiple of GDP.*
- *Intra-regional investment, at about 30% of total FDI in RCEP, has significant room for further growth. It is relatively low compared to other major economic partnerships. The ASEAN group, at the heart of RCEP, will play an important role. Already about 40% of investment in ASEAN comes from RCEP members.*
- *Likely investment policy priorities for the partnership will include:*
    - *Boosting investment in sustainable post-pandemic recovery.* This requires investment in infrastructure, clean energy and healthcare, all of which rely on increasing international project finance. RCEP includes several top source countries for project finance. There is room for growth, for example: RCEP attracts projects in line with its global FDI share but accounts for only about 12% of projects in renewable energy.
    - *Supporting resilience-seeking FDI.* The need for multinational enterprises (MNEs) to diversify supply sources and strengthen regional value chains should translate not only in shifting FDI patterns within the region but also in renewed overall growth of international investment in industry. Greenfield investment in trade-exposed manufacturing in the region has decreased by more than 40% over the last decade.
    - *Promoting investment for development.* The least developed country (LDC) signatories Cambodia, Myanmar and Lao People's Democratic Republic respectively receive more than 70%, 80% and 90% of their FDI from other RCEP members. Economic cooperation under the partnership could further boost both project finance in infrastructure and industrial investment to increase their GVC participation.

The RCEP initiative was launched in November 2012 and the negotiations of the Agreement started in May 2013. The RCEP Agreement, signed on 15 November 2020 is a major undertaking involving 15 countries, including the 10 ASEAN Member States, plus Australia, China, Japan, the Republic of Korea and New Zealand.

RCEP is a broad integration agreement aimed at strengthening flows of trade, investment and services, as well promoting development cooperation across signatory states. It includes liberalization, facilitation, promotion and cooperation measures.

RCEP is coming into effect at a time of great global economic and political uncertainty. This adds significantly to the importance of RCEP for member countries, as well as for third-country trade and investment partners. The agreement could help revive post-COVID economic growth, boost intra-regional trade and investment links at a time of global trade tensions, and provide a framework for further regional cooperation.

This Monitor provides an overview of the current state of foreign direct investment in the region and assesses the potential contribution that the RCEP agreement could make to investment flows. It focuses on implications for development, regional value chains, and post-COVID recovery prospects.

The RCEP agreement: highly relevant for cross-border investment

The RCEP Agreement builds on existing commitments on market access and disciplines for trade and investment and strengthens them in some areas. It provides a framework for further commitments to be negotiated in future.

The RCEP initiative ties together many overlapping issues covered in different free trade agreements (FTAs) and bilateral investment treaties (BITs) among countries in the region. It builds on elements of other agreements such as the ASEAN-China FTA, ASEAN-Australia-New Zealand FTA, ASEAN-Japan FTA, and the ASEAN-Republic of Korea FTA. Negotiations have been complex in part because there are as many as 27 existing FTAs and 44 BITs between RCEP countries. With the exception of Japan, all RCEP members including ASEAN as a group have FTAs with one another, all with varying provisions and rules and disciplines governing trade, investment and services.

RCEP will have important implications for FDI and value chain development within and outside the group. The RCEP Agreement contains measures in key areas such as market access, economic cooperation, and rules and disciplines (table 1). The specific provisions on investment could enhance investment opportunities in the long term, but the provisions related to trade in goods and services, intellectual property and e-commerce will do more to increase flows of investment in the short term by facilitating the exchange of goods and services, and by lowering transaction costs for business.

