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WORLD INVESTMENT REPORT 2014

INVESTING IN THE SDGs: AN ACTION PLAN

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PREFACE

This edition of the World Investment Report provides valuable analysis that can inform global discussions on how to accelerate progress toward the Millennium Development Goals and shape a long-range vision for a more sustainable future beyond 2015.

The Report reveals an encouraging trend: after a decline in 2012, global foreign direct investment flows rose by 9 per cent in 2013, with growth expected to continue in the years to come. This demonstrates the great potential of international investment, along with other financial resources, to help reach the goals of a post-2015 agenda for sustainable development. Transnational corporations can support this effort by creating decent jobs, generating exports, promoting rights, respecting the environment, encouraging local content, paying fair taxes and transferring capital, technology and business contacts to spur development.

This year's World Investment Report offers a global action plan for galvanizing the role of businesses in achieving future sustainable development goals, and enhancing the private sector's positive economic, social and environmental impacts. The Report identifies the financing gap, especially in vulnerable economies, assesses the primary sources of funds for bridging the gap, and proposes policy options for the future.

I commend this Report to all those interested in steering private investment towards a more sustainable future.

BAN Ki-moon
Secretary-General of the United Nations

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GLOBAL INVESTMENT TRENDS

Cautious optimism returns to global foreign direct investment (FDI). After the 2012 slump, global FDI returned to growth, with inflows rising 9 per cent in 2013, to $1.45 trillion. UNCTAD projects that FDI flows could rise to $1.6 trillion in 2014, $1.7 trillion in 2015 and $1.8 trillion in 2016, with relatively larger increases in developed countries. Fragility in some emerging markets and risks related to policy uncertainty and regional instability may negatively affect the expected upturn in FDI.

Developing economies maintain their lead in 2013. FDI flows to developed countries increased by 9 per cent to $566 billion, leaving them at 39 per cent of global flows, while those to developing economies reached a new high of $778 billion, or 54 per cent of the total. The balance of $108 billion went to transition economies. Developing and transition economies now constitute half of the top 20 ranked by FDI inflows.

FDI outflows from developing countries also reached a record level. Transnational corporations (TNCs) from developing economies are increasingly acquiring foreign affiliates from developed countries located in their regions. Developing and transition economies together invested $553 billion, or 39 per cent of global FDI outflows, compared with only 12 per cent at the beginning of the 2000s.

Megaregional groupings shape global FDI. The three main regional groups currently under negotiation (TPP, TTIP, RCEP) each account for a quarter or more of global FDI flows, with TTIP flows in decline, and the others in ascendance. Asia-Pacific Economic Cooperation (APEC) remains the largest regional economic cooperation grouping, with 54 per cent of global inflows.

The poorest countries are less and less dependent on extractive industry investment. Over the past decade, the share of the extractive industry in the value of greenfield projects was 26 per cent in Africa and 36 per cent in LDCs. These shares are rapidly decreasing; manufacturing and services now make up about 90 per cent of the value of announced projects both in Africa and in LDCs.

Private equity FDI is keeping its powder dry. Outstanding funds of private equity firms increased to a record level of more than $1 trillion. Their cross-border investment was $171 billion, a decline of 11 per cent, and they accounted for 21 per cent of the value of cross-border mergers and acquisitions (M&As), 10 percentage points below their peak. With funds available for investment ("dry powder"), and relatively subdued activity in recent years, the potential for increased private equity FDI is significant.

State-owned TNCs are FDI heavyweights. UNCTAD estimates there are at least 550 State-owned TNCs – from both developed and developing countries – with more than 15,000 foreign affiliates and foreign assets of over $2 trillion. FDI by these TNCs was more than $160 billion in 2013. At that level, although their number constitutes less than 1 per cent of the universe of TNCs, they account for over 11 per cent of global FDI flows.

