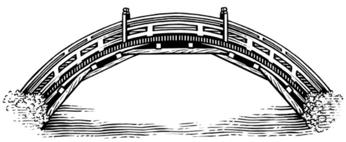
asia policy, volume 16, number 4 (october 2021), 1–64
~ http://asiapolicy.nbr.org ~

ROUNDTABLE

Advancing Sustainable Development in Asia: What Role for Trade and Investment?



Dini Djalal

Gary P. Sampson

Ellen L. Frost

Vasuki Shastry

Mihir S. Sharma

note: *This roundtable was made possible by the generous support of the Hinrich Foundation ~ https://www.hinrichfoundation.com.*

Introduction

Dini Djalal

The triumph of global trade and investment is a key milestone of the latter part of the twentieth century. As the pace of growth for world trade accelerated, at times by more than double the rate of global GDP, new jobs were created and incomes improved. Around 120 million people rose out of poverty between 1993 and 1998, partly due to these trends.[1] By the year 2000, global GDP had multiplied by seven times in five decades. Study after study has outlined the benefits of trade. For example, the International Monetary Fund estimates the value of liberalization at more than ten times the costs of deregulation and has tracked the faster growth enjoyed by developing countries with lower tariffs.[2] Meanwhile, FDI in many cases has contributed to the improvement of skills, technology, labor rights, and environmental standards.

Today, the trust that has bound and upheld the global system for trade and investment is, at best, tenuous. Not only are trade partners increasingly skeptical of one another—and the notion that potential allies may be mutually supportive of their interests—but there is increasing distrust in trade itself. Governments issue regulations that are wary of foreign investment even as they make welcoming announcements. More parties view economic integration and globalization as a source of ills, be they loss of jobs, competitiveness, or market power. Confidence is waning in vehicles for global integration, such as the World Trade Organization (WTO).

This shifting mindset is concerning because collective, cross-sectoral global action is needed to effectively address the critical challenges of our time: the climate crisis and growing inequality. In this *Asia Policy* roundtable, four essays examine the connection of trade, investment, and sustainability in terms of both climate adaptation and social welfare.

DINI DJALAL is Associate Director for Editorial at the Hinrich Foundation (Singapore), where she commissions and manages research, content, and partnerships. She can be reached at <dini.djalal@hinrichfoundation.com>.

NOTE: This roundtable was made possible by the generous support of the Hinrich Foundation ~ https://www.hinrichfoundation.com.

1 International Monetary Fund, "Global Trade Liberalization and the Developing Countries," Issue Brief, November 2001 ~ https://www.imf.org/external/np/exr/ib/2001/110801.htm.

2 Ibid.

The roundtable opens with Gary Sampson's examination of sustainable trade in the context of the WTO and the Sustainable Development Goals (SDGs). Focusing on the interface between trade rules and the goals of sustainable development, Sampson describes some of the transformative effects of trade liberalization in Asia he has seen firsthand under the WTO, where he was director from 1995 to 2005. He argues that the WTO can play a critical role in fostering sustainability if the execution of the multilateral trading system is an interdisciplinary task. As an example, Sampson highlights the WTO's negotiations over fisheries subsidies, presented as a policy deliberation centered on "the nexus of trade policy, natural resources economics, and environmental conservation." If this deadlock can be unwound—and that is not assured given years of stalled negotiations—the breakthrough could create more opportunities for the global trading system to better reflect the SDGs.

Sampson presents another opportunity for the WTO to play a critical role in climate adaptation. By exploring the tools available to accommodate efforts at carbon border adjustment mechanisms—currently proposed by the European Union and under consideration in other countries—the WTO could offer solutions that defy expectations. The key issue is trust or the lack thereof. After more than a decade of criticism of the global agency, can the WTO regain public trust?

Trust is also explored in Ellen Frost's essay on the geopolitics of trade and investment in Asia. This topic, keenly debated in academic discourse and around the proverbial water cooler, has received no shortage of analysis. Frost's question is simple, however: In Asia's changing landscape for trade and investment, whom do countries trust?

Predictably, the answer is multifaceted. Japan, the benign benefactor and Southeast Asia's top investor as of 2019, wields less influence than the world's two largest economies. But overall, with superpower leadership absent, nations in Asia are first and foremost putting trust in themselves. They prefer to retain their new agency and exercise what Frost describes as "selective multilateralism, regionalism, and protectionism." If or when the United States reverses course, removes trade barriers, and takes a seat at the table to listen rather than to lead, more meaningful conversation may ensue.

Asia has forced itself to accept this reality. As the African proverb reminds, when elephants fight, it is the grass that suffers. The ten nations that make up the Association of Southeast Asian Nations (ASEAN) know too well that their economic fortunes have been dependent on the shifting of geopolitical winds. And for several decades, recounts Vasuki Shastry in his essay, ASEAN expertly attracted and absorbed FDI to transform some of its members into low-cost manufacturing hubs. Singapore, Vietnam, Thailand, Malaysia, Cambodia, and, to a lesser extent, Indonesia thrived on more open trade, investment, and supply chains, particularly with China. ASEAN trusts commerce and distrusts efforts that distract from commerce, such as taking sides or stoking geopolitical tension. But investors looking to contribute to climate resilience have an opportunity. Through their investments, they can ensure better implementation of environmental, social, and governance standards and advocate for more tangible action on climate change.

If trust of the superpowers is the issue in Southeast Asia, in India it is investors who are wary of the investment landscape. As the world's second-largest country by population, with a buoyant technology sector that aims to rival China's, India should be a magnet for FDI. Yet, as Mihir Sharma explains in his essay, FDI in India has been "disappointing," and nowhere more so than in manufacturing. Given the "catastrophic capital loss" experienced by several multinational corporations, the relatively low level of FDI in India becomes understandable. Trust is a two-way street and FDI is a long-term game. To attract more players, India's government must commit to sustained regulatory reforms—and political, judicial, and administrative ones too.

As with the other essays, Sharma points out a critical opportunity for India. FDI inflows into the clean energy sector account for only 1% of total FDI flows. It is now up to the government to walk the talk in sustainable investing and minimize the risks posed to would-be investors, even in relatively successful sectors such as solar power generation. Given the persistently populist tone of the Modi administration's pronouncements, however, such an outcome may be wishful thinking.

The Hinrich Foundation is guided by the concepts of mutual benefit in trade and investment and sustainable trade through sustained trust and reciprocity. History has shown that lasting and successful trade results from such a dynamic. We support informed policy discussions, such as those facilitated in this *Asia Policy* roundtable, to remind the beneficiaries of trade and investment—policymakers and citizens alike—to not take these benefits for granted.

The world is now at a moment when these positive notions are in flux. Populist leaders are emerging to test public commitment to community and globalization. Continued tests to the experiment of deep economic integration—the failure of the Trans-Pacific Partnership, the success of

Brexit—are encouraging an alphabet soup of bilateral agreements and a fixation on protectionist policies. The slogans say it all: "Buy American." "Stand Up India." Borders are closing, even for data, an essential element of the digital economy.

Who will suffer most from a turning away from openness? One study finds that the lowest decile of consumers would face a 63% loss in purchasing power as the costs of goods and services increase.[3] These consumers, and the rest of our communities, already face uncharted challenges, from climate change to the possibility of future pandemics even more catastrophic than Covid-19. To address these challenges, the international community must take advantage of trade and investment policy—with a sustainable development mindset—that can enable more innovation, cooperation, and solutions. ◈

3 Pablo Fajgelbaum and Amit Khandelwal, "Measuring the Distributional Effects of Trade through the Expenditure Channel," VoxEU, November 28, 2015 ~ https://voxeu.org/article/pro-poor-bias-trade-new-research-expenditure-channel.

asia policy, volume 16, number 4 (october 2021), 7–22
~ http://asiapolicy.org ~

ROUNDTABLE ESSAY

The WTO, Trade Agreements, and Sustainable Trade: The Asian Experience

Gary P. Sampson

gary p. sampson *is a Professor of International Trade at Melbourne Business School at the University of Melbourne (Australia). He was formerly director at the GATT and WTO, as well as senior counsellor to the WTO director general. He can be reached at <g.sampson@mbs.edu>.*

note: *This roundtable was made possible by the generous support of the Hinrich Foundation ~ https://www.hinrichfoundation.com.*

keywords: wto; trade liberalization; sustainable development goals

EXECUTIVE SUMMARY

This essay highlights how trade policies and sustainable development are inextricably connected. It selectively focuses on links of importance to Asian countries, the WTO, and the United Nation's 2030 Agenda for Sustainable Development.

MAIN ARGUMENT

The evolution of the world trading system over the past half century has significantly changed the relationship between trade and sustainable development. The principal link comes from trade liberalization, which promotes growth and provides additional resources to advance sustainable development. Nowhere has this played a larger role than in Asia's economic transformation and with it the rise of millions out of poverty. For this link to be positive, a global trading system is needed with rules that support sustainable development while leaving the policy space to permit the appropriate national choices to be pursued. The WTO has a central role to play in achieving sustainable development. It has been greatly weakened in past years, but recent events indicate that the time is ripe to strengthen its rules to enhance its contribution to sustainable development.

POLICY IMPLICATIONS

- The strengthening and reform of the WTO should be undertaken with a clear understanding of the interface between trade rules and the goals of sustainable development as well as the many options available to modify or create trade agreements. What is needed is an inventory of useful potential rule changes and the options available.

- The reduction of trade barriers and the ensuing trade expansion will remain essential to promoting the growth and development of the Asian economies. In Asia, as elsewhere, expanded resources improve standards of living and reduce poverty while providing the means to protect and preserve the environment.

- Numerous WTO and intergovernmental declarations stress the need for greater coherence and cooperation in global policymaking. Given the interdisciplinary nature of sustainable development and the overlap between trade and sustainable development, governments and organizations should make efforts to ensure the convergences of these policies are constructively exploited.

One of the most memorable phrases in the United Nations' 2030 Agenda for Sustainable Development resides in the preamble: "There can be no sustainable development without peace and no peace without sustainable development."[1] Cordell Hull, winner of the 1947 Nobel Peace Prize and the intellectual force behind the creation of the rules-based trading system (i.e., the General Agreement on Tariffs and Trade, or GATT) wrote that "you could not separate the idea of commerce from the idea of war and peace…if we could increase trade among nations, we would go a long way toward eliminating war itself."[2]

The positive link between trade and development, including sustainable development, has not been lost on governments. According to the 2030 Agenda for Sustainable Development, governments need to "promote a universal, rules-based, open, non-discriminatory, and equitable multilateral trading system under the World Trade Organization (WTO)."[3] Not all governments have been forthcoming in promoting such a system. Recent experience has been characterized by unilateral trade restrictions, unauthorized retaliatory measures, trade advantages via state-owned enterprises, and the demise of the dispute settlement system. All have contributed to a marginalization of the WTO rules-based system.

However, the mood of the day may well be changing, creating a window of opportunity to better reflect sustainable development goals in the global trading system. The recent G-7 declaration, for example, states: "We agree on the need…to unite behind a shared vision to ensure the multilateral trading system is reformed with a…reformed WTO at its center, to be free and fair for all, sustainable, resilient and responsive to the needs of global citizens."[4] The important question then becomes whether a reformed multilateral system will emerge as an improved vehicle to achieve the goals of sustainable development.

Specific trade actions are interwoven throughout the seventeen Sustainable Development Goals (SDGs) and the 169 core targets adopted by all UN member states in 2015, which are reflected in the 2030 Agenda for Sustainable Development. Unlike its predecessor the GATT, the WTO has

---

1 UN Department of Economic and Social Affairs, "Transforming Our World: The 2030 Agenda for Sustainable Development," 2015 ~ https://sdgs.un.org/2030agenda.

2 Cordell Hull, *The Memoirs of Cordell Hull* (New York: Macmillan, 1948).

3 UN Department of Economic and Social Affairs, "Transforming Our World," Sustainable Development Goal (SDG) 17.1.

4 G-7, "Carbis Bay G-7 Summit Communique: Our Shared Agenda for Global Action to Build Back Better," June 11–13, 2021 ~ https://www.g7uk.org/wp-content/uploads/2021/06/Carbis-Bay-G7-Summit-Communique-PDF-430KB-25-pages-5.pdf.

now adopted sustainable development as a formal objective, declaring "trade relations should be conducted allowing for the optimal use of the world's resources in accordance with the objective of sustainable development."[5]

The working hypothesis of the WTO is that removing trade restrictions efficiently allocates resources domestically and contributes to their optimal use. As a result, production and income are increased and more resources are made available for economic development, environmental management, and improving social conditions—the three pillars of sustainable development. The system is underpinned with legally binding rules and a compliance mechanism that ensure predictability and stability in trading arrangements. The conclusion is that trade liberalization promotes growth and, along with binding trade rules, environmental and social goals can be pursued.

Notwithstanding the overarching goal of sustainable development, the phrase does not appear in any of the 492 pages of the WTO legal texts. The term sustainable development has not lent itself to creating the legal rights and obligations that typify WTO commitments such as dumping, subsidies, and nondiscrimination. However, this should not hide the fact that the WTO and the interrelated subsystem of free trade areas, multilateral agreements, and plurilateral agreements have key roles in addressing the 2030 Agenda for Sustainable Development.

The objective of this essay is not to attempt a comprehensive review of all trade policies that bear on sustainable development; rather, it is to highlight the fact that trade policies and sustainable development are inextricably linked in multifarious ways.[6] It selectively focuses on the links of importance to Asian countries using the 2030 Agenda for Sustainable Development as a benchmark. Further, the focus is on the WTO as a multinational body that facilitates trade and establishes trade rules rather than the achievement of sustainable development goals at the national level. This is a topic dealt with comprehensively elsewhere.[7]

---

5 World Trade Organization (WTO), "The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts," WTO Secretariat, 2002, 4 ~ https://docs.wto.org/gtd/WTOlegaltexts/Legal_texts_e.pdf.

6 For a more complete coverage, see Gary P. Sampson, *The WTO and Sustainable Development* (Tokyo: United Nations University Press, 2006).

7 See, for example, Asian Development Bank, *Accelerating Sustainable Development after Covid-19: The Role of SDG Bonds* (Manila: Asian Development Bank, 2021), available at https://www.wto.org/english/tratop_e/devel_e/a4t_e/gr19_e/a4treportasian2019_e.pdf.

TRADE LIBERALIZATION, GROWTH, AND SUSTAINABLE TRADE

The importance of the WTO for Asian countries is underscored by the fact that of the 32 member countries of the Asian Development Bank, 27 are full members of the WTO and 4 are in the process of acceding. Trade-induced economic growth (SDG 8) is well-recognized as a major contributor to ending poverty (SDG 1), and trade liberalization has been key to Asia's economic transformation over the past half century. Trade in goods and services has averaged 11.3% growth annually since 1991, and real GDP per capita has more than tripled, "lifting over a billion people out of poverty."[8]

Asia includes China and India, the two most populous nations in the world, as well as several other countries with both large populations and millions of poor households (e.g., Bangladesh, Indonesia, Myanmar, Pakistan, the Philippines, and Vietnam). The International Monetary Fund estimates that China's share of global GDP, for example, will increase to 18.8% in 2021, up from just 7.7% in 2001. High per capita growth in China and other Asian countries has meant a substantial reduction in the number of households with incomes below the poverty line. Trade expansion in services has also been critical, generating over half the region's output, comprising a quarter of its trade, and employing more women than men, encouraging the empowerment of women. China, the leading exporter among developing economies, ranks fifth in the world in service exports at $283 billion. All top five service exporters from the developing world are from Asia. In 2019 they held a world market share of almost 15%, the same as all other developing economies combined.[9]

Free trade agreements (FTAs) are also important for meeting the goals of sustainable development. Of the over four hundred FTAs involving the 164 WTO members, five of the signatories to the largest number of FTAs are Asian.[10] These FTAs are important from both an economic and social perspective. The Regional Comprehensive Economic Partnership (RCEP) among the Asia-Pacific nations, for example, covers a market of 2.2 billion people, or almost 30% of the world's population. Its combined GDP is

8 Asian Development Bank, *Aid for Trade in Asia and the Pacific: Promoting Economic Diversification and Empowerment* (Manila: Asian Development Bank, 2019), available at https://www.wto.org/english/tratop_e/devel_e/a4t_e/gr19_e/a4treportasian2019_e.pdf.