Table 1. RCEP Agreement: Implications for FDI

Key areas	Provisions most relevant for international investment
Investment	• Consolidation of existing market access (as contained in myriad bilateral agreements); • Negative list approach for investment entry; framework for future liberalization efforts • Investment facilitation (transparency and streamlining of administrative procedures for investors) • Core investment protection and non-discrimination provisions (investor-state dispute settlement not included)
Trade in goods	• Consolidation of tariff preferences, single set of rules of origin (a major advancement in regional integration), facilitating trade in regional value chains • Trade facilitation (rules for custom procedures, technical standards and non-tariff barriers; promotion of transparency and cooperation)
Trade in services	• Market access for service suppliers and transparency and predictability of regulations affecting services trade • Enhanced rules for cross-border supply of financial services to facilitate regional business operations • Reduced barriers to cross-border supply of professional services and framework for recognition of professional qualifications and licenses
e-Commerce	• Enhanced rules governing cross-border supply and use of telecommunication services • Digital trade facilitation (promotion of digital documentation, electronic signatures) • No comprehensive coverage of cross-border dataflows and localization requirements, but reduced scope for new restrictions
Other rules and disciplines	• Facilitation of cross-border movement of businesspeople • Standardized rules to streamline intellectual property transactions • Common rules on government procurement
Economic cooperation	• Capacity building and technical assistance to support implementation of the agreement • Programmes to enhance the capability of SMEs to benefit from the agreement

Source: UNCTAD.

RCEP: by some measures the world’s largest trade and investment block

By some measures RCEP will create the world’s largest trade bloc, with 30% of world population, GDP and goods exports. RCEP is 4.5 times the population covered by the Comprehensive and Progressive Agreement of the Trans-Pacific Partnership[1] and more than 5 times that of the European Union. By 2030, RCEP is projected to add about 0.2 percentage points to GDP growth in the region.[2] It is also expected to boost exports of the members by over 10% by 2025.

RCEP is a highly diverse group of economies. The members differ markedly in terms of their level of development and per capita incomes, economic structure and resource endowments. Three members, Cambodia, Lao People’s Democratic Republic and Myanmar, are among the least developed countries (LDCs); China, Indonesia, Malaysia and Thailand are middle-income countries; and Australia, Japan, the Republic of Korea, New Zealand and Singapore are high-income economies. Several are rich in natural resources, including Australia, Indonesia, Lao People’s Democratic Republic and Myanmar. The lower income countries still have a high agricultural contribution to GDP, while several high-income members are services economies and high-tech manufacturing hubs.

[1] The members of the Trans-Pacific Partnership grouping are Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Viet Nam.

[2] Based on a study by the Peterson Institute for International Economics (2020).

The region is a manufacturing powerhouse. The group accounts for nearly 50% of global manufacturing output. About 50% of global automotive and as much as 70% of electronics production are done in RCEP. The share of manufacturing in GDP is relatively high across most RCEP members, including the CLMV countries (Cambodia, Lao People's Democratic Republic, Myanmar and Viet Nam), which have rapidly increased (mostly low-tech) manufacturing output over the last decade, including with the help of FDI.

The diversity among RCEP members represents a significant challenge for integration efforts but presents even greater opportunities. It enhances the attractiveness of the group as a whole for investment, with complementary locational advantages among the members. And it provides catch-up development opportunities for the lower income economies that are as yet less integrated in trade and investment networks. Among the members, the share of exports in GDP ranges from less than 10% to more than one third, and FDI stock ranges from less than 5% to a multiple of GDP.

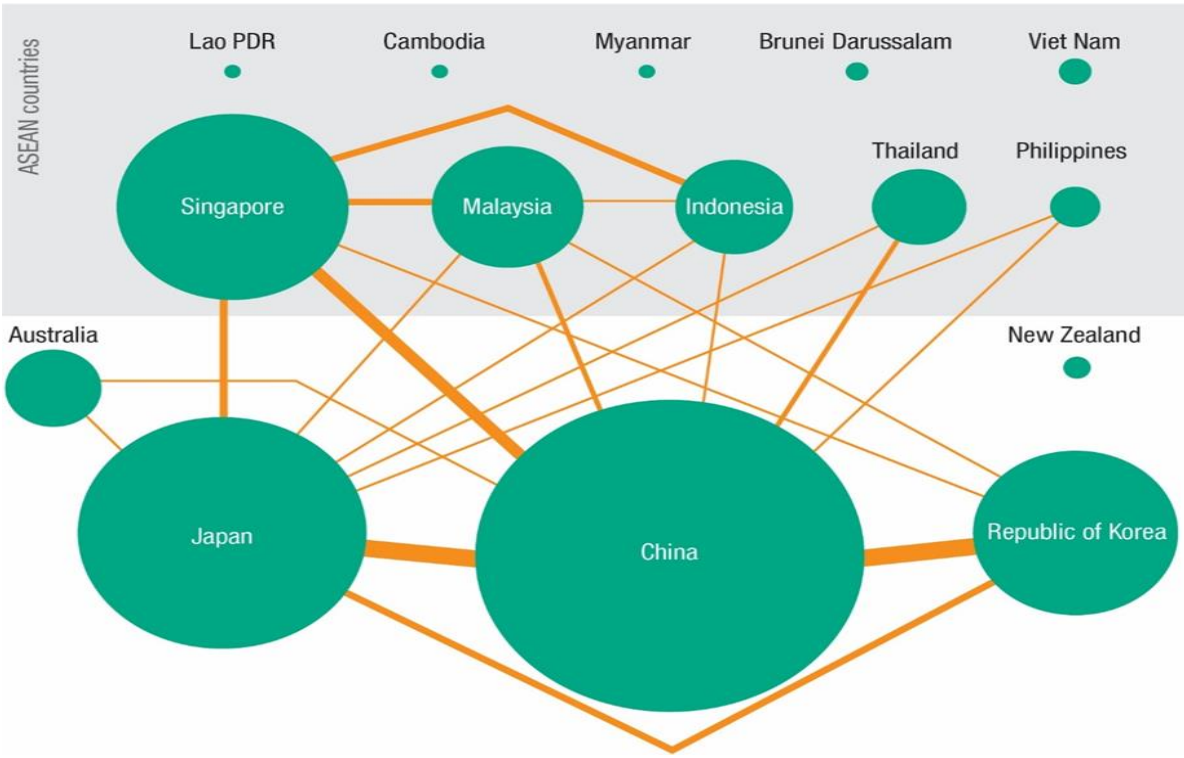
While the promotion of intra-regional trade and investment is a key objective for any economic partnership, the RCEP group is hugely important as a trade and investment block for the rest of the world. About 70% of FDI inflows in RCEP are from non-RCEP economies. Extra-RCEP trade (exports and imports) is significant, and RCEP is also a major source of investment to the rest of the world.

GVCs in RCEP: a key driver of regional investment trends

Most RCEP countries are highly integrated in GVCs. The group accounts for 26% of world GVC trade volume (including goods and services) and trade in intermediate goods is rapidly growing both within RCEP and with non-RCEP countries. The volume of GVC trade of RCEP countries increased by 34% between 2010 and 2018.

Intra-regional value chain trade is growing even faster. GVC trade among RCEP members amounted to $1.5 trillion in 2017. This represents a growth of 50% over the 2010 level. The potential for RCEP to support further intra-regional value chain growth could be especially important in light of the expected shifts in regional trade and investment patterns as a result of the trade tensions affecting China as well as post-COVID supply chain diversification and resilience-seeking investment trends.

Figure 2. Value chain connections within RCEP



Source: UNCTAD, based on the UNCTAD-Eora database, 2019.
Notes: The size of spheres represents the share of intra-RCEP value chain trade. The thickness of the lines depicts the volume of value chain trade. Only trade volumes above $10 billion are included.

Value chain trade among RCEP members is centered around a few main nodes (figure 2). ASEAN as a group, China, Japan and the Republic of Korea are major GVC hubs. RCEP could be a growth opportunity for several smaller economies in the group that currently have a peripheral role in GVCs.

Five industries dominate GVC trade in RCEP, namely electrical and machinery, petroleum and chemicals, metal, textile and apparel, and transport equipment. These industries account for about 60% of the region's total GVC trade. In electronics and machinery, RCEP members contribute 35% of the total value added in global gross exports. This industry accounts for 24% of total GVC trade in the world but for 37% of the GVC trade of RCEP countries.

RCEP is an important global sourcing hub for these industries. For instance, about 47% of Samsung Electronics (Republic of Korea) suppliers' factories accounting for 80% transaction volume are based in other RCEP countries. Apple's (United States) supply chain involves more than 200 suppliers and about 800 factories. Some 80% of these factories are based in RCEP (primarily in China, Japan and Republic of Korea). About 40% of the production facilities of Nissan and Toyota (Japan) are based in other RCEP countries. Volkswagen (Germany) and Ford (United States) each have more than a quarter of their global production facilities in RCEP grouping.

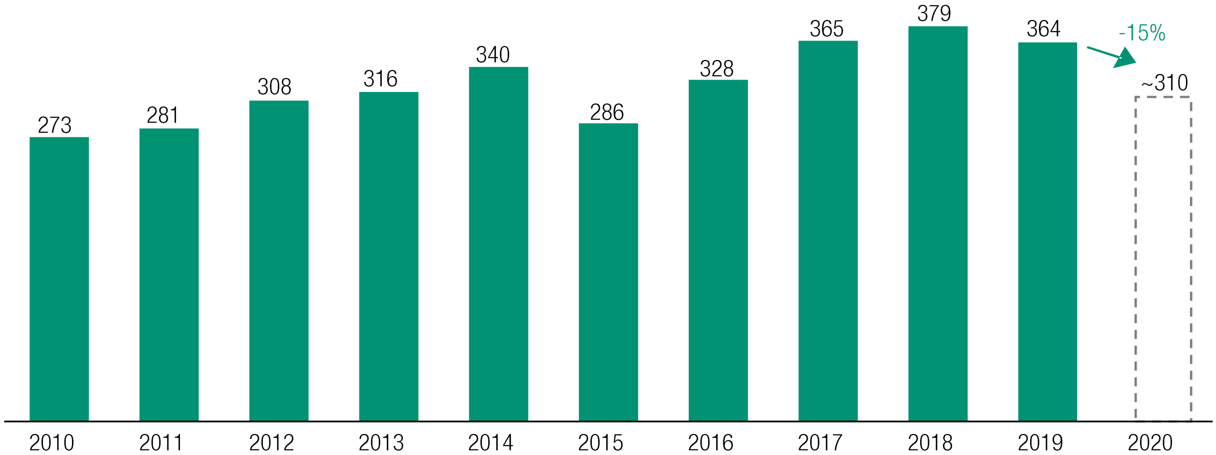
GVC patterns in the region are closely connected to FDI patterns. The top 5 GVC industries in RCEP account for more than 50% of the value of greenfield investment project announcements in the group, with the highest share in petroleum products and chemicals followed by electrical and machinery. Although transport equipment has a lower share in the group's GVC trade, 10% of new greenfield investment project announcements in 2019 were in that industry, suggesting it could expand in the coming years.

FDI trends in RCEP: the main source of growth for global investment

RCEP is a major global FDI destination. FDI flows to the group have increased almost every year during the last decade, against a backdrop of stagnating global FDI flows. The upward trend was mainly the result of continued strong inflows in China and the ASEAN region. RCEP accounted for 24% of global FDI flows in 2019. Growing annual inflows brought FDI stock in the group from $2.7 trillion in 2010 to $5.7 trillion in 2019, an average growth rate of 9% per year. Exceptionally, RCEP FDI inflows fell by 4% in 2019, to $364 billion mainly due to a significant decline in investment in Australia (-47%, to $36 billion) from high cross-border M&A-driven levels in the previous year

In 2020, FDI in the region is projected to fall by about 15%, based on FDI data for the first six months (figure 3). Cross-border M&As, greenfield and project finance data for the first three quarters of the year suggest a similar trend. As in other regions, measures to slow the spread of COVID-19 are affecting the implementation of investment projects, the economic slowdown and slump in global demand is causing firms to reassess new projects, and corporate earnings available for reinvestment are drying up. The GVC-intensity of investment in the region reinforces the trend, as supply chain stoppages in the first half of 2020 hit typical GVC industries, and the longer-term trade policy implications of the pandemic are causing uncertainty for export-oriented investors.

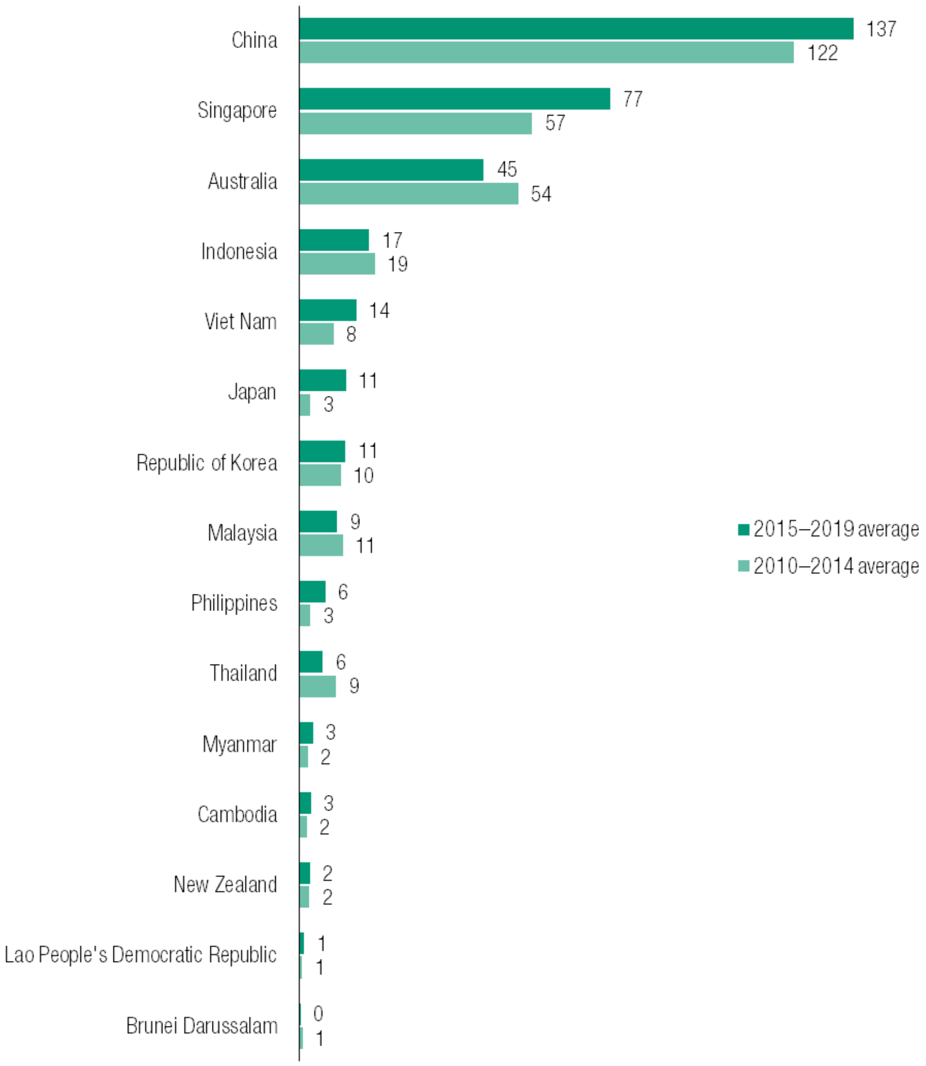
Figure 3. FDI inflows in RCEP, 2010–2020
(Billions of dollars)



Source: UNCTAD.
Note: 2020 based on annualized first half data.

FDI inflows in RCEP are concentrated in five countries (China, Singapore, Australia, Indonesia and Viet Nam) (figure 4). These countries accounted for 84% of FDI inflows in RCEP in the last 5 years (2015-2019). In terms of inward FDI stock, China, Singapore, Australia, Thailand and Republic of Korea together accounted for 82% of existing investment in the group in 2019.

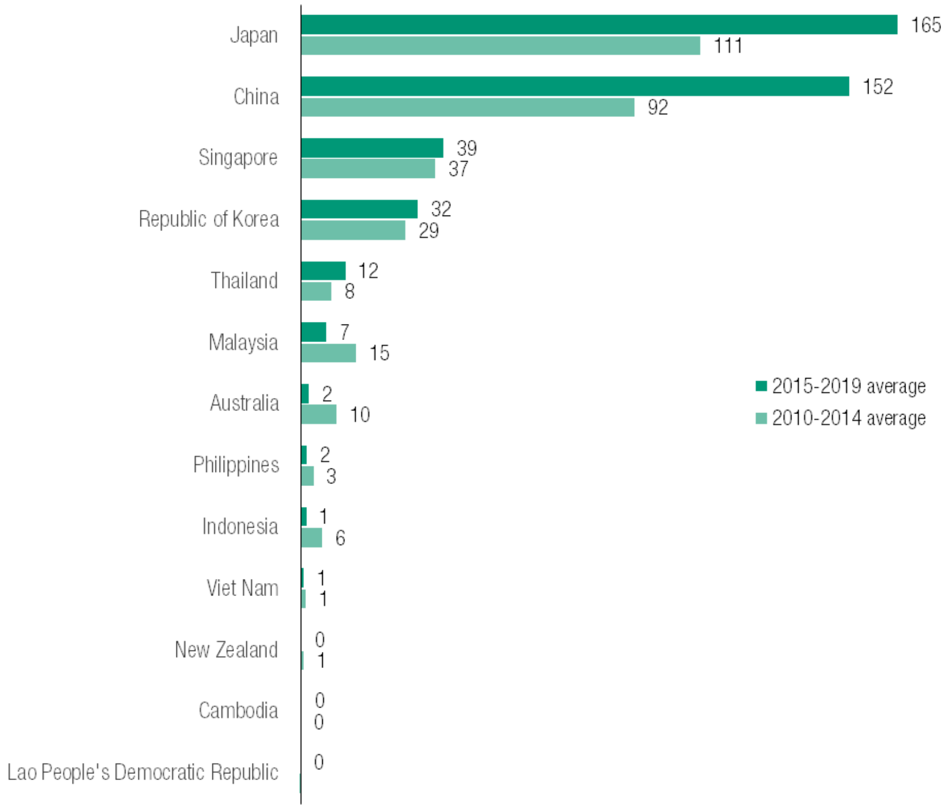
Figure 4. RCEP: FDI inflows by host economy, 2010–2014 and 2015–2019 averages
(Billions of dollars)



Source: UNCTAD.

RCEP is also a major and growing source of FDI for the world. The group accounted for 36% of global FDI outflows in 2019, up from just 17% in 2010. The rise in outflows pushed up outward FDI stock of RCEP economies from $2.4 trillion in 2010 to $6.5 trillion in 2019 – more than twice the growth rate of global FDI outward stock in the same period. A few countries are major sources of investment. These are Japan, China, Singapore, and the Republic of Korea (figure 5). The high outward investment from Japan compared to relatively limited inflows into Japan are the main reason for the net FDI outflows from RCEP, even though most RCEP members remain capital importers.

Figure 5. RCEP: FDI outflows by home economy, 2010–2014 and 2015–2019 averages
(Billions of dollars)



Source: UNCTAD.