REGIONAL INVESTMENT TRENDS

FDI flows to all major developing regions increased. Africa saw increased inflows (+4 per cent), sustained by growing intra-African flows. Such flows are in line with leaders' efforts towards deeper regional integration, although the effect of most regional economic cooperation initiatives in Africa on intraregional FDI has been limited. Developing *Asia* (+3 per cent) remains the number one global investment destination. Regional headquarter locations for TNCs, and proactive regional investment cooperation, are factors driving increasing intraregional flows. *Latin America and the Caribbean* (+6 per cent) saw mixed FDI growth, with an overall positive due to an increase in Central America, but with an 6 per cent decline in South America. Prospects are brighter, with new opportunities arising in oil and gas, and TNC investment plans in manufacturing.

Structurally weak economies saw mixed results. Investment in the *least developed countries* (LDCs) increased, with announced greenfield investments signalling significant growth in basic infrastructure and energy projects. *Landlocked developing countries* (LLDCs) saw an overall decline in FDI. Relative to the size of their economies, and relative to capital formation, FDI remains an important source of finance there. Inflows to *small island developing States* (SIDS) declined. Tourism and extractive industries are attracting increasing interest from foreign investors, while manufacturing industries have been negatively affected by erosion of trade preferences.

Inflows to developed countries resume growth but have a long way to go. The recovery of FDI inflows in developed countries to $566 billion, and the unchanged outflows, at $857 billion, leave both at half their peak levels in 2007. Europe, traditionally the largest FDI recipient region, is at less than one third of its 2007 inflows and one fourth of its outflows. The United States and the European Union (EU) saw their combined share of global FDI inflows decline from well over 50 per cent pre-crisis to 30 per cent in 2013.

FDI to transition economies reached record levels, but prospects are uncertain. FDI inflows to transition economies increased by 28 per cent to reach $108 billion in 2013. Outward FDI from the region jumped by 84 per cent, reaching a record $99 billion. Prospects for FDI to transition economies are likely to be affected by uncertainties related to regional instability.

INVESTMENT POLICY TRENDS AND KEY ISSUES

Most investment policy measures remain geared towards investment promotion and liberalization. At the same time, the share of regulatory or restrictive investment policies increased, reaching 27 per cent in 2013. Some host countries have sought to prevent divestments by established foreign investors. Some home countries promote reshoring of their TNCs' overseas investments.

Investment incentives mostly focus on economic performance objectives, less on sustainable development. Incentives are widely used by governments as a policy instrument for attracting investment, despite persistent criticism that they are economically inefficient and lead to misallocations of public funds. To address these concerns, investment incentives schemes could be more closely aligned with the SDGs.

International investment rule making is characterized by diverging trends: on the one hand, disengagement from the system, partly because of developments in investment arbitration; on the other, intensifying and up-scaling negotiations. Negotiations of "megaregional agreements" are a case in point. Once concluded, these may have systemic implications for the regime of international investment agreements (IIAs).

Widespread concerns about the functioning and the impact of the IIA regime are resulting in calls for reform. Four paths are becoming apparent: (i) maintaining the status quo, (ii) disengaging from the system, (iii) introducing selective adjustments, and (iv) undertaking systematic reform. A multilateral approach could effectively contribute to this endeavour.

INVESTING IN THE SDGs: AN ACTION PLAN FOR PROMOTING PRIVATE SECTOR CONTRIBUTIONS

Faced with common global economic, social and environmental challenges, the international community is defining a set of Sustainable Development Goals (SDGs). The SDGs, which are being formulated by the United Nations together with the widest possible range of stakeholders, are intended to galvanize action worldwide through concrete targets for the 2015–2030 period for poverty reduction, food security, human health and education, climate change mitigation, and a range of other objectives across the economic, social and environmental pillars.

The role of the public sector is fundamental and pivotal, while the private sector contribution is indispensable. The latter can take two main forms, good governance in business practices and investment in sustainable development. Policy coherence is essential in promoting the private sector's contribution to the SDGs.

The SDGs will have very significant resource implications across the developed and developing world. Global investment needs are in the order of $5 trillion to $7 trillion per year. Estimates for investment needs in developing countries alone range from $3.3 trillion to $4.5 trillion per year, mainly for basic infrastructure (roads, rail and ports; power stations; water and sanitation), food security (agriculture and rural development), climate change mitigation and adaptation, health, and education.