9 Ibid.

10 Singapore (27 agreements), South Korea (20 agreements), India (17 agreements), China (16 agreements), and Malaysia (15 agreements).

$26.2 trillion, or about 30% of global GDP, and it accounts for nearly 28% of global trade.[11]

From a social perspective, FTAs can be "deeper" than WTO agreements, with commitments that extend beyond those of the WTO.[12] The European Commission, for example, in assessing its FTA with Indonesia, concluded: "In terms of social impacts, the agreement would raise wages in Indonesia…contribute to the advancement of human rights...be carbon efficient and create growth in trade and output."[13]

There are also liberalizing plurilateral (as opposed to multilateral) agreements between WTO members that address the SDGs.[14] In the Doha Development Agenda, ministers agreed to negotiate "the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods…to enhance the mutual supportiveness of trade and environment." Though stalled in late 2016, of the 46 WTO members involved in this, 8 were Asia-Pacific states.[15] The countries involved account for 90% of global trade in environmental goods.

Additionally, new interest has emerged in the Trade and Environmental Sustainability Structured Discussions (TESSD) group of 53 WTO countries. This group was created in November 2020 to "collaborate, prioritize and advance discussions on trade and environmental sustainability."[16] In May 2021 the second session of the TESSD dealt with the liberalization of trade in environmental goods, including examining lessons from the Asia-Pacific

---

11 RCEP negotiations were launched in November 2012 between the ten Association of Southeast Asian Nations (ASEAN) members—Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam—and ASEAN's FTA partners—Australia, China, India, Japan, New Zealand, and South Korea. Since then, India withdrew from the negotiations, and the agreement was concluded among the remaining fifteen states in November 2020, with the state-level ratification process now underway.

12 For a discussion of deeper trade agreements, see Aaditya Mattoo, Nadia Rocha, and Michele Ruta, *Handbook of Deep Trade Agreements* (Washington, D.C.: World Bank, 2020) ~ https://openknowledge.worldbank.org/handle/10986/34055.

13 European Commission, *Impact Assessment (SIA) in Support of Free Trade Agreement (FTA) Negotiations between the European Union and the Republic of Indonesia: Final Report* (Luxembourg: Publications Office of the European Union, 2019) ~ https://trade.ec.europa.eu/doclib/docs/2020/july/tradoc_158901.pdf.

14 Multilateral agreements are agreed to by the full membership of the WTO (164 signatories). Plurilateral agreements are those among a subset of WTO members, such as the Government Procurement Agreement (48 signatories).

15 The countries are Australia; China; Hong Kong, China; Japan; South Korea; New Zealand; Singapore; and Chinese Taipei (Taiwan).

16 WTO, "Communication on Trade and Environmental Sustainability," November 17, 2020 ~ https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/CTE/W249.pdf&Open=True.

Economic Cooperation (APEC) states' reduction of tariffs on 54 environmental goods to 5% or less.[17]

Another area where targeted liberalization is important, especially given the Covid-19 pandemic, is access to affordable medicines and vaccines (SDG 3). No country is entirely self-reliant in the products and equipment it needs for its public health system; most rely heavily on imports. Perversely, numerous countries maintain high tariffs on imports of medical products and equipment. World average tariffs on personal protective products are 11.5%—and as high as 27% in some countries. Seventy-six countries have average tariffs higher than 20%, and for individual products as basic as hand soap—the first line of protection against infection—the world average tariff is 17%. Discussions are underway in the WTO to revitalize an earlier agreement that would reduce to zero all tariffs on medical products for all countries.[18]

Zero tariffs have long been granted for imports of manufactured products from the least developed countries (LDCs). For the poorest states, the thinking in the WTO has been that equal treatment of unequals is unfair. The need to improve access to the markets of developed countries led to the concept of "special and differential treatment" providing for duty-free imports from LDCs and flexibility in the application of WTO rules. Of the 44 countries designated an LDC by the United Nations, 12 are in the Asia-Pacific region.[19]

SDG 17.11 pledged to double LDCs' share in global exports by 2020. This goal has not been achieved. Their share in world merchandise exports has actually decreased from 1.1% in 2000 to 0.9% today.[20] These exports amounted to $173 billion in 2020, a 12% decrease from 2019, while their commercial service exports totaled $28 billion, falling by 35%. This disappointing outcome is linked to the erosion of the preferences schemes of developed countries due to their tariff reductions and some unilateral initiatives that curtail preferences for nontrade reasons.

---

17 "WTO Members Assess MC12 Options for Trade, Environmental Sustainability Work," International Institute for Sustainable Development, June 3, 2021 ~ https://sdg.iisd.org/commentary/policy-briefs/wto-members-assess-mc12-options-for-trade-environmental-sustainability-work.

18 See Gary P. Sampson, "Trade in the Post-Pandemic World," Committee for Economic Development of Australia, May 27, 2020 ~ https://apo.org.au/node/306303.

19 These twelve Asian LDCs are Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Laos, Myanmar, Nepal, Solomon Islands, Timor-Leste, Tuvalu, and Yemen.

20 WTO Sub-Committee on Least Developed Countries, "Market Access for Products and Services of Export Interest to Least Developed Countries," Note by the Secretariat, WT/COMTD/LDC/W/67.

SUSTAINABLE TRADE AND WTO RULES: CHALLENGES AHEAD

Sustainable Development Goals are embedded in the everyday activities of the WTO. The nature of the activities varies greatly. At one extreme, there are negotiations that extend over years (the Doha Development Agenda), while others are ongoing dialogues, such as the "Informal Dialogue on Plastics Pollution and Environmentally Sustainable Plastics Trade." The following three examples of WTO activities are very different, but all are important for sustainable development.

Subsidies and the Challenge of Their Elimination

The world's fish stocks have experienced a downward trend with few underexploited resources and an increasing number of overexploited ones. Beyond overfishing, the factors that explain fish stock decline include inappropriate fisheries management, marine pollution, increased mortality of noncommercial fish bycatch, and various other practices that adversely affect marine biodiversity and habitats. However, another candidate is subsidies, which are widespread in this sector. It has been reasoned that their reduction or removal would result in less capital flowing into the sector, lower fish-harvesting levels, and facilitate sustainable fisheries management systems.[21]

The WTO Subsidy Agreement is the only multilateral agreement that monitors and disciplines the use of subsidies. Containing fisheries subsidies has become a focus of attention for environmentalists and others.[22] The agreement has detailed rules for determining whether an imported product is being subsidized. Though subsidies are not illegal, if the subsidized products are "causing injury" to a domestic industry, countervailing duties may be applied. The essential legal question has been how to modify existing WTO rules to effectively constrain fisheries subsidies.

Negotiations were launched in 2001 at the WTO Doha Ministerial Conference to "clarify and improve the Agreement on Subsidies and Countervailing Measures with respect to fisheries subsidies." This has proven to be a complex task. Fisheries subsidies come in many guises. Not all are

21 This example draws on Sampson, *The WTO and Sustainable Development*, 65–74.

22 See David Schorr, "Fisheries Subsidies and the WTO," in *Trade, Environment, and the Millennium*, ed. Gary P. Sampson and Bradnee Chambers (Tokyo: United Nations University Press, 1999). A lesson that can be learned from these negotiations is the time it takes to reach consensus approval for any modification of existing WTO agreements—over two decades in this case.

damaging, and some contribute to sustainable fisheries by reducing fleet capacity, offering job retraining, enhancing fish stocks, promoting vessel buybacks, and encouraging technological improvements. SDG 14.6 states that by 2020, governments should prohibit "fisheries subsidies which contribute to overcapacity and overfishing…this should be an integral part of the WTO fisheries subsidies negotiations." While agreement has not yet occurred, significant progress has been made. The expectation is that the negotiations will be finalized for the WTO Ministerial Meeting in November or at least by the end of this year.

The conclusion is that the fisheries subsidies experience may well define a new role for the WTO. According to a former director general of the World Wildlife Fund International, this case "presents the first instance of a WTO negotiation centered explicitly at the nexus of trade policy, natural resource economics, and environmental conservation."[23] This begs the question of whether the WTO can modify other agreements to advance sustainable development objectives.

By way of example, some governments consider that fossil fuel subsidies—estimated at $478 billion in 2019—are ripe for reduction or elimination, given their negative financial, climate, and public health impacts, and have sought to bring these concerns to the multilateral agenda.[24] In a proposed statement for the WTO Ministerial Meeting in November 2021, several WTO members have proposed that, considering SDG 12, a "phase-out of fossil-fuel subsidies would effectively contribute to the Paris Agreement objectives."[25] However, it is certainly early days for this. In its current form, this proposal is for inclusion in a ministerial declaration, not negotiation. Based on the fisheries experience, there is a long way to go before it could lead to a modification of the WTO Subsidies Agreement.

Sanctions and the Challenge of Like Products and Standards

A frequent argument is that the WTO is not "pulling its weight" by failing to authorize trade sanctions for countries not meeting agreed upon social

23 Claude Martin, "Preface," in "Healthy Fisheries, Sustainable Trade: Crafting New Rules on Fishing Subsidies in the World Trade Organization," ed. David K. Schorr, World Wildlife Fund International, June 2004, v.

24 Harro van Asselt and Tom Moerenhout, "Fit for Purpose? Toward Trade Rules that Support Fossil Fuel Subsidy Reform and the Clean Energy Transition," Nordic Council of Ministers, November 30, 2020 ~ https://pub.norden.org/temanord2020-539/#43719.

25 WTO, "Proposed Fossil Fuel Subsidies Ministerial Statement," July 16, 2021 ~ https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=275605&CurrentCatalogueIdIndex=0&FullTextHash=371857150&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True.

and environmental targets. This criticism requires some explanation. WTO rules treat traded goods that have the same physical form as "like products," even if they have been produced according to lower standards than held by importing countries. For example, hand-knotted carpets made by children are treated the same as carpets made by adults. In the same vein, products that are made in a polluting manner are treated the same as those that are not. The concept of like products is central to many WTO agreements, and its role is to ensure governments do not discriminate against imports that are physically similar to domestic products but produced in a different manner. It also helps the WTO avoid passing judgement on whether nontrade considerations are justified as trade restrictions and thereby meddling in areas outside its mandate. Trade officials reason that labor standards, human rights, and environmental standards, for example, are best left to the International Labour Organization, Human Rights Commission, and UN Environment Programme. Developing countries strongly resist changing the interpretation of like products to reflect the standards of wealthy importing countries that they claim infringe on their national sovereignty.[26] This puts significant constraints on using trade measures for the achievement of some sustainable development goals.

One long-standing example of the policy implications of like products involves restrictions on imports from low-wage countries that do not meet "core" labor standards, which increases their competitive advantage. The counterargument is that such labor standards distort the comparative advantage of many developing countries and are nothing more than protectionism behind a humanitarian mask. Discriminating between imports according to production methods has been strongly resisted by virtually all developing countries, and a consensus is required to change the status quo. The clout of developing countries in such matters has increased—these states now account for two-thirds of WTO membership and 43% of world trade. There may be storm clouds on the horizon that do not bode well for furthering the SDGs in the WTO.

In a speech at an AFL-CIO event in June outlining President Joe Biden's "worker-centered" trade policies, U.S. Trade Representative Katherine Tai stated that the "WTO's rules actually don't include any labor standards, and workers are often an afterthought. This needs to change."[27]

---

26 See Gary P. Sampson, ed., *The Role of the WTO in Global Governance* (Tokyo: United Nations University Press, 2001).

27 Katherine Tai, "Remarks of Ambassador Katherine Tai Outlining the Biden-Harris Administration's 'Worker-Centered Trade Policy,'" Office of the U.S. Trade Representative, June 10, 2021 ~ https://ustr.gov/about-us/policy-offices/press-office/speeches-and-remarks/2021/june/remarks-ambassador-katherine-tai-outlining-biden-harris-administrations-worker-centered-trade-policy.

A very different approach came from Peter Sutherland, the first director-general of the WTO: "Labour rights do indeed belong on the international agenda…but they need to be handled by an institution with the competence and mandate to address them with the seriousness they deserve. The International Labour Organization is the obvious candidate."[28]

A general conclusion that emerges—and will be addressed below—is the need for greater coherence and cooperation between international institutions.

Penalties, Exceptions, and the Challenge of Concerns Beyond Trade

Discrimination between countries based on production methods is nowhere more evident than for measures designed to reduce carbon leakage.[29] This occurs when goods produced locally are imported without equivalent carbon taxes in the exporting country. The solution proposed by the European Union is to tax the carbon content of imports to ensure that equivalent taxes are paid in both the importing and exporting countries. The United States is heading in the same direction. The Biden administration intends to apply a "carbon adjustment fee against countries that are failing to meet their climate obligations."[30] Such carbon border adjustment mechanisms (CBAMs) are clearly border measures, and their legality or otherwise falls within the authority of the WTO.[31] Their use creates a number of potential problems as they would discriminate between supplying countries on the basis of how goods are produced.

There are also practical problems in determining a carbon-related import tax. The exporting company may have already paid its own carbon tax, which would require adjustment at the border for taxes already paid, or the product may have been manufactured with imported intermediate goods where taxes have been paid. In addition, the exporting country may not have a carbon price at all but employ alternative measures for controlling carbon emissions.

---

28 Peter Sutherland, John Sewell, and David Weiner, "Addressing Global Governance in the WTO," in Sampson, *The Role of the WTO in Global Governance*, 96.

29 This discussion of rules around carbon leakage draws on Gary P. Sampson, "WTO and Climate Change—A Clash of Treaties," Pearls and Irritations, May 5, 2021 ~ https://johnmenadue.com/wto-and-climate-change-a-clash-of-treaties; and Gary P. Sampson, "Carbon Leakage: The Achilles Heel of Climate Change," Pearls and Irritations, July 1, 2021 ~ https://johnmenadue.com/carbon-leakage-the-achilles-heel-of-climate-change.

30 "The Biden Plan for a Clean Energy Revolution and Environmental Justice," Biden-Harris Democrats ~ https://joebiden.com/climate-plan.

31 See Gary Clyde Hufbauer, "Divergent Climate Change Policies among Countries Could Spark a Trade War. The WTO Should Step In," Peterson Institute for International Economics, August 30, 2021 ~ https://www.piie.com/blogs/trade-and-investment-policy-watch/divergent-climate-change-policies-among-countries-could.

In the face of these problems, a proposed solution for carbon leakage is for the EU or United States to evaluate whether an exporting country is "doing enough" to meet the Paris Accord targets. If it is not, they would unilaterally apply what is effectively a penalty tariff on a like product as a means of coercion. Once again, this does not bode well for future deliberations in the WTO.

In terms of the reactions of Asian countries, a recent survey concluded, "China will likely oppose the EU CBAM…India perceives the EU CBAM as strongly protectionist…and Japan has already begun opposing the plans."[32] Australia has neither a carbon tax nor an emission trading scheme but is looking to technology for future induced carbon abatement.

The way forward is for WTO members to agree via consultation with other international institutions to the conditions whereby they are prepared to forgo their right not to be discriminated against. The need for this consultation is acknowledged in the SDG's preamble.

There are precedents for this cooperation. More than 20 of the 250 current multilateral environment agreements contain trade provisions that violate WTO rules. The Montreal Protocol, for example, restricts trade in chlorofluorocarbons, and the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) bans international trade in threatened animal and plant species. Before these agreements and others came into force, the parties agreed on the nature and purpose of restrictions. None has ever been the subject of a WTO dispute.

SUSTAINABLE DEVELOPMENT AND THE ROAD AHEAD FOR THE WTO

Though beyond the scope of this essay, support for the WTO has languished in recent years. But as noted above, there is a realization among key WTO members that reform is necessary, creating the possibility to strengthen the link between trade and sustainable development.[33] An important question is how this could be achieved.

32 Frédéric Simon, "Asian Countries See EU Carbon Border Levy as Protectionist: Survey," EURACTIV, March 10, 2021 ~ https://www.euractiv.com/section/energy-environment/news/asian-countries-see-eu-carbon-border-levy-as-protectionist-survey.

33 Gary P. Sampson, "Challenges Facing the World Trade Organization: An Overview," *Australian Economic Review* 51, no. 4 (2018): 1–21 ~ https://onlinelibrary.wiley.com/doi/full/10.1111/1467-8462.12301.

"Mainstreaming" sustainable development into the WTO agreements has been explored.[34] If this means adapting existing agreements through consensus agreement, based on the experience of the fisheries subsidies, negotiations could be long and arduous with uncertain outcomes. There are other mechanisms.

One is to advance to multilateral agreement through regional trade agreements and then extend the results more broadly.[35] Chapter 24 of the United States-Mexico-Canada FTA, for example, states that "each Party shall adopt, maintain, and implement laws, regulations, and all other measures necessary to fulfill its respective obligations under the following multilateral environmental agreements."[36] The agreement identifies seven multilateral environment agreements, including the Montreal Protocol and CITES, where WTO rights are forgone to achieve an environmental goal (the Paris Accord is conspicuous by its absence).[37]

Governments have discussed in the past the creation of an "environment window" where exceptions from WTO obligations could be accorded for environmental management reasons. Presently, the WTO provides for "general exceptions," in which WTO members may be exempted from rules for measures deemed necessary for exhaustible natural resource conservation. Yet a more promising option for CBAMs could be for WTO members to seek a waiver to allow nonconforming WTO measures following a two-thirds majority vote. The waiver would relieve the countries imposing the CBAM from the obligation of nondiscrimination for a fixed time period. Waivers do not modify existing WTO provisions. As they are exceptional in nature, subject to strict discipline, and require two-thirds vote rather than consensus, some argue that this could be a realistic option.[38]

The coronavirus pandemic has rekindled the debate on whether the WTO Trade-Related Aspects of Intellectual Property Rights Agreement (TRIPS), which sets minimum standards for intellectual property protection, unduly limits access to essential medical products. The agreement permits a country to waive intellectual property rights requirements in exceptional

---

34 WTO, *Mainstreaming Trade to Attain the Sustainable Development Goals* (Geneva: WTO Secretariat, 2018) ~ https://www.wto.org/english/res_e/booksp_e/sdg_e.pdf.

35 Sampson, "Carbon Leakage."

36 "Agreement between the United States of America, the United Mexican States, and Canada 7/1/20 Text," Office of the U.S. Trade Representative, chap. 24 ~ https://ustr.gov/sites/default/files/files/agreements/usmca/24_Environment.pdf.

37 An associated benefit would be to lessen the load on the dispute settlement system.

38 James Bacchus, "Legal Issues with the European Carbon Border Adjustment Mechanism," Cato Institute, Briefing Paper, no. 125, August 9, 2021 ~ https://www.cato.org/briefing-paper/legal-issues-european-carbon-border-adjustment-mechanism.

circumstances to produce a generic copy of a product for the domestic market without the patent owner's consent. There is a precedent in that governments agreed to waive TRIPS provisions for pharmaceutical products and LDCs.

In October 2020 India and South Africa, with the support of 62 other WTO countries, many from Asia, launched an initiative to waive intellectual property rights for vaccines and vaccine-related technologies to prevent, contain, and treat Covid-19. Many high-income countries, including some EU member states, the United Kingdom, Japan, Canada, and Australia, have opposed the initiative. The Biden administration has announced support for negotiating a waiver.

In more general terms, it is important for governments to work collaboratively to achieve their trade and sustainable development goals. In a WTO Ministerial Declaration, trade ministers agreed that "the interlinkages between the different aspects of economic policy require that the international institutions with responsibilities in each of their areas follow consistent and mutually supportive policies."[39] Declarations such as this open the door to agreements negotiated outside the WTO to accompany WTO legal agreements.

CONCLUSION

From both an economic and a social perspective, stable and rules-based societies constitute a necessary condition for sustainable development, a well-functioning world economy, and an international trading system. Viewing the WTO agreements through the prism of sustainable development clearly demonstrates the extent to which the effective functioning of the multilateral trading system is now an interdisciplinary task. WTO rules are not only based on traditional principles of economics, law, and international relations; disciplines such as ethics, equity, the environment, public health, and many others have a role to play. Recognition of this fact is important for policymakers of all disciplines to have the right toolbox to deal with the trade and sustainable development issues on the WTO agenda.

The reduction of trade barriers and the ensuing trade expansion has been, and will remain, essential to promoting the growth and development of the Asian economies. In Asia, as elsewhere, expanded resources improve standards of living and reduce poverty while providing the means to protect and preserve

[39] See WTO, "The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts"; and WTO, "On the Contribution of the World Trade Organization to Achieving Greater Coherence in Global Economic Policymaking," Declaration of the WTO, April 15, 1994, available at https://www.wto.org/english/res_e/publications_e/legal_texts_e.htm.

the environment. Achieving this requires supportive international trade rules coupled with domestic policies to meet environmental and social objectives. As major beneficiaries and active participants in trade agreements, whether these agreements be regional, plurilateral, or multilateral, Asian countries are well-placed to take a front-running position in reform of the world trading system. It is to their own advantage and to that of all others. ◈

ASIA POLICY, VOLUME 16, NUMBER 4 (OCTOBER 2021), 23–36
~ HTTP://ASIAPOLICY.ORG ~

ROUNDTABLE ESSAY

The New Geopolitics of Trade and Investment in Asia: Multilateralism, Regionalism, Protectionism, or All of the Above?

Ellen L. Frost

ELLEN L. FROST *is a Senior Advisor and Fellow at the East-West Center (United States). She can be reached at <ellen.frost1945@gmail.com>.*

NOTE: *This roundtable was made possible by the generous support of the Hinrich Foundation ~ https://www.hinrichfoundation.com.*

KEYWORDS: TRADE; INVESTMENT; GEOPOLITICS; JAPAN; CHINA; UNITED STATES; ASEAN

EXECUTIVE SUMMARY

This essay analyzes the impact of recent geopolitical trends on Asia's regional trade and investment order, highlights the rival strategies pursued by China and Japan, and draws some conclusions about the future role of the U.S.

MAIN ARGUMENT

The geopolitical foundations supporting Asia's rapid economic growth are weaker than they were at the turn of the millennium. The security environment has deteriorated sharply. Many of the tariffs erected by the Trump administration against imports from China, as well as from allies and friendly countries, are still in place. The most striking feature of the new trade and investment landscape is the emergence of rival regionalisms forged by China and Japan. As they navigate these contrasting initiatives, Asian governments, particularly in Southeast Asia, are exercising new agency and are not likely to relinquish it just because the U.S. claims to be "back." This combination means that the future of Asia's economic order is likely to be a mixture of selective multilateralism, regionalism, and protectionism.

POLICY IMPLICATIONS

- Japan has become the de facto leader of the emerging economic order in Asia, while China has amassed enormous regional influence. As trade and economic negotiations proceed, the U.S. will have a seat at the table but will no longer sit at the head.

- The fastest and most direct way for the U.S. to re-enter the leadership circle would be to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). The Biden administration should slowly and quietly build the case in Congress and with the public for making such a move after the 2022 midterm elections.

- The Biden administration should ensure that "foreign policy for the middle class" does not lead to new trade barriers against other nations, especially allies and friends. Selective removal of existing barriers would help restore goodwill. U.S. negotiators should adopt a style of engagement that emphasizes listening to other countries' concerns.

The geopolitical foundations supporting Asia's rapid economic growth have been changing recently in some disturbing ways. The region's trade and investment landscape brims with overlapping political and economic organizations and institutions. These groupings have reinforced peaceful norms and taken important steps to liberalize intraregional and global trade and investment, but in the absence of strong leadership their future is uncertain. During the Trump era, the United States largely withdrew from an economic leadership position, leaving the field to Japan and China and forcing other Asian governments to exercise more agency of their own.

This essay surveys these changes and weighs the consequences of current geopolitical trends for regional and trans-Pacific trade and investment negotiations. It pays special attention to the evolving regional rivalry between Japan and China and weighs the leadership potential of each. Based on current trends, it makes some predictions about the future role of the United States as it re-engages with a region increasingly characterized by selective multilateralism and rival regionalisms.

NEW CHALLENGES TO ASIAN TRADE AND INVESTMENT

Between roughly 1980 and the global financial crisis of 2008–9, at least six factors contributed mightily to the expansion of trade and investment in the Asia-Pacific and hence to the region's global engagement and growing prosperity. Spearheaded by the "four tigers" (Singapore, Hong Kong, South Korea, and Taiwan), and spurred by China's spectacular economic growth, Asia grew richer faster than any other region. Causes included:

1. Market-opening reforms in China, backed by relatively cooperative and outward-facing governments;
2. The proliferation of China-centered regional and trans-Pacific supply chains, fueling expanded trade in parts and components among those countries that could establish a competitive niche;
3. A functioning multilateral set of norms-based trade rules implemented through the World Trade Organization (WTO);
4. A relatively open U.S. market;
5. Regional integration initiatives promoted by the ten-member Association of Southeast Asian Nations (ASEAN); and crucially,
6. Peace and stability in the region, backed by credible U.S. security guarantees and a robust U.S. military presence.

In the last decade, however, several of these positive drivers have exhibited backsliding or are at some degree of risk:

- Chinese president Xi Jinping has backed away from his 2013 commitment to assign a "decisive role" to market forces.[1] Beijing is also using trade restrictions to punish other governments for alleged transgressions unrelated to trade.
- The Covid-19 pandemic has stifled growth. Supply chains are hampered by pandemic-related bottlenecks and delays, giving rise to measures designed to bolster resilience and reserves.
- U.S. and allied sanctions against China are altering corporate plans. A climate of uncertainty is discouraging new investment. Some companies are pulling out of China, while others are becoming more localized.
- The WTO is no longer the wellspring of multilateral rulemaking and has not been for many years. The Trump administration refused to enable the WTO's appellate process to function. Necessary WTO reforms remain stalled.
- Under former president Trump, the U.S. market became far less welcoming, and the Biden administration is keeping many Trump-era tariffs in place. No one expects any serious trade initiatives to be submitted to Congress until after the November 2022 elections, if then.
- The security environment has deteriorated sharply. Relations in several important dyads—the United States and China, Japan and South Korea, and China and India—are at their lowest ebb in years.
- China's aggressive behavior in the South China Sea and both its mounting incursions into Taiwanese airspace and its activities near Japan's Senkaku Islands (known as the Diaoyu Islands in China) remain largely unchallenged. Political crackdowns in Hong Kong and the harsh treatment of the Uighurs have triggered further sanctions. The United States will be under domestic pressure to boycott the 2022 Winter Olympics in Beijing.
- Chinese leaders have convinced themselves that Washington wants to "contain" China, block its growth, deny its legitimate place in the regional and global order, and interfere in its domestic affairs.

1 Cary Huang, "Party's Third Plenum Pledges 'Decisive Role' for Markets in China's Economy," *South China Morning Post*, November 12, 2013 ~ https://www.scmp.com/news/china/article/1354411/chinas-leadership-approves-key-reform-package-close-third-plenum.

Every major sign of instability is attributed to the "hidden hand" of a U.S.-led conspiracy.[2]

- If Covid-19 and its Delta variant cannot be contained, major economic activities such as construction, shipping, travel, and tourism will revert to low or negative growth, dampening trade and investment prospects.

To be sure, the future is not entirely bleak. Asia has witnessed at least three important and constructive achievements in the last decade: (1) the ASEAN-driven Regional Comprehensive Economic Partnership agreement (RCEP) was successfully concluded in 2020, (2) the eleven-member Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) entered into force in 2018, and (3) bilateral and multilateral agreements concerning the digital economy have rapidly expanded, covering such issues as cross-border electronic commerce, cybersecurity, privacy, standards, data localization, and more. This last trend is particularly important for Asia. Singapore has already negotiated two digital economy agreements, one with both Chile and New Zealand and the other with Australia. The United States has reached a similar agreement with Japan.[3] There are chapters on the digital economy in virtually every bilateral and trilateral preferential trade agreement recently negotiated by the United States.[4] Unfortunately, China's fixation on retaining cyber sovereignty and tight control over the flow of information diminishes the prospect of truly global rules.

Prospects are also fairly bright for other sectoral agreements that do not require congressional approval, such as those covering pharmaceuticals and environmental goods. Assuming that no major war breaks out, the pattern of trade and investment agreements in the Asia-Pacific will likely remain mixed for the next few years and beyond. Both Asian governments and their Western partners will engage in a combination of selective multilateralism and rival regionalisms—with no single leader.

What leadership there is has taken the form of regional initiatives. In 2014, I argued that, from an Asian perspective, a combination of developments called

2 Wang Jisi, "The Plot Against China? How Beijing Sees the New Washington Consensus," *Foreign Affairs*, July/August 2021, 48–57 ~ https://www.foreignaffairs.com/articles/united-states/2021-06-22/plot-against-china.

3 "U.S.-Japan Digital Trade Agreement Text," Office of the U.S. Trade Representative, October 7, 2019 ~ https://ustr.gov/countries-regions/japan-korea-apec/japan/us-japan-trade-agreement-negotiations/us-japan-digital-trade-agreement-text.

4 "Digital Trade & E-Commerce FTA Chapters," Office of the U.S. Trade Representative ~ https://ustr.gov/issue-areas/services-investment/telecom-e-commerce/e-commerce-fta-chapters.

into question the legitimacy of the existing U.S.-led global and regional order. Both Russia and China were taking advantage of a "slow crisis of legitimacy" to advance rival regionalisms.[5] Since then, the nature and identity of rival regionalisms have shifted markedly. Russian initiatives have proven neither attractive nor economically significant, and the Russian economy does not offer a model for others. By contrast, Chinese leaders have launched a wide range of new and old construction initiatives that crystallized into the Belt and Road Initiative (BRI). China's combination of market-fueled economic growth and political dictatorship appeals to many Asian strongmen.

Enter a rival regional leader: Japan.

JAPAN: A RE-EMERGING LEADER

Faced with the challenge from China and building on a long and constructive postwar aid and investment relationship with Asia, the Japanese government has taken on an unprecedented leadership role. More than fifteen years earlier, Japan had already demonstrated an ability to step into a leadership position when the United States was inward-looking or distracted as it is now. During the 1997–98 Asian financial crisis, the U.S.-backed International Monetary Fund (IMF) preached austerity and short-term hardship. U.S. financial authorities in Washington, preoccupied by other congressional priorities, did little or nothing to ease the economic and social pain until later, and then only selectively. Japan, by contrast, took the lead in establishing a set of bilateral currency-swap arrangements known as the Chiang Mai Initiative (eventually becoming the Chiang Mai Initiative Multilateralization Agreement) to address short-term liquidity problems during a financial crisis.

Prime Minister Shinzo Abe's second term in office (2012–20) took Japan's economic statecraft in Asia to a new stage. He strengthened already close ties with the United States and presided over a far-reaching U.S.-Japan bilateral trade agreement that included the politically sensitive area of agriculture. He expanded foreign assistance and partially reoriented it to countries of "strategic" significance to Japan (the official use of the word "strategic" in this context was a notable first). He established the Japanese equivalent of the U.S. National Security Council, lodged it in the prime minister's office, and subsequently added a unit to coordinate and strengthen

[5] Ellen L. Frost, "Rival Regionalisms and Regional Order: A Slow Crisis of Legitimacy," National Bureau of Asian Research (NBR), NBR Special Report, no. 48, December 2014.

Japan's economic statecraft that is second only in size to the more traditional national security directorate.

Implicitly challenging China's headline-grabbing BRI, in 2015 Japan launched the Partnership for *Quality* Infrastructure (emphasis added) and enhanced it the following year. In early 2017, after newly elected president Donald Trump took the United States out of the Trans-Pacific Partnership (TPP), Japanese negotiators stepped into a leadership role, shepherded the removal of certain controversial provisions, and brought the negotiations to a successful end under its new name, the CPTPP.

Since goodwill is a strategic asset, it is noteworthy that Japan is quite popular in most of Southeast Asia. Unlike their counterparts in South Korea and China, older people there have largely put memories of Japanese wartime atrocities behind them. Moreover, the demographics in Southeast Asia trend young, and Japan's pop culture is well-liked among the youth.

Japan's international behavior also wins plaudits. In an ISEAS–Yusof Ishak Institute poll in 2021, when ordinary Southeast Asians were asked which country they trusted the most to "do the right thing," the hands-down winner was Japan with a trust rating of 67.1% (China, by contrast, only garnered a trust rating of 16.5%).[6] Few saw Japan's economic and military power as a threat.[7] And Japan, not China, is the biggest investor in Southeast Asian infrastructure, with $367 billion in projects compared to China's $255 billion in projects as of 2019.[8]

These conditions add up to an ongoing leadership role for Japan. Tokyo's emphasis on quality, transparency, debt sustainability, and sound investment practices is already proving attractive to many lenders in Japan and elsewhere. Nevertheless, Japan cannot replace the United States as a dominant regional leader. Such a role requires a much greater military presence than Japan's constitution and postwar political culture permit. Moreover, it is highly unlikely that any near-term successor in the prime minister's office can or will demonstrate Abe's political courage, vision, and strategic ambition.

---

6 Survey participants were asked to select among the United States, the European Union, Japan, China, and India. For this and other related polling data, see Sharon Seah et al., "The State of Southeast Asia: 2021 Survey Report," ISEAS–Yusof Ishak Institute, February 2021, 3 ~ https://www.iseas.edu.sg/articles-commentaries/state-of-southeast-asia-survey/the-state-of-southeast-asia-2021-survey-report.

7 Ibid.

8 Panos Mourdoukoutas, "Japan, Not China, Is the Biggest Investor in Southeast Asia's Infrastructure," *Forbes*, June 26, 2019 ~ https://www.forbes.com/sites/panosmourdoukoutas/2019/06/26/japan-beats-china-in-the-philippines-singapore-and-vietnam/?sh=37d3a0ad39d8. According to this article, Japan's projects are largely concentrated in the Philippines, Singapore, and Vietnam.

CHINA: TWO DIFFERENT FACES

At the turn of the millennium, China emerged as a major regional player in the multilateral arena. Beijing joined the WTO and committed to a set of market-opening reforms intended to address foreign complaints and erase its designation as a nonmarket economy within fifteen years. China-centered regional supply chains multiplied, offering lucrative roles for competitive manufacturing centers in Japan, South Korea, Vietnam, Malaysia, Thailand, the Philippines, and Taiwan. On the security front, China maintained a relatively low profile, focusing on military modernization and participating in regional exercises devoted to rescue at sea, disaster relief, and other humanitarian goals.

Today's trade and investment conditions are quite different, and China's behavior is a major reason why. Chinese Communist Party leaders have strengthened the party's oversight of private and semi-private companies, showered protection and subsidies on state-owned enterprises, and ramped up efforts to acquire high-end proprietary technology from foreign companies. Economic reforms have been suspended or reversed.[9] Many of China's efforts are part of a national drive to become self-sufficient in key technologies and industries by 2025. This behavior has serious implications for trade.[10] China's lurch toward economic nationalism and tight political control in the Xi Jinping era (2012 to the present) raises questions about the sincerity of Beijing's commitment to a multilateral, norms-based regional trade and investment order. Two different Chinas appear to be at work.

The first China is the one that created or helped to create BRI, the Asian Infrastructure Investment Bank (AIIB), the New Development Bank, and other multilateral organizations. This China has utilized the WTO's dispute settlement mechanism on numerous occasions, has the third-largest share of voting power in the World Bank, and is comfortable cooperating with the IMF and other postwar international institutions established by Western governments. There is only one Chinese national on the AIIB's senior management team—President Jin Liqun.[11] As if on cue, just five days

9 For a more refined discussion of current economic reform efforts, see Daniel Rosen and Jude Blanchette, "Is Xi a Failure?" interview by Jordan Schneider, China Talk, July 20, 2021 ~ https://chinatalk.substack.com/p/is-xi-a-failure-plus-older-gentlemen.

10 See James McBride and Andrew Chatzky, "Is 'Made in China 2025' a Threat to Global Trade?" Council on Foreign Relations, Backgrounder, updated May 13, 2019 ~ https://www.cfr.org/backgrounder/made-china-2025-threat-global-trade.

11 Jin Liqun, "The Case for More (and Better) Multilateralism in Times of Crisis" (speech at the Peterson Institute for International Economics, webcast, August 24, 2021) ~ https://www.piie.com/events/case-more-and-better-multilateralism-times-global-crisis.

after President Joe Biden's inauguration in January 2021, Xi Jinping made multilateralism the theme of his speech to the World Economic Forum's virtual conference. Hailing "the torch of multilateralism," he said that "the authority and effectiveness of multilateral institutions should be safeguarded." Slipping in an implicit dig at U.S. behavior, he declared that "decisions should not be made by simply showing off strong muscles or waving a big fist."[12]

Although the AIIB is a genuinely multinational institution, BRI is not. BRI provides an outlet for overcapacity in China's construction industry while throwing a visionary verbal blanket over a hodgepodge of existing and previously planned Chinese-funded infrastructure projects. Although the interest rates charged on BRI loans are not that far below market rates (and higher than what Japan offers), BRI represents an opportunity to wave the flag of multilateralism and portray China as a generous, noninterfering economic partner in other states' economic and infrastructure development.

The other, quite different China is a cauldron of outraged nationalism, practicing "wolf warrior" diplomacy and reacting with fury to perceived infringements on its sovereignty.[13] At the direction of the party, the government uses facial recognition technology to identify dissidents and crack down on them. The leadership suppresses China's Uighur minority, distorts history both at home and to a foreign audience, and requires key populations to study "Xi Jinping Thought" (now enshrined in the Chinese constitution). Scenes from Hong Kong and news of multiple military jet sorties into Taiwan's airspace have nullified "one country, two systems" as an attractive vision for the future. Cyber intrusions are a frequent occurrence; the U.S. intelligence community recently reported on a slew of Chinese state-sponsored, malicious cyber operations directed against the United States.[14]

Although all Asian governments want to continue to protect their extensive economic engagement with China, Chinese actions in the South China Sea, Hong Kong, and at home undermine Beijing's bid for leadership in the region. Claiming jurisdiction over waters falling within its "nine-dash

12 Xi Jinping, "Let the Torch of Multilateralism Light Up Humanity's Way Forward," Ministry of Foreign Affairs (China), January 25, 2021 ~ https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1848323.shtml. For a concise commentary on the speech, see Stephen M. Walt, "Xi Tells the World What He Really Wants," *Foreign Policy*, January 29, 2021 ~ https://foreignpolicy.com/2021/01/29/xi-tells-the-world-what-he-really-wants.

13 The term "wolf warrior" comes from a series of Rambo-style Chinese films.

14 A recent report from the U.S. intelligence community highlighted malicious cyber activities sponsored by the Chinese state. TTPs are tactics, techniques, and procedures. See "Chinese State-Sponsored Cyber Operations: Observed TTPs," National Security Agency, Cybersecurity and Infrastructure Security Agency, and Federal Bureau of Investigation, July 2021 ~ https://media.defense.gov/2021/jul/19/2002805003/-1/-1/1/csa_chinese_state-sponsored_cyber_ttps.pdf.

line," Beijing has fought off conflicting claims from Malaysia, Vietnam, Brunei, the Philippines, and Indonesia.[15] Chinese vessels patrol illegally acquired reefs and shoals while driving local fishermen out of their traditional fishing grounds.

This second China has jarred sensibilities in both Asia and the United States. Although the motivations behind China's strident assertions are not new, China's behavior is. A difference in degree has turned into a difference in kind. As a result, China's image in the rest of Asia has suffered. Although BRI projects are supposed to benefit partners by bringing new jobs and better infrastructure, polls reveal that China's role as an economic powerhouse is not necessarily welcome. For example, 72.3% of respondents polled in Southeast Asia in 2021 are "worried about [China's] growing regional economic influence."[16] According to new polls, respondents in South Korea are more critical of China than they are of Japan.[17] This combination is not a recipe for durable leadership.

China has recently applied formally to join the CPTPP (as has Taiwan) and will continue to seek more influence within the existing regional order. China's push for self-sufficiency and its preoccupation with party control, national sovereignty, and territorial claims will probably outweigh any interest in undermining the regional and global economic order in any fundamental way. Party leaders see little reason to actively cripple or overhaul the system from which China has gained so much. Nor is there domestic support for "debt-trap diplomacy," if it ever existed; Chinese state-owned enterprises have no desire to take ownership of aging infrastructure facilities in the event of a default. Consultation with the IMF and the AIIB to ascertain a debtor country's financial potential is becoming routine.

Xi Jinping will have to design a more stable combination of feeding domestic nationalism, responding to the pushback triggered by wolf warrior diplomacy, and simultaneously striving to consolidate a degree of power not seen since the days of Mao Zedong. So far, most of China's economic partners have adjusted to this dynamic and see little reason to lessen their heavy dependence on trade with China or to cancel BRI construction projects. But as China moves up the high-tech ladder and labor costs continue to rise, low-cost manufacturing will

---

15 Though Indonesia is not a claimant to the disputed land formations within the South China Sea, the country possesses an exclusive economic zone from the Natuna Islands that extends into the sea, overlapping with waters (and fisheries) China claims within its nine-dash line.

16 Seah et al., "The State of Southeast Asia: 2021 Survey Report," 20.

17 Choe Sang-Hun, "South Koreans Now Dislike China More Than They Dislike Japan," *New York Times*, August 20, 2021 ~ https://www.nytimes.com/2021/08/20/world/asia/korea-china-election-young-voters.html.

likely continue to shift to Bangladesh, Indonesia, and other low-wage producers even as these countries' strategic concerns persist.

IMPLICATIONS FOR THE UNITED STATES

Americans have an enormous stake in the liberalization of trade and investment in Asia. U.S. merchandise exports to Asia grew from $252 billion in 2005 to almost $500 billion in the pre-Covid year 2019.[18] Approximately 30% of U.S. goods and services exports go to Asia.[19] In the decade 2010–20, two-way investment with Asian countries roughly doubled.[20] New agreements facilitated this growth. However, as former congressman Charles Boustany has pointed out, "formal U.S. economic engagement in the Indo-Pacific has failed to keep pace with regional developments."[21] The two most prominent examples of this failure are former president Trump's decision to withdraw from the TPP and the Obama administration's unsuccessful effort to block other states' participation in the AIIB.

President Biden and his top foreign policy aides have repeatedly promised to work with multilateral organizations, allies, and fellow democracies to address common global problems. Within hours of his inauguration, for example, the new president announced that the United States would rejoin the Paris Agreement on climate change and the World Health Organization.

The Biden administration's emphasis on multilateralism is embedded in a wider narrative centered on restoring U.S. leadership. In a 2020 article entitled "Why America Must Lead Again," then candidate Biden pledged to put the United States back "at the head of the table." Citing multiple global

---

18 U.S. Census Bureau, "Trade in Goods with Asia" ~ https://www.census.gov/foreign-trade/balance/c0016.html.

19 "Asia Matters for America/America Matters for Asia," East-West Center, 2018 ~ https://asiamattersforamerica.org/uploads/publications/2018-Asia-Matters-for-America.pdf.

20 U.S. direct investment in Asia grew from $570.1 billion in 2010 to $969.7 billion in 2020. In the same period, incoming investment from Asia grew from $346.6 billion to $914.9 billion. Statista, "Direct Investment Position of the United States in Asia Pacific from 2000 to 2020" ~ https://www.statista.com/statistics/188604/united-states-direct-investments-in-the-asia-pacific-region-since-2000; and Statista, "Foreign Direct Investment (FDI) from Asia Pacific in the United States from 2000 to 2020" ~ https://www.statista.com/statistics/188932/foreign-direct-investment-from-the-asia-pacific-area-in-the-us-since-1990.

21 Charles W. Boustany, "Prospects for U.S. Trade Engagement in the Indo-Pacific and Options for the Biden Administration," NBR, Commentary, April 6, 2021 ~ https://www.nbr.org/publication/prospects-for-u-s-trade-engagement-in-the-indo-pacific-and-options-for-the-biden-administration.

challenges, he asserted that "it falls to the United States to lead the way."[22] As he introduced his new security team shortly after the election, he described as a "fact" that "America is back, ready to lead the world, not retreat from it."[23] But back to what? A lot has changed in Asia. Elevating multilateralism as a pathway to restoring U.S. leadership in regional forums seems to assume that Asians want a return to the previous status quo. They do and they don't.

Virtually all leaders in Asia, even (arguably) in China, want the United States to maintain its military presence in Asia in some capacity for the sake of stability. During the Trump era, however, Asian governments were forced to exercise more agency of their own. Today, they are not likely to change their ways just because Washington wants to start leading again. Leaders in Asia want the United States to return to the table but not necessarily to sit at the head. As examples of this new agency, ASEAN is negotiating a free trade agreement with the European Union, while South Korea already has one. The United Kingdom is in negotiations to join the CPTPP. Members of CPTPP will need to decide soon on what conditions should be attached to China's proposed membership—and how to handle the difficult issue of Taiwan's application before China has the chance to veto it (the vote to admit new members must be unanimous). Will Beijing accept a name like those used in other organizations, such as "Chinese Taipei"? As a nonmember of the CPTPP, the United States will not have the same degree of influence that it would have if it sat at the table. Although Biden has reportedly signaled that he would like the United States to join the CPTPP, for political reasons he is not likely to submit any large-scale trade legislation to Congress until after the November 2022 elections, if then. His administration did not even seek formal renewal of Trade Promotion Authority, which expired on July 1, 2021.[24]

Instead, throughout his first term Biden is likely to focus primarily on domestic goals, particularly rebuilding the United States' physical and human infrastructure and creating jobs at home. He is unlikely to lead any

---

22 Joseph R. Biden Jr., "Why America Must Lead Again: Rescuing Foreign Policy after Trump," *Foreign Affairs*, March/April 2020 ~ https://www.foreignaffairs.com/articles/united-states/2020-01-23/why-america-must-lead-again.

23 Trevor Hunnicutt and Humeyra Pamuk, "Biden's Aim to Restore U.S. Leadership Could Be Tall Order in a Changed World," Reuters, November 24, 2020 ~ https://www.reuters.com/article/usa-election-biden/bidens-aim-to-restore-u-s-leadership-could-be-tall-order-in-a-changed-world-idUSKBN2842V4.

24 Erik Martin, "Biden's Fast-Track Trade Authority Is Set to Expire This Week," Bloomberg, July 29, 2021 ~ https://www.bloomberg.com/news/newsletters/2021-06-29/supply-chains-latest-biden-lets-trade-promotion-authority-lapse. Article I, section 8 of the U.S. Constitution assigns to Congress the authority to "regulate Commerce with foreign Nations." Trade Promotion Authority temporarily delegates that authority to the executive branch and allows the president to proceed with negotiations. The resulting agreement is then submitted to Congress for up-or-down approval without amendments.

new trade initiatives unless he can certify that significant progress is made on those fronts. And there is more than a whiff of a "Buy America" trade policy in Biden's proclamation of a new "foreign policy for the middle class."[25] On the global front, his administration is likely to concentrate on adopting meaningful measures to fight climate change and to overcome current and future pandemics. In Congress, there is strong bipartisan support for being "tough on China," while there is near-zero support for spending near-term political energy on large-scale trade and investment agreements such as the CPTPP.

Another obstacle to renewed U.S. trade and investment leadership is that Washington lacks the resources to match China's deep pockets. The cost of the Biden administration's legislative proposals is already sky-high. Moreover, Washington has not funded major construction projects such as ports and railways since Senator Hubert Humphrey and others mandated redirecting U.S. foreign aid toward "appropriate technology" half a century ago. For their part as well, U.S. companies have shown little appetite for what they perceive as risky, long-term infrastructure construction projects that are often hampered by bureaucratic interference and corruption. The result is that Chinese companies dot the landscape in many Asian countries, but evidence of U.S. firms' presence is far less visible. Meanwhile, Chinese investment in the United States has fallen off sharply.[26]

The Biden administration's answer to BRI, adopted by the G-7 in June 2021, is the Build Back Better World (B3W).[27] Taking its name from one of Biden's domestic slogans, it builds on the new Blue Dot Network. This multi-stakeholder initiative—launched by the United States, Japan, and Australia—assesses and certifies infrastructure projects based on environmental, social, financial, and other measures, including transparency.[28]

It remains to be seen how President Biden's firm commitment to combating climate change will intersect with U.S. trade policy. Pro-environment provisions are now standard fare in U.S. trade agreements,

---

25 "Remarks by President Biden on America's Place in the World," White House, February 4, 2021 ~ https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/02/04/remarks-by-president-biden-on-americas-place-in-the-world.

26 Derek Scissors, "China's Overseas Investment Starts the Long Climb Back," American Enterprise Institute, July 20, 2021.

27 Ritika Passi, "Competing Infrastructure in the Indo-Pacific: Enter the B3W," Italian Institute for International Political Studies, August 6, 2021 ~ https://www.ispionline.it/en/pubblicazione/competing-infrastructure-indo-pacific-enter-b3w-31343.

28 For information on the Blue Dot Network, see U.S. Department of State, "Blue Dot Network" ~ https://www.state.gov/blue-dot-network; and U.S. International Development Finance Corporation, "Blue Dot Network" ~ https://www.dfc.gov/our-work/blue-dot-network.

but local enforcement is problematic. Environmental goods and services are difficult to define, and trade in that sector is by no means free. Moreover, most measures designed to reduce pollution take place behind borders, raising Asian concerns about interference in domestic affairs.

Given the current state of American politics, it will take some time to restore the credibility of the U.S. commitment to strengthening the multilateral trade and investment system. In the meantime:

- The United States will have a seat at the table but no longer at the head. Japan, China, ASEAN, and probably the EU will occupy important chairs.
- Japan will remain a strong defender of the prevailing multilateral order and a leader in negotiating new sectoral agreements.
- China will continue to participate in the international trading system even as its leaders pursue other forms of economic statecraft. Beijing's wolf warrior diplomacy will be toned down in words, if not in actions.
- More RCEP members, including China, will be admitted to the CPTPP, prompting corporate pressure on U.S. policymakers to join as well. Joining the CPTPP would be the single best step that the United States could take to restore its credibility as a leader of the evolving trade and investment order.
- The AIIB is here to stay. Ultimately, and if possible politically, the United States should join it.

In sum, the trade and investment environment in Asia will remain relatively open, but it will be fragmented, vulnerable to protectionist pressures, and crisscrossed by selective multilateralism and rival regionalisms. The worsening strategic environment and the economic ravages of Covid-19 are serious threats to the regional order. Overcoming these challenges will require both high-level U.S. attention and more intense consultation and coordination among all players, including China. ◈

asia policy, volume 16, number 4 (october 2021), 37–48
~ http://asiapolicy.org ~

ROUNDTABLE ESSAY

FDI in the ASEAN States: The Engine that Roared

Vasuki Shastry

vasuki shastry *is an Associate Fellow in the Asia-Pacific Programme at Chatham House (United Kingdom), where his research interests are Asian economic and financial integration and the interplay between technology and democracy. He has previously worked in the public and private sectors, including for the International Monetary Fund, the Monetary Authority of Singapore, and Standard Chartered Bank. His most recent book is* Has Asia Lost It? Dynamic Past, Turbulent Future *(2021). He can be reached at <vshastry@icloud.com>.*

note: *This roundtable was made possible by the generous support of the Hinrich Foundation ~ https://www.hinrichfoundation.com.*

keywords: southeast asia; fdi; economic development; supply chains

EXECUTIVE SUMMARY

This essay examines how Southeast Asia's economic fortunes are at risk as the climate for trade and investment sours.

MAIN ARGUMENT

FDI is the engine that has propelled economic growth in Southeast Asia over the last few decades. The region, grouped together as ASEAN, has astutely used foreign investment and know-how to upgrade technology and skills and to transition from a low-cost manufacturing model to high-value goods and services. This openness to trade and investment has transformed the region's economic fortunes, with front-runners such as Singapore, Vietnam, Malaysia, Cambodia, and Thailand at the vanguard of global manufacturing in fields as diverse as electronics, automobiles, pharmaceuticals, and textiles. ASEAN's success as a manufacturing hub would not have been possible without both an openness to trade and the presence of regional supply chains that favorably position Southeast Asia as an essential supplier of raw materials and key components for final assembly in China. But this defining economic model is confronting headwinds that could upend its continued success. The region's policymakers face a difficult set of challenges as they navigate an increasingly disruptive external and internal landscape.

POLICY IMPLICATIONS

- ASEAN is at the epicenter of growing trade and geopolitical tensions between the U.S. and China, which raises the threat of decoupling and supply chain reconfiguration and potentially places the region in a difficult position of having to take sides.

- Deglobalization and reshoring also pose a risk to manufacturing and investment, which ASEAN states depend on. Protectionist policies are resurging in Europe and the U.S., and the Covid-19 pandemic highlights the fragility of just-in-time supply chain management, encouraging instead a just-in-case approach. This will test the region's ability to sustain its high pace of economic growth to meet rising public aspirations and concerns about stalling social mobility.

- Southeast Asia is already facing climate-related devastation due to rising ground temperatures and sea levels. The region is challenged to adjust its economic model to build a more sustainable future.

The Association of Southeast Asian Nations (ASEAN) has always been about making things work to attract foreign investment. Whether delivering contract manufacturing in toys and fashion for Hong Kong traders like Li & Fung or e-commerce for venture capital, the 54-year-old bloc uses its diversity in levels of economic development, technological sophistication, and wage structure as a major strategic economic advantage.[1] Embracing its own variations, ASEAN has single-mindedly focused on economic and financial integration as its *sine qua non* and achieved one of the world's greatest economic success stories as a result, eclipsed in recent years only by China. "The ASEAN Economic Community (AEC) is one of the more successful economic groupings in the world, and a prime example of how a united ASEAN is much larger than a sum of its parts," stated Singaporean prime minister Lee Hsien Loong in 2018.[2]

A major point in proof of ASEAN's success has been its ability to attract and retain FDI to the region. At the same time, however, it is becoming more difficult for ASEAN to navigate the uncertainties spilling into the investment environment from three areas often outside its control: geopolitics and decoupling, deglobalization, and climate change. This essay examines both the tailwind trends behind ASEAN's success in becoming a leading region for FDI and the headwinds that threaten to slow its ascent.

TRANSFORMING THE REGION: FDI AND FTAS

Southeast Asia has become the "world's most important FDI region."[3] The evidence is incontrovertible: a key measure, FDI over GDP, increased from 20.6% in 1995 to close to 70.0% in 2015. In dollar terms, FDI increased from a modest $21.8 billion in 2000 to an impressive $160.0 billion in 2019.[4] This growth has been the economic engine that has propelled growth and prosperity in ASEAN over the last few decades. Its openness to trade and investment

1 ASEAN is an atypical grouping. Not fully integrated like the European Union (and consequently less cantankerous), the bloc includes some of the richest nations in Asia (Singapore and Brunei), some of the poorest (Cambodia, Laos, and Myanmar), and several middle-income nations in between. It also has a significantly larger population than the EU, with 675 million people versus 447 million, and a combined GDP of $2.8 trillion, which places the bloc in the top tier of the world's largest economies.

2 Lee Hsien Loong (remarks at the opening ceremony of the 50th ASEAN Economic Ministers' Meeting, Singapore, August 29, 2018).

3 Suteera Sitong, "The ASEAN Economic Integration and Foreign Direct Investment: A Case Study of Japan's FDI on the Automotive Industry," Policy Research Institute, Ministry of Finance (Japan), 2017.

4 ASEAN Secretariat, *ASEAN Key Figures 2020* (Jakarta: ASEAN Secretariat, 2020) ~ https://www.aseanstats.org/wp-content/uploads/2020/11/ASEAN_Key_Figures_2020.pdf.

has transformed the region's economic fortunes, with front-runners such as Singapore, Vietnam, Malaysia, Cambodia, and Thailand at the vanguard of global manufacturing of electronics, automobiles, pharmaceuticals, and textiles. There are, however, also laggards in the region, such as Indonesia, whose resource-rich economy has been buffeted by a virulent strain of nationalism that has hampered FDI flows, and the Philippines, which has eschewed FDI in manufacturing to focus on services. There has additionally been a dramatic change in sources of foreign capital as well, with traditional investors such as the United States, Europe, Japan, and South Korea being disrupted by China, which has transformed itself from merely a destination for FDI into a reliable source of capital for ASEAN.

It is FDI that created the foundation for Singapore's transformation from a third-world country to a first-world one in the 1970s and 1980s, followed in short order by Malaysia, Thailand, Indonesia, and Vietnam in subsequent decades. Even low-income countries in the region such as Cambodia and Myanmar have made a virtue out of FDI by becoming some of the world's largest garment exporters.

ASEAN's economic success and ability to attract FDI have been built on successive free trade agreements (FTAs), beginning in 1992 with the ASEAN Free Trade Area, followed by bilateral and regional FTAs with states in the wider region. The cornerstone of this approach is ASEAN's bilateral FTAs with its so-called dialogue partners—China, Japan, South Korea, India, Australia, and New Zealand. These FTAs, which provide duty-free access to many goods originating from the subregion, have given the grouping the political muscle to forge more ambitious broader regional agreements. While several ASEAN members (Singapore, Brunei, Malaysia, and Vietnam) are part of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the apogee of ASEAN ambitions is the Regional Comprehensive Economic Partnership (RCEP), which was signed last year. Described as a triumph of ASEAN's "middle-power diplomacy," the RCEP brings ASEAN together with its +3 partners, China, Japan, and South Korea, as well as Australia and New Zealand, in a regional FTA that Brookings researchers estimate could add $209 billion annually to world incomes and $500 billion to world trade by 2030.[5]

Many commentators have quibbled about the shortcomings of the RCEP. To some, it is regarded as a China-centered FTA that delivers little by way

---

5 Peter A. Petri and Michael Plummer, "RCEP: A New Trade Agreement That Will Shape Global Economics and Politics," Brookings Institution, November 16, 2020.

of additional economic impact and is primarily aimed at challenging U.S. primacy as an economic and political power in the region. The RCEP has also been criticized for not including provisions for so-called 21st-century principles in trade agreements. Yet the effects of the partnership "are impressive even though the agreement is not as rigorous as the CPTPP," the Brookings researchers noted. "It incentivizes supply chains across the region but also caters to political sensitivities. Its intellectual property rules add little…and the agreement says nothing at all about labor, the environment, or state-owned enterprises—all key chapters in the CPTPP." They observed, however, that "ASEAN-centered trade agreements tend to improve over time."[6]

AN ECOSYSTEM FOR FOREIGN INVESTMENT

By establishing itself as an indispensable partner for FTAs, ASEAN in effect has created an ecosystem for foreign investors to access the region with certainty about market access and predictable regulations. Members of the group have also been astute in the way they have attracted foreign investment in technology-intensive sectors, even though many ASEAN members initially lacked the industrial base or relevant infrastructure. For example, Singapore still accounts for a significant share of FDI into the ASEAN region, with researchers positing that the city-state serves as an important channel of technology and knowledge transfer to the wider grouping.[7] "Singapore set up industrial estates and clusters in association with both FDI and innovation-friendly domestic policies such as in the field of biotechnology.… FDI can be a key to innovation creation because it is a major channel of technology spillovers into ASEAN member states from other developed countries."[8]

Regional supply chains, with China as the final assembly point, have also served as a transmission mechanism for the region to upgrade its technological know-how. An official paper published by the ASEAN Secretariat in October 2020 noted that the increasing level of connectivity between the group and its +3 partners drove favorable economic outcomes.[9] The report observed that "connectivity serves as a platform for production networks to settle and

6 Petri and Plummer, "RCEP."

7 This point is drawn from Patrick Ziegenhain, "ASEAN 2025: Towards Increased Foreign Direct Investment in Southeast Asia?" *AEGIS* 4, no. 1 (2020).

8 Ibid.

9 "Joint Study on 10 + 3 Cooperation for Improvement of Supply Chain Connectivity (SCC)," ASEAN Secretariat, November 2020.

helps connect local companies within the [ASEAN +3] region with global value chains, thus allowing resources to be allocated efficiently and keeping the products affordable for consumers." Two major trends highlighted by the study include:

- The share of intermediate goods trade in total trade by the ASEAN +3 countries is considerably high, indicating a close involvement in supply chains throughout the region.
- Imported inputs—another measure of interdependence—coming from the +3 countries amounted to slightly more than 40% of the total ASEAN member inputs in 2015, with input from China accounting for about half of this.

Of course, the vibrancy of regional supply chains in Asia is in equal measure due to the primary source of demand for finished products originating from Europe and the United States, which remain among the largest providers of FDI into ASEAN. Apple's iPhone exemplifies the strength of the U.S. company's deep presence in supply chains and contract manufacturers across the region. An analysis by Damien Ma shows the heavy concentration of Apple's suppliers in East Asia, with China, Japan, South Korea, and Taiwan serving as focal points for key iPhone components:

> Not only did Apple concentrate more suppliers in China from 2017–2019, it also increased its overall supplier presence in East Asia, from 83.6% to 86.5%.... [T]o the extent there is some diversification from China, the shifts have been largely intra-Asia among Asian suppliers. Some Japanese and even Chinese firms have relocated to Southeast Asia.[10]

This case illustrates how the ASEAN region has benefited in terms of fresh FDI and technology spillover from production work in East Asia, especially China. There is a virtuous circle in U.S. and European multinationals tasking East Asian contract manufacturers to assemble components for final assembly in China, for example, and for the finished product to be shipped back to consumers in the United States, Europe, and the rest of the world. Contract manufacturers, such as Taiwanese tycoon Terry Gou's Foxconn, are indispensable Apple suppliers and major investors in production facilities across ASEAN. At the other end of the manufacturing spectrum, in low-wage, labor-intensive sectors, Hong Kong–based Li & Fung serves as

10 Damien Ma, "How Apple Exemplifies the Resilience of East Asian Supply Chains," MacroPolo, June 2, 2020.

a key intermediary for global fashion, toy, and furniture brands by sourcing products from factories across Asia, including ASEAN.

While contract manufacturing is a global phenomenon, it has been perfected in Asia through the emergence of companies like Foxconn and Li & Fung that serve as intermediaries for global firms and are major investors themselves in businesses and production facilities. Their presence has made it possible for ASEAN to excel in both high-value markets such as electronics and low-wage sectors such as textiles. ASEAN is also at the vanguard of the mobility and e-commerce revolution, which has created a new generation of tech-savvy entrepreneurs. The rise of start-ups like Indonesia's GoTo (a result of the recently merged ride-hailing company Gojek and e-commerce firm Tokopedia) and Singapore's wide-ranging services firm Grab was fueled by investments from China's tech majors Alibaba and Tencent and Japan's SoftBank. Venture capital flows into the region have remained buoyant with an estimated $8.2 billion in 2020 alone.[11] These are primarily flowing into technology-intensive sectors such as e-commerce, mobility, and financial technology, although the pandemic will cause an increase in health technology investing. It is an open question, though, whether these flows will continue apace as China places ever greater restrictions on the operations of its tech majors, which could reduce investment flows in the future.

China has also played a visible role in investing in ASEAN's infrastructure via its Belt and Road Initiative (BRI). The Asia-Pacific Research Exchange estimates that Chinese BRI investments in ASEAN are concentrated in Indonesia, Malaysia, the Philippines, and Vietnam.[12] However, these BRI projects have not been immune from recipient country concerns about their lack of transparency and the overburdening of projects with high levels of debt, as has become evident in parts of South Asia and Africa. In Malaysia, for example, former prime minister Mahathir Mohamad sought to renegotiate terms with Beijing during his tenure over a controversial train project. Following a one-year delay, the project was resumed after the two countries mutually agreed to cut project costs to around $11 billion.[13]

These concerns notwithstanding, ASEAN's diversity in levels of economic development, technological sophistication, and wage structure is a major

11 Cento Ventures, "Southeast Asia Tech Investment—FY 2020," March 26, 2021 ~ https://www.cento.vc/southeast-asia-tech-investment-report-full-year-2020.

12 Albert Park, Angela Tritto, and Dini Sejko, "The Belt and Road Initiative in ASEAN," HKUST Institute for Emerging Market Studies, ARX Series, December 31, 2020.

13 Joseph Sipalan, "China, Malaysia Restart Massive 'Belt and Road' Project after Hiccups," Reuters, July 24, 2019.

strategic advantage as a combination of souring geopolitics and rising wages drives investment southward from China. ASEAN wants to have its cake and eat it too by benefiting from foreign investor relocation away from China as well as by gaining access to Beijing's wallet and know-how in building quality infrastructure. The region is well-positioned for this because of varying levels of economic development (which makes it wage-competitive for foreign investors) and the simple fact that ASEAN is indispensable for economic outreach by China and other competing powers. This point was underscored by consulting firm BCG, which has stated that the region has a "golden opportunity to move up the manufacturing value chain" as geopolitics and rising costs force companies to rethink "where and how they make and source their goods."[14] The region comprises one of the world's largest, fastest-growing markets and has an extensive manufacturing base that spans light, heavy, and high-tech industries. If ASEAN can take advantage of these trends, BCG estimates that "by 2030 the region can generate up to $600 billion a year in additional manufacturing output, increase annual FDI in manufacturing by up to $22 billion, and create up to 140,000 new jobs a year."[15]

GEOPOLITICAL, ECONOMIC, AND ENVIRONMENTAL HEADWINDS AHEAD

These numbers are dazzling by any yardstick, but there is a problem with the rosy projections. The ASEAN region is hostage to turbulence in the global economy and geopolitics that it cannot completely control. Challenges include:

- Deteriorating relations between an incumbent and rising superpower—the United States and China—which will have a tangible impact on politics and economics in ASEAN and the wider region for the foreseeable future. There is a real risk of decoupling and the establishment of distinct spheres of U.S. and Chinese influence.

- The threat of deglobalization and reshoring, which jeopardizes ASEAN's economic model that is built on openness toward trade and investment.

- Finally, ASEAN is still a laggard in complying with environmental, social, and governance (ESG) standards as foreign investors step up

14 Michael Meyer et al., "How ASEAN Can Move Up the Manufacturing Value Chain," BCG, June 15, 2021.

15 Ibid.

> compliance as a result of pressure from regulators, investors, and NGOs. The region is also experiencing significant impacts from climate change due to a rise in ground temperatures and sea levels.

Geopolitics first. Singapore's foreign minister Vivian Balakrishnan was speaking for the rest of ASEAN when he told an audience in Washington, D.C., that the way competitive dynamics between the United States and China play out in trade, technology, and security will affect the region disproportionately: "Southeast Asia, which stands at the intersection of major power interests, is viewing the duet with great concern, maybe even grave concern. And one point is that for us in the middle, especially for smaller countries, we do not wish to be forced into making invidious choices."[16] On his first visit to Singapore as defense secretary, Lloyd Austin sought to reassure ASEAN partners that the United States is attempting to build a "constructive, stable relationship with China" and that, even in times of competition, Washington's enduring ties with Southeast Asia are bigger than geopolitics. He emphasized that "we are not asking countries in the region to choose between the United States and China. In fact, many of our partnerships in the region are older than the People's Republic of China itself."[17]

The worst-case scenario for ASEAN is decoupling, which would force countries into making choices that could splinter the wider region into distinct U.S. and Chinese spheres of influence, with separate channels for trade, investment, and technology flows and standards. It is no exaggeration to say that such decoupling would be an economic disaster for ASEAN, which has prided itself on its ability to host foreign investment regardless of political systems and ideology. For foreign investors, who treasure certainty and predictability when deciding to put money into a country, decoupling would also upend their business models, which are built on gaining market access to the world at large. Although decoupling concerns are tangible, to date there is little evidence that the region is splintering. Within ASEAN, there are countries such as Cambodia and Laos that are pro-China in their foreign policy approach, while Singapore and the Philippines are regarded as closer to the United States. Yet neither set of alignments has stopped Cambodia from becoming the preferred location for global fashion brands to source

16 Vivian Balakrishnan, "Seeking Opportunities Amidst Disruption" (remarks at CSIS Banyan Tree Leadership Forum, Washington, D.C., May 15, 2019).

17 Lloyd J. Austin III, "The Imperative of Partnership" (Fullerton lecture, IISS-Asia, Singapore, July 27, 2021) ~ https://www.iiss.org/blogs/podcast/2021/07/40th-fullerton-lecture-us-secretary-of-defense-austin.

supplies or Chinese companies from targeting Singapore as the base for their regional ambitions.

The second risk for ASEAN stems from concerns over deglobalization, which originated from the populist backlash in the United States and Europe manifested in Donald Trump's victory in the 2016 presidential election and the United Kingdom's Brexit referendum. As one of the single-largest beneficiaries of globalization, trade, and investment, ASEAN stands to lose out the most if U.S. and European investors, under pressure from politicians and the public at home, reverse course and reshore some of their manufacturing facilities. For ASEAN, this would represent as great an economic shock as decoupling because of the region's dependence on FDI. Covid-19 has aggravated concerns that some level of reshoring is perhaps inevitable given the persistent shortages of medical supplies and equipment at the outset of the pandemic in 2020.

To date, such concerns are not yet backed up by hard data. Although the latest data from the UN Conference on Trade and Development does show a steep 25% contraction in FDI into ASEAN in 2020 to $136 billion, the slowdown in investment flows has been attributed to the pandemic, supply chain disruptions, and delayed investment plans.[18] One country, Thailand, recorded an actual decline because of a divestment—a local business group acquired the retail operations of the United Kingdom's Tesco for $10 billion. ASEAN policymakers are also fretting about the Biden administration's "Buy America" mandate to the federal government, which they fear may lead to significant reshoring and reduce inbound investment flows.

The third risk for ASEAN is from climate change. Many countries in the region are already at risk from climate distress, and ever-higher requirements are being imposed on multinational corporations by investors and regulators in terms of ESG standards. Countries on the front line of climate distress include Indonesia, which is host to rapidly dwindling rainforests in Borneo, and Vietnam, where rising sea levels have placed low-lying coastal areas at risk from flooding. ASEAN leaders have been parsimonious in outlining their nationally determined contributions (NDCs), climate change policies that they have committed to undertake under the 2015 Paris Agreement. Indonesia is certainly the worst offender because authorities there have failed to contain devastating forest fires in Borneo from annual slash-and-burn practices by corporate palm oil plantations. The region is also promiscuous in

18 "Investment Flows to Developing Asia Defy Covid-19, Grow by 4%," UN Conference on Trade and Development, June 21, 2021.

its use of coal as the primary feedstock for power generation—a trend that is evident in the broader Asian region. "Over 80% of global coal power capacity under construction is in this region," according to Kaveh Zahidi of the UN Economic and Social Commission for Asia and the Pacific. "Our region is still the one where the greatest new investments are being made in coal and clearly that is incompatible with the ambitions of Paris."[19]

The international aid community and foreign investors have some leverage with ASEAN policymakers in bringing about a change in behavior and attitudes toward ESG and climate compliance. Sustainable development has featured as a rhetorical priority in ASEAN ministerial communiques and pledges, but tangible progress has been slow. This issue is where ASEAN's official partners and foreign investors can make a difference. In the aftermath of the pandemic, the region will be eager to boost official and private investment flows. Multilateral institutions like the World Bank and Asian Development Bank can help the region "build back better" by rigorously enforcing higher environmental and social standards. The private sector is already under pressure to do the same. Global fashion and footwear brands, for example, have imposed rigorous social standards on their suppliers in Cambodia requiring them to improve working conditions and wages. International banks and asset managers operating in the region have also used the power of their purses to force borrowers and investee companies to comply and implement rigorous ESG standards. This shift is beginning to happen with mixed results. Many international banks have pulled out of lending to polluting sectors like palm oil and coal, for example. However, this divestment has not stopped local banks in Indonesia from doubling down on lending to these sectors instead, making the net climate impact still negative. Global consumer companies, which source palm oil as a key ingredient, have also committed to using sustainable practices. Yet international NGO Greenpeace is not impressed: "After tremendous consumer pressure worldwide, many of these companies committed to put an end to deforestation and exploitation in their palm oil supply chains by 2020. None of them are on track to meet this deadline."[20] Palm oil usage as a raw material and ingredient remains pervasive in the food and cosmetic sectors, and global efforts to label the end product as sustainable based on independent validation have been unsuccessful.

---

19 Trudy Harris, "Asia Undermining Efforts to Reduce Coal Dependence," SciDev.Net, September 8, 2019.

20 "Indonesian Forests and Palm Oil," Greenpeace.

CONCLUSION

In the end, ASEAN is too open and integrated with the global economy to ignore either the real threat from global climate change or the impact it will have on future economic prospects. More than ever, the region needs to sustain its high pace of economic growth to meet rising public aspirations and concerns about stalling social mobility. There will need to be increasing convergence between the NDCs, which must be scaled up in ambition, and foreign investor preconditions on ESG rules of the road. Unlike China and India—continent-sized economies with large domestic drivers of growth—most ASEAN states rely on FDI and trade to sustain their high pace of development. A more coherent approach toward sustainable development, higher ESG standards, and tangible action on climate change would make the region even more attractive for foreign and local investors. The centerpiece of this effort is the region's aspirations to build an ASEAN Economic Community by 2025, which will require significant reworking to deal with emerging challenges of environmental and social sustainability. After enjoying favorable economic tailwinds for several decades, Southeast Asia must demonstrate that it is able to navigate climate and geopolitical headwinds to retain bragging rights as one of the world's truly spectacular economic success stories. ◈

asia policy, volume 16, number 4 (october 2021), 49–64
~ http://asiapolicy.org ~

ROUNDTABLE ESSAY

Moving Beyond Disappointment: India, FDI, and Sustainability

Mihir S. Sharma

mihir s. sharma *is the Director of the Centre for Economy and Growth at the Observer Research Foundation (India). He can be reached at <mihir.sharma@orfonline.org>.*

note: *This roundtable was made possible by the generous support of the Hinrich Foundation ~ https://www.hinrichfoundation.com.*

keywords: india; fdi; sustainable development; manufacturing; services; regulation

EXECUTIVE SUMMARY

This essay examines what lessons can be learned for sustainable finance from India's recent history of foreign investment.

MAIN ARGUMENT

India has not increased its share of FDI in recent years as much as has been hoped. Risks for FDI continue to be high, especially due to growing economic nationalism and flawed dispute resolution mechanisms. The destinations for the investment India receives are strongly shaped by the risk perceptions of foreign investors—they prefer the stock market, services sector, and projects with minimal upfront investment and no political exposure. This has hindered the government's attempts to mobilize investment into the manufacturing sector and has negative implications also for sustainable finance. Most green infrastructure projects in India, or those related to sustainable development, do not fit the risk profile preferred by foreign investors. Thus, judging by India's recent history with FDI, energizing sustainable finance into India will require deeper reform.

POLICY IMPLICATIONS

- The Indian government will have to bring its actual regulation of foreign investment closer to its welcoming rhetoric to improve the climate for FDI.
- To attract greater levels of investment, attempts to favor "Indian" companies over others in various sectors must end.
- Dispute resolution mechanisms must be reformed to encourage FDI—both by expanding capacity in India's judicial system and by accepting international arbitration awards.
- Sectors in India crucial to sustainable and greener development, such as renewable energy and green infrastructure, will need to be ring-fenced from political risk.

India's star may be rising, but as a destination for foreign investment to help power that economic rise, not enough has changed. India's performance as a destination for FDI is dependent not just on its position as a lower-middle-income economy but also on its relatively mature financial markets that coexist with a regulatory and judicial environment that can be quite arbitrary. This essay will examine four areas of interest regarding FDI flows into India. First, data suggests India is disappointing as an FDI destination. Second, manufacturing in India has been a particular letdown in spite of the recent government focus on encouraging FDI to the sector. Third, these issues may be caused in part by poor dispute settlement mechanisms, arbitrariness at the state level, and discrimination against foreign investors—in essence, a poor climate for FDI. And fourth, these same problems are likely holding back what would otherwise be a sizable flow of funds into sectors relevant for India's sustainable development, including private climate finance.

FDI IN INDIA: HOW MUCH, WHERE, AND IN WHAT?

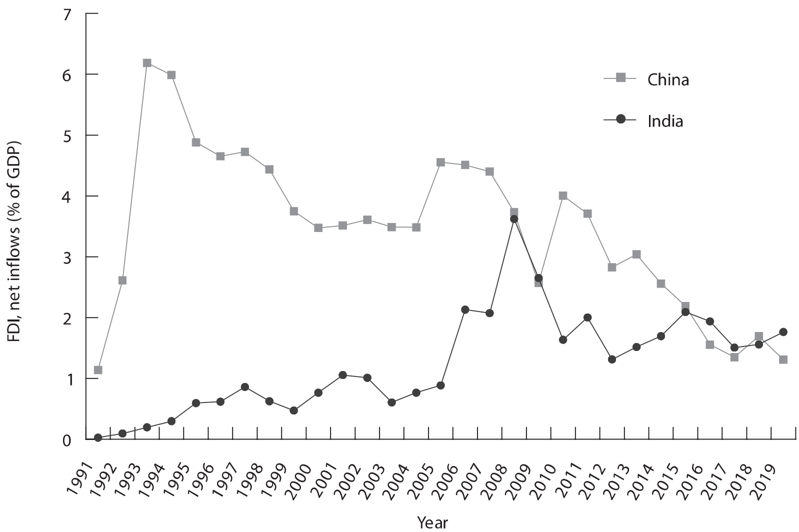
For Indian analysts, the most crucial comparison in terms of the country's success in attracting FDI is China. The fact is, however, that FDI has never been as much of a driver of growth in India as it has been in China, where it has been an order of magnitude greater. Importantly, FDI has historically been a considerably larger proportion of China's GDP than that of India (**Figure 1**) ever since India began economically liberalizing in 1991. As the figure demonstrates, FDI has consistently been a major component of China's GDP and a larger proportion of gross investment into its economy. By Chinese government estimates, enterprises depending on foreign investment represented over 50% of China's trade in 2010, produced 30% of its manufacturing, and 22% of that sector's profits.[1]

In other words, unlike India, China in its economic rise did not have to depend so much on internal savings for investment. Briefly, in the mid-2000s—when India had a short-lived growth spurt that reached China-like double-digit growth—the two lines converged. But subsequently, even though FDI in China has trailed off as domestic private investment has increased and the policy environment there has turned adverse, India has not been able to raise the amount of FDI it receives as a percentage of its GDP to the levels that China achieved during its period of rapid industrialization

1 "FDI—The China Story," World Bank, July 16, 2010 ~ https://www.worldbank.org/en/news/feature/2010/07/16/foreign-direct-investment-china-story.

FIGURE 1

India and China, Comparative FDI Percentage since 1991



Source: World Bank, DataBank, https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?end=2019&locations=IN&name_desc=true&start=2007.

from the mid-1990s onward. In 2018 the share of FDI as a percentage of gross capital formation in the economy was only 5.1%, a mere two percentage point increase in two decades.[2]

How Much?

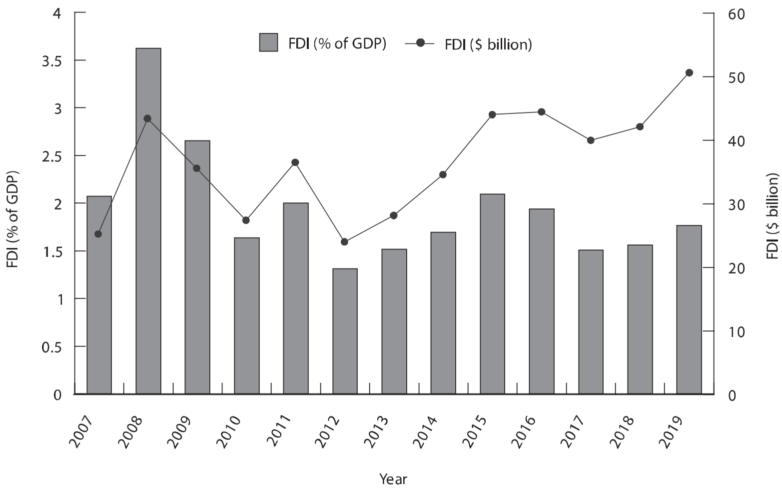
A closer look at India's more recent experience puts this in perspective. **Figure 2** shows FDI in India as a percentage of GDP since just before the global financial crisis of 2008.

If considered only in dollar terms, FDI appears to follow an upward trend. By 2019, India was regularly receiving more FDI than it did in 2008. However, when considered as a percentage of GDP—in other words, by measuring its contribution to the Indian economy more broadly—FDI seems to have largely stagnated for more than a decade. And while there has been a rising trend of

2 Keshab Bhattarai and Vipin Negi, "FDI and Economic Performance of Firms in India," *Studies in Microeconomics* 8, no. 1 (2020): 44–74 ~ http://doi.org/10.1177/2321022220918684.

FIGURE 2

FDI in India since the Financial Crisis



Source: World Bank, DataBank.

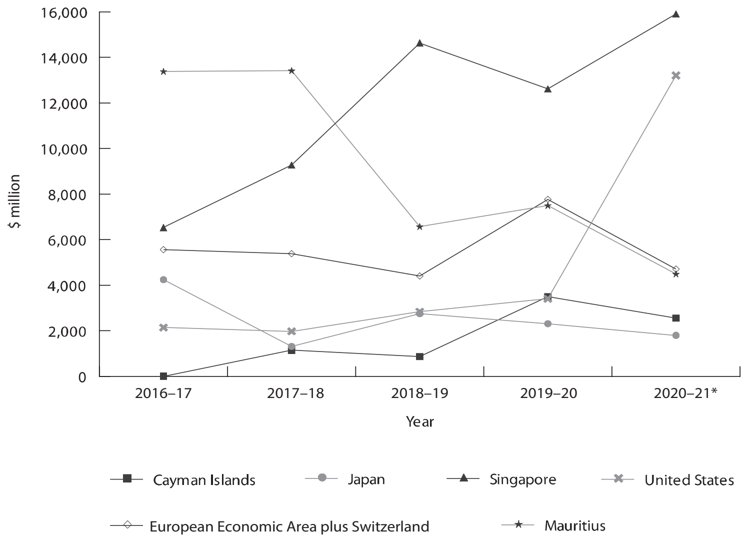
FDI into India as a proportion among lower-middle-income countries since 2012, India has still not generally received the share it did in 2009. In other words, this is not a breakout period for FDI.

From and to Where?

Tracking the source of FDI over time is revealing in its own way. Consider **Figure 3**, which looks at the movements of some major investors into India. These include locations such as Singapore, the Cayman Islands, and Mauritius—all low-tax jurisdictions that may well serve as conduits for capital from elsewhere. The declining figures for Mauritius over time are likely a consequence of India's renegotiation of a tax treaty in response to concerns that a lot of FDI was actually "round-tripping," or Indian money being reinvested in the Indian economy via low-tax jurisdictions to evade or avoid taxes. The most sustained and transparent investment comes from Europe (here an aggregate of several major economies in the European Economic Area plus Switzerland). If the United Kingdom were included, as it was prior to Brexit, most years the figure for Europe would be 20%–25% higher. The presence of major low-tax jurisdictions and possible

FIGURE 3

The Six Largest Sources of FDI to India since 2016 by Jurisdiction



Source: Reserve Bank of India, "Annual Report of the Reserve Bank of India," May 27, 2021 ~ https://m.rbi.org.in/Scripts/AnnualReportPublications.aspx?Id=1336.

Note ~ Asterisk indicates data is provisional.

round-tripping among the major investors in the Indian economy suggests that the real figure for FDI might be considerably below even the relatively discouraging official figures.

As for the geographical distribution of FDI across the country, Indian authorities do not issue disaggregated figures. State competition for FDI usually takes the form of inflated project announcements, few of which usually come to fruition.[3] Competition between state governments tends to be somewhat self-defeating, as the end goal is not necessarily increasing investment flows in a sustained manner but rather ensuring that positive headlines of investor intent dominate the intrastate political conversation for a few news cycles.

3 Sebastian P.T., "How Vibrant Is the Gujarat Growth Story?" *Business Today*, February 6, 2013 ~ https://www.businesstoday.in/magazine/features/story/vibrant-gujarat-summit-discordant-notes-38673-2013-02-06.

Recent econometric research into the geographical distribution of FDI in India has revealed that it is sharply limited. According to Soumya Bhowmick and Roshan Saha, "FDI inflows in the country have tended to concentrate in three economic belts: Delhi (North); Maharashtra-Gujarat (West); and Karnataka–Tamil Nadu–Andhra Pradesh–Telangana (South)."[4] They show that, in fact, the overwhelming majority of FDI flows into just 7 of India's 30-odd states and territories, with the lesser beneficiaries receiving less than 10% of the remainder with considerable variation between years.

There are five macroeconomic facts that need to be reiterated for the rest of this analysis. First, India's record in receiving FDI trails China's not just in absolute terms but also relative to the size of its economy and is therefore less of a motive force for India's economy than in China's case. Second, in dollar terms, India has seen a substantial recovery in FDI since it suffered a mini-economic crisis in the early 2010s (a crisis coincident with the "taper tantrum" affecting emerging economies following the U.S. Federal Reserve's announcement that it would begin the withdrawal of quantitative easing after the global financial crisis). Third, this recovery has nevertheless not resulted in FDI accounting for more than 1.5%–2.0% of its overall GDP. Fourth, India's FDI might be underestimated in official data and is concentrated in a few high-performing states. And fifth, India has maintained and perhaps even slightly improved its position as drawing between a quarter and a third of the FDI eligible for its class of emerging economies over the last decade.

This last point might in fact be considered discouraging, given that recent years have seen decreased interest in investing in the Chinese economy and that India could therefore have increased its share of global FDI at China's expense. Yet this has not happened to the degree that was expected about a decade ago. In particular, following the 2014 election of Narendra Modi as prime minister, expectations that accelerated economic reform would ensure that India became a major FDI magnet—perhaps even an investment class in and of itself the way that China had—have been belied.

In What?

Indeed, the false dawn for foreign investment in India since 2014 is well worth investigating more closely. In his first major speech as prime minister, Modi focused on selling India as a destination for FDI into mass manufacturing, which he correctly argued would produce jobs essential to

4 Roshan Saha and Soumya Bhowmick, *Foreign Direct Investments in Indian States: The SDG Cornerstones* (New Delhi: Observer Research Foundation, 2020).

employ India's burgeoning youth population. In August 2014, on Indian Independence Day, he said:

> Now India cannot decide its future by remaining isolated and sitting alone in a corner…. I want to appeal to all the people world over, from the ramparts of Red Fort, "Come, make in India," "Come, manufacture in India." Sell in any country of the world but manufacture here. We have skill, talent, discipline, and determination…. [F]rom electrical products to electronics, "Come, Make in India"; from automobiles to agri-business value addition, "Come, Make in India"; paper or plastic, "Come, Make in India"; satellite or submarine, "Come, Make in India." Our country is powerful. Come, I am giving you an invitation.[5]

As Figures 1 and 2 above show, there was a spurt of interest in Indian FDI in the year or two following this declaration of intent by India's most powerful prime minister in three decades. Yet not just the overall FDI level underwhelmed, but so did its composition. It was the services sector, not manufacturing, into which FDI flowed in subsequent years (**Figure 4**).

The largest sectoral components of FDI tell a similar story of decreasing interest in manufacturing (**Figure 5**). Thus, a major point of inquiry should be why, in spite of a rhetorical commitment, has manufacturing distinctly underperformed—even by the low standards set for FDI in India?

This is not just because manufacturing growth continues to be the best bet for an enduring increase in living standards for a country with a surplus of low-skilled labor. A further consideration must be that the constraints holding back manufacturing investment will also likely impact the flow of funds into sustainable or greener sectors in coming years.

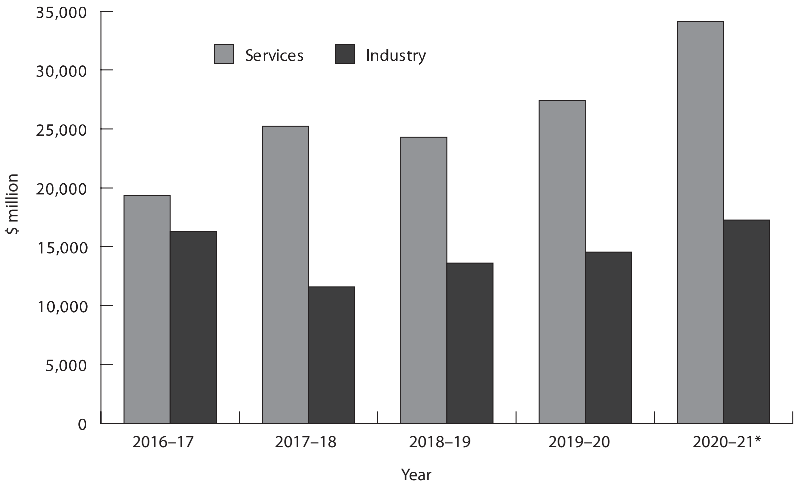
RISKS, RETURNS, AND NARRATIVES

India's mechanism for classification of FDI is in itself considerably revealing of the preferred mechanisms for investing in the Indian economy. The usual understanding of FDI is that it represents a long-term investment in a particular economy and is often associated with the notion that the investor is taking on local entrepreneurial and managerial risk. This is often distinguished from foreign portfolio investment, which could include speculative capital flows. Usually this form of investment can leave open economies considerably quicker than the capital embedded in FDI and so has less exposure to the risk.

5 Narenda Modi, "Text of Narendra Modi's I-Day Address," reprinted in the *Deccan Herald*, August 15, 2014 ~ https://www.deccanherald.com/content/425622/text-narendra-modis-day-address.html.

FIGURE 4

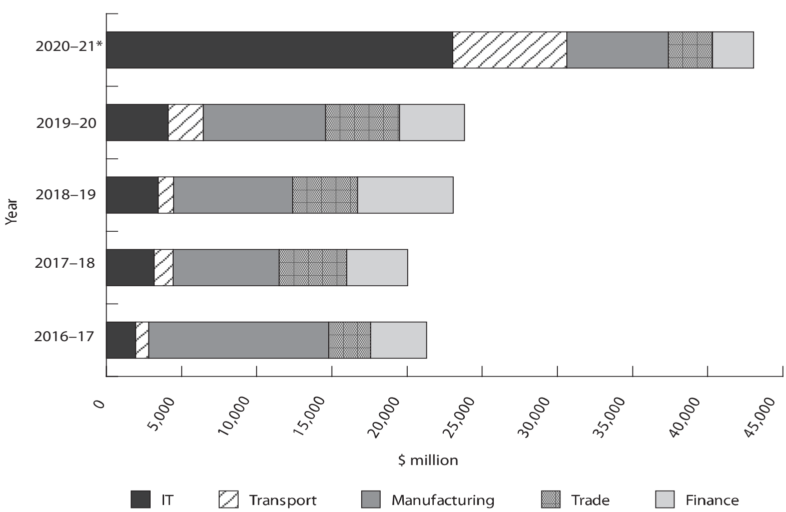
A Comparison of FDI into Services and Industry in India



Source: Reserve Bank of India, "Annual Report of the Reserve Bank of India."
Note ~ Asterisk indicates data is provisional.

FIGURE 5

The Biggest Sectors for FDI in Recent Years



Source: Reserve Bank of India, "Annual Report of the Reserve Bank of India."
Note ~ Asterisk indicates data is provisional.

There are multiple risk profiles that investors consider when making a foreign investment: multidimensional country risk; institutional risk, the product of underdeveloped regulation or dispute settlement; and political risk, the exposure to administrative or policymaking caprice.[6] FDI into developing countries in particular is a complex learning process for investors, requiring an understanding of the incomplete nature of institutions and differences in political systems.[7]

The crucial point here is that the level of institutional completeness can vary greatly across sectors and forms of investment. There is a common intuition, for example, that investment in extractive sectors, such as mining, carries considerably more exposure to various forms of country risk than in consumer goods, such as soft drinks. Most current measures of risk, such as the widely used Political Constraint Index dataset at Wharton,[8] fail to make a clear distinction between these sectors. Even the World Bank's "Ease of Doing Business" ranking has treated each country as a single unit, ignoring not just vast regional disparities in investment climate but also even vaster sectoral differences in risk exposure.

In India there are big differences in risk profiles between states, across sectors, and depending on the instrument used for investment. Indian stock markets are typically well-regulated, and the Securities and Exchange Board of India is generally accepted to be independent and effective. It is true that, as in many countries with large family-owned conglomerates, minority shareholders in a corporation are often at risk of malpractice by those with a controlling stake—called "promoters" in India. Yet securities regulation and legislation are relatively effective in protecting investors in the stock markets as well as those in the (far more limited) regulated markets for debt. Corporate governance and transparency requirements are carefully considered and often revised. The stock markets are, in addition, relatively liquid with a large pool of domestic institutional investors, and thus exiting an investment is not usually a problem.

Foreign companies that invest "directly" in sectors such as highways, electricity, or manufacturing—by, for example, finding a partner, buying land,

6 Peter J. Buckley et al., "Experience and FDI Risk-Taking: A Microfoundational Reconceptualization," *Journal of International Management* 22, no. 2 (2016): 131–46.

7 Andrew Delios and Witold J. Henisz, "Political Hazards, Experience, and Sequential Entry Strategies: The International Expansion of Japanese Firms, 1980–1998," *Strategic Management Journal* 24, no. 11 (2003): 1153–64.

8 Witold J. Henisz, "Political Constraint Index (POLCON) Dataset," Wharton School of the University of Pennsylvania ~ https://mgmt.wharton.upenn.edu/faculty/heniszpolcon/polcondataset.

signing contracts with suppliers and purchasers, or hiring labor—are exposed to far more risk than those who invest in Indian securities markets or those who buy stakes in large companies that are not listed on a stock exchange. At each point in the direct chain, there is uncertainty regarding regulation and dispute resolution (e.g., difficulty in dealing with duplicitous local partners in the Indian judicial system, or restrictive labor laws that allow arbitrary action by labor commissioners). The institutional support and structure for financial investment into existing companies is far more reliable. The contrast is remarkable: in the World Bank's "Doing Business" ranking, in enforcement of contracts, India placed 163rd out of 190 countries; in protection of minority investors, it is 13th in the world.[9]

It would be reasonable to expect, therefore, that foreign investment into India through the well-regulated securities markets would vastly outweigh direct investment on the ground. Perhaps this is the case, but since a 2013 rule change on how investment is classified in India, the two have become hard to tell apart in the data. With the change, "foreign direct investment" became henceforth all foreign investment into India, regardless of method, route, or instrument, that bought more than 10% of a listed company.

As a consequence, India's FDI data does not necessarily reflect investors' appetite for direct investment per se. A significant portion of FDI appears to be the purchase of large stakes in companies without major exposure to the complete set of risks traditionally associated with FDI. Movements in macro-sectoral FDI data can thus often be tracked to major stock transfers, mergers, and acquisitions. In the past, large share buybacks and even multinationals retaking majority control of their subsidiaries have pushed FDI numbers upward. The 2020 data for FDI into the information technology sector, for example, appears to have spiked upward dramatically (Figure 5), perhaps because of a series of billion-dollar investments into tech company Reliance Jio by companies and funds such as KKR, Silver Lake, the Abu Dhabi and Saudi sovereign wealth funds, Google, Intel, and Facebook.[10]

However, the preference for financialized mergers and acquisitions over more traditional FDI does not mean there is no risk. In fact, the actual experience of many major investments in India, regardless of sector and mechanism, has been troubled. Consider just a few major source regions for financial investment capital, including institutional capital:

9 World Bank, "Doing Business" ~ https://www.doingbusiness.org/en/data/exploreeconomies/india.

10 Grady McGregor, "11 Deals for $15 Billion in 10 Weeks: Why India's Jio Platforms Is on an Investment Spree," *Fortune*, June 20, 2020 ~ https://fortune.com/2020/06/20/mukesh-ambani-jio-platforms-deals.

the United Arab Emirates, Japan, South Korea, the United Kingdom, and the Nordic states. Over the past ten years, each has seen a headline FDI project in India suffer catastrophic capital loss due to state action of one kind or another. Etisalat (UAE) and Telenor (Norway) lost their entire investments in India after the supreme court unilaterally canceled second-generation spectrum allocations.[11] Telenor's accumulated losses in India approached $3 billion when it exited the country in 2017 after less than a decade.[12] South Korean steelmaker POSCO lost its capital in a giant new factory in eastern India—which at $12 billion was long India's largest single foreign investment[13]—after the government reneged on various promises. The Anglo-Dutch company Vodafone struggled when Indian tax authorities issued an enormous retrospective tax demand. Japan's DOCOMO lost $1.3 billion in Indian telecom, and then found it could not even exit the joint venture because the Reserve Bank of India objected to the settlement, though the Delhi High Court eventually overruled the central bank.[14]

The greatest fear for investors is not underperformance but catastrophic capital loss. A series of high-profile FDI failures in India had, by the mid-2010s, significantly reduced investor appetite for Indian projects. When considering the future flow of sustainable investment, it is vital to understand that many relevant sectors—green infrastructure and renewable energy, in particular—need committed capital at a high level early in the project. A country in which investors worry about catastrophic capital loss is one that will have difficulty attracting projects with a front-loaded financial profile.

RHETORIC AND REALITY

A stated aim of India at both the union and provincial levels has been to reverse this narrative. Modi's call for investment in his first major speech

11 "Telenor's India Loss to Be Biggest by a Norwegian Company Abroad," *Business Standard*, January 21, 2013 ~ https://www.business-standard.com/article/companies/telenor-s-india-loss-to-be-biggest-by-a-norwegian-company-abroad-112051300013_1.html.

12 Sunny Sen, "Telenor Exits India as Airtel Acquires Local Arm to Fight Reliance Jio," *Hindustan Times*, February 23, 2017 ~ https://www.hindustantimes.com/business-news/telenor-exits-india-as-airtel-acquires-its-operations/story-Lt5i5JDUafAnLvAfm6GdHP.html.

13 Penny McRae, "India Approves $12 Billion Steel Plant Built by POSCO," *IndustryWeek*, January 31, 2011 ~ https://www.industryweek.com/the-economy/environment/article/21941199/india-approves-12-billion-steel-plant-built-by-posco.

14 Ben Carroll, "Delhi High Court Rejects RBI's Intervention in Arbitration Proceedings to Which It Is Not a Party," Linklaters, September 21, 2017 ~ https://www.linklaters.com/fr-fr/insights/blogs/arbitrationlinks/2017/september/delhi-high-court-rejects-rbis-intervention-in-arbitration-proceedings-to-which-it-is-not-a-party.

kickstarted an assiduous attempt to woo foreign investment. Several policy changes were made to this effect, many of which were long overdue.

Perhaps most significant was the 2017 replacement of the Foreign Investment Promotion Board, which oversaw and approved all major investments in India, with a more streamlined process designed to reduce the number of possible bureaucratic vetoes or delays.[15] FDI oversight in India is determined by sectoral caps on foreign ownership; for each sector, foreign investment in a company up to a particular level is allowed without government approval, and to a higher limit with government approval. In recent years, these caps have been relaxed in various sectors, including some that were initially argued should be domestically controlled for strategic reasons. In much of the defense sector, for example, since 2014, foreign ownership up to 74% is allowed without approval, and completely foreign-owned companies are now permitted with government oversight. Similar relaxations have been pushed through in pharmaceuticals, insurance, coal mining, construction, aviation, and even railway infrastructure.[16] This list of sectors is perhaps revealing of the government's motivation. FDI reforms are not necessarily driven by a desire to open India's economy to foreign investment but by specific funding constraints in particular sectors—especially related to infrastructure finance, where there has been a decade-long private investment crisis.

It is worth noting, however, that by global standards India continues to be objectively restrictive of foreign equity holding. The OECD's FDI Index for 2020 ranks legal and regulatory restrictions on FDI in OECD members alongside those in several major emerging economies. In its ranking, India remains close to the bottom of the list, with only China, Indonesia, Russia, and New Zealand doing worse.[17] Yet recent measures, ostensibly designed to attract more FDI, have not had the effect expected—and in fact may even have been counterproductive. Some of them, for example, appeared to permit FDI in sectors where most investors believed it was already allowed—creating uncertainty about the scope of other sectoral regulations.

A fraught example has been electronic retail. Amazon and Walmart are among the biggest recent foreign investors in India, but policy regulating foreign investment in retail has been subject to multiple revisions that have

---

15 "FIPB Abolition: Will the Wheels of Foreign Investment Approval Slow Down," *Economic Times* (India), July 15, 2017 ~ https://economictimes.indiatimes.com/small-biz/legal/fipb-abolition-will-the-wheels-of-foreign-investment-approval-slow-down/articleshow/59605833.cms.

16 Department for the Promotion of Industry and Internal Trade (India), "Foreign Direct Investment Reforms in India," June 11, 2021 ~ https://dpiit.gov.in/sites/default/files/FDI-Reforms-11June2021.pdf.

17 Organisation of Co-operation and Economic Development (OECD), "OECD Foreign Direct Investment Regulatory Restrictiveness Index," http://goingdigital.oecd.org/en/indicator/74.

effectively changed the rules of the game for investors after the investments have been made. There are indications that the government intends to favor Indian companies over foreign ones in retail and other sectors. The World Bank has described new e-commerce rules in India as "targeting only foreign firms" and "creating an unlevel playing field."[18] In fact, the commerce minister said that Amazon, which had just committed over one billion dollars in investment, was "not doing us a favor."[19]

Several other substantive changes by the government have effectively undermined India's attempts to become an attractive FDI destination. Shortly after Modi took office in 2014, the administration unilaterally terminated many of India's bilateral investment treaties, with 74 of 87 revoked by December 2020.[20] Research has suggested that this action has had a substantial effect on FDI and caused a relative reduction of 14%–28% in investment flows.[21] In 2016, India published a new model bilateral investment treaty that has been described as "tilting the scales in favor of the host state" over the protection of foreign investors.[22] At the same time, the Indian government has actively fought, and in most cases lost, major arbitration cases filed by foreign investors, including by Vodafone and the Scottish energy company Cairn. In both cases, it has also refused to implement arbitration rulings, leading Cairn to take action and impound Indian government property worldwide, including diplomatic apartments in Paris.[23]

An incomplete approach to dispute settlement is one reason why manufacturing suffers compared to services, as well as why sustainable investment going forward will have to closely consider various forms of political risk.

---

18 World Bank, *World Development Report 2021: Data for Better Lives* (Washington, D.C.: World Bank Group, 2021).

19 Neha Alawadhi and Subhayan Chakraborty, "Amazon Not Doing India a Favour by Investing Billion Dollars: Piyush Goyal," *Business Standard*, January 17, 2020 ~ https://www.business-standard.com/article/economy-policy/amazon-not-doing-india-a-favour-by-investing-billion-dollars-piyush-goyal-120011601673_1.html.

20 Abhishek Dwivedi, "India's Flawed Approach to Bilateral Investment Treaties," *Diplomat*, December 4, 2020 ~ https://thediplomat.com/2020/12/indias-flawed-approach-to-bilateral-investment-treaties.

21 Simon Hartmann and Rok Spruk, "The Impact of Unilateral Bilateral Investment Treaties Terminations on FDI: Evidence from a Natural Experiment," *International Trade eJournal* (2020) ~ http://dx.doi.org/10.2139/ssrn.3591529.

22 Prabhash Ranjan and Pushkar Anand, "The 2016 Model Indian Bilateral Investment Treaty: A Critical Deconstruction," *Northwestern Journal of International Law and Business* 38 (2017) ~ https://scholarlycommons.law.northwestern.edu/njilb/vol38/iss1/1.

23 David Sheppard, Amy Kazmin, and David Keohane, "Cairn Energy Freezes Indian State-Owned Properties in Paris," *Financial Times*, July 8, 2021.

A SUSTAINABLE FUTURE?

There are both differences and overlaps between fund flows categorized as "green" or "climate finance" and those categorized as "sustainable and responsible" investment (SRI). Either way, however, reliable estimates of these fund flows into the Indian economy are rare. Climate Policy Initiative has estimated that FDI categorized as climate-related accounted for only one billion dollars per year in 2018–19 and that it was "allocated almost exclusively to the clean energy sector and was almost equally split between solar and wind energy projects due to the presence of advanced markets. While FDI inflows into the clean energy sector have been steadily increasing…they still account for only 1% of the total FDI flows into the economy."[24] SRI funds, as estimated by the Shakti Foundation in 2019, are higher but demonstrate a similar bias toward public rather than private investment.[25] In both cases, domestic private financing is an order of magnitude greater than foreign public financing—which in turn is overwhelmingly more than foreign direct private investment.

The Indian government's commitment to several sustainable sectors—from the modernization of water access to electric mobility to renewable power generation—is incontrovertible. However, an unfortunate comparison can be made to its emphasis on mass manufacturing as a destination for FDI in the years since 2014. Though India's rhetorical commitment was compelling, actions on the ground led to the promise of increased FDI in manufacturing being belied. Similar levels of risk are even now being observed in the relatively successful, ring-fenced sector of solar-power generation. Power purchase agreements signed with state governments have become a particular problem. These have to be implemented by publicly owned electricity distribution companies that are typically bankrupt and hold back on paying renewable energy companies. There was at least one well-publicized occasion in which a transfer of power at the state level led to the government reneging on all its agreements signed with private-sector renewable energy suppliers.[26]

Like in manufacturing, the threat of catastrophic capital loss and regulatory and political risk is thus especially real for sectors that are the focus

---

24 Mahua Acharya et al., "Landscape of Green Finance in India," Climate Policy Initiative, September 11, 2020 ~ https://www.climatepolicyinitiative.org/publication/landscape-of-green-finance.

25 "Catalysing Private Capital for Green Investments in India," Shakti Sustainable Energy Foundation, 2019 ~ https://shaktifoundation.in/report/catalysing-private-capital-for-green-investments-in-india.

26 Haripriya Suresh, "Explained: The Tussle between Andhra Govt and Renewable Energy Producers," News Minute, August 17, 2019 ~ https://www.thenewsminute.com/article/explained-tussle-between-andhra-govt-and-renewable-energy-producers-107381.

of sustainable and responsible FDI. Without reforms to the political, judicial, administrative, and regulatory climate to help FDI into manufacturing, investment into capital-heavy, politically exposed sectors relevant for sustainable development will be similarly disappointing. ◈