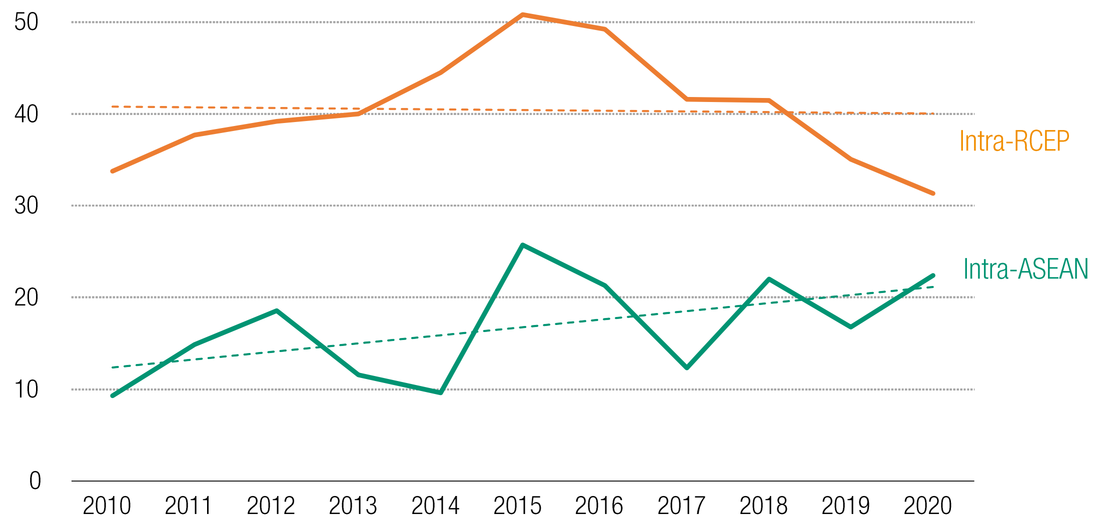
Intra-regional investment: already big, but potential for more

Intra-regional investment accounts for just over 30% of FDI in RCEP. It is largely driven by a few major capital-exporting countries, including China, Japan, the Republic of Korea, and Singapore. More than 30% of Japan's, 50% of Singapore's and 40% of Thai investment stock abroad is in other RCEP countries. About 40% of the $1.7 trillion cumulative FDI flows in ASEAN between 2000 and 2019 are from within ASEAN (16%) and other RCEP countries (24%).

Despite the significant role that intra-regional flows already play among the RCEP economies, compared to other major economic groupings such as the European Union, the United States-Mexico-Canada Agreement and the TransPacific Partnership the current level of intra-RCEP investment is still low. The agreement could provide further impetus to strengthen intra-regional flows.

ASEAN's integration could be a blueprint for the potential impact of RCEP on FDI patterns. ASEAN's integration efforts have led to a rapid rise in intra-ASEAN investment and FDI from the region. While intra-regional greenfield investment among RCEP members at just over 30% in 2019 was the same as in 2010, the share of intra-regional greenfield investment in ASEAN doubled from 10% to more than 20% in the same period (figure 6). Inflows into ASEAN from other RCEP countries kept pace with intra-ASEAN flows, suggesting the current agreement is a logical extension from an investment perspective.

Figure 6. Shares of intra-RCEP and intra-ASEAN greenfield investment project announcements, 2010–2019
(Per cent)



Source: UNCTAD.

M&As mostly drive financial sector integration in the region

Cross-border M&As are a significant proportion of FDI in RCEP. Transactions in RCEP members accounted for about 40% of global M&A activity in 2010-2020. However, most M&A sales are concentrated in Japan, China, Singapore and the Republic of Korea due to their relatively more mature M&A environment. More than 40% of M&As are intra-RCEP transactions.

Five industries accounted for almost 60% of the value of total M&A sales in RCEP over the last decade, including finance, real estate, mining, food and beverage, and logistics services. M&As in food and beverages and transportation and storage are driven by strong economic growth and increasing numbers of more affluent consumers in the region. Several RCEP countries are resource rich, which explains an annual average $5 billion of M&A transactions in extractive industries over the decade. The importance of finance and real estate activities reflects global consolidation trends in these industries.

In the financial sector, recent years have seen mega M&A transactions in RCEP countries, mainly by investors headquartered within the region. Mitsubishi UFJ Financial Group (Japan) made several significant acquisitions in Australia, Indonesia and the Philippines between 2016 and 2019. Thai banks also acquired banking assets in neighbouring countries and strengthened their position at home by acquiring foreign financial institutions with operations in Thailand. As American and European banks divested assets abroad to consolidate their international operations following the financial crisis, banks from China, Japan, the Republic of Korea and ASEAN countries increased their internationalization in the RCEP area. The internationalization of RCEP financial institutions has pushed up FDI flows in finance.