The SDGs will require a step-change in the levels of both public and private investment in all countries. At current levels of investment in SDG-relevant sectors, developing countries alone face an annual gap of $2.5 trillion. In developing countries, especially in LDCs and other vulnerable economies, public finances are central to investment in SDGs. However, they cannot meet all SDG-implied resource demands. The role of private sector investment will be indispensable.

Today, the participation of the private sector in investment in SDG-related sectors is relatively low. Only a fraction of the worldwide invested assets of banks, pension funds, insurers, foundations and endowments, as well as transnational corporations, is in SDG sectors. Their participation is even lower in developing countries, particularly the poorest ones.

In LDCs, a doubling of the growth rate of private investment would be a desirable target. Developing countries as a group could see the private sector cover approximately the part of SDG investment needs corresponding to its current share in investment in SDG sectors, based on current growth rates. In that scenario, however, they would still face an annual gap of about $1.6 trillion. In LDCs, where investment needs are most acute and where financing capacity is lowest, about twice the current growth rate of private investment is needed to give it a meaningful complementary financing role next to public investment and overseas development assistance (ODA).

Increasing the involvement of private investors in SDG-related sectors, many of which are sensitive or of a public service nature, leads to policy dilemmas. Policymakers need to find the right balance between creating a climate conducive to investment and removing barriers to investment on the one hand, and protecting public interests through regulation on the other. They need to find mechanisms to provide sufficiently attractive returns to private investors while guaranteeing accessibility and affordability of services for all. And the push for more private investment must be complementary to the parallel push for more public investment.

UNCTAD's proposed Strategic Framework for Private Investment in the SDGs addresses key policy challenges and options related to (i) guiding principles and global *leadership* to galvanize action for private investment, (ii) the *mobilization* of funds for investment in sustainable development, (iii) the *channelling* of funds into investments in SDG sectors, and (iv) maximizing the sustainable development *impact* of private investment while minimizing risks or drawbacks involved.

Increasing private investment in SDGs will require leadership at the global level, as well as from national policymakers, to provide guiding principles to deal with policy dilemmas; to set targets, recognizing the need to make a special effort for LDCs; to ensure policy coherence at national and global levels; to galvanize dialogue and action, including through appropriate multi-stakeholder platforms; and to guarantee inclusiveness, providing support to countries that otherwise might continue to be largely ignored by private investors.

Challenges to *mobilizing* funds in financial markets include start-up and scaling problems for innovative financing solutions, market failures, a lack of transparency on environmental, social and corporate governance performance, and misaligned rewards for market participants. Key constraints to *channelling* funds into SDG sectors include entry barriers, inadequate risk-return ratios for SDG investments, a lack of information and effective packaging and promotion of projects, and a lack of investor expertise. Key challenges in managing the *impact* of private investment in SDG sectors include the weak absorptive capacity in some developing countries, social and environmental impact risks, and the need for stakeholder engagement and effective impact monitoring.

UNCTAD's Action Plan for Private Investment in the SDGs presents a range of policy options to respond to the mobilization, channelling and impact challenges. A focused set of action packages can help shape a *Big Push* for private investment in sustainable development:

- *A new generation of investment promotion and facilitation.* Establishing SDG investment development agencies to develop and market pipelines of bankable projects in SDG sectors and to actively facilitate such projects. This requires specialist expertise and should be supported by technical assistance. "Brokers" of SDG investment projects could also be set up at the regional level to share costs and achieve economies of scale. The international investment policy regime should also be reoriented towards proactive promotion of investment in SDGs.
- *SDG-oriented investment incentives.* Restructuring of investment incentive schemes specifically to facilitate sustainable development projects. This calls for a transformation from purely "location-based" incentives, aiming to increase the competitiveness of a location and provided at the time of establishment, towards "SDG-based" incentives, aiming to promote investment in SDG sectors and conditional upon their sustainable development contribution.
- *Regional SDG Investment Compacts.* Launching regional and South-South initiatives towards the promotion of SDG investment, especially for cross-border infrastructure development and regional clusters of firms operating in SDG sectors (e.g. green zones). This could include joint investment promotion mechanisms, joint programmes to build absorptive capacity and joint public-private partnership models.
- *New forms of partnership for SDG investments.* Establish partnerships between outward investment agencies in home countries and investment promotