

Reducing Trade Costs in Asia and the Pacific: Impact on Foreign Direct Investment

Countries that implement trade facilitation reforms and enhance trade efficiency and connectivity are generally expected to attract more foreign direct investment (FDI). Using a unique bilateral dataset on FDI flows covering both OECD and developing economies in Asia and the Pacific, UN ESCAP estimated gravity models of FDI featuring relevant trade costs and trade facilitation indicators.

The findings of the ESCAP analysis indicate that the quality of the business regulatory environment is generally the key determining factor in attracting FDI. However, evidence suggests that high trade costs also have a significant impact on FDI. A one percent reduction in comprehensive international trade costs (excluding tariff) between source and host country leads to a 0.8 percent increase in FDI inflows on average. Import tariffs of the host country are also found to have a significant but small negative impact on FDI inflows.

In the Asia-Pacific region, if measures are taken by high-tariff countries to reduce the average tariff to that of the developing country average this would result in a 6-7% increase in FDI inflows to the region. Moreover, reducing other types of trade costs in high-cost countries in Asia-Pacific to the developing country average can be expected to increase FDI flows by 20%.

In turn, a moderate improvement in the quality of the domestic business environment by just 10% on average across the Asia-Pacific region would increase FDI flows by over 60%. Improving shipping liner connectivity of all lagging countries in the sample to match the developing country average would also significantly increase FDI, but this would likely require massive investment in maritime infrastructure in many countries.

Overall, the analysis fully supports the view that trade facilitation should be a core component of any foreign direct investment development strategy and provides further evidence of the benefits associated with enhancing trade efficiency.

Source:

Duval, Y. and Utokham, C. (2014) Impact of Trade Facilitation on Foreign Direct Investment, ESCAP Trade and Investment, Working Paper Series No. 04/14, Bangkok¹

For other notes on Reducing Trade Costs in Asia and the Pacific see: <http://www.unescap.org/resources/notes-reducing-trade-costs-asia-and-pacific>

This note, based on in-house research and analysis, is a contribution by the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) to The Fifth Global Review of Aid for Trade (July 2015) organized at the WTO on the theme of "Reducing Trade Costs for Inclusive, Sustainable Growth". For more information on ESCAP's work on reducing trade costs and trade facilitation, please visit: <http://www.unescap.org/our-work/trade-investment/trade-facilitation>

¹ <http://www.unescap.org/resources/impact-trade-facilitation-foreign-direct-investment>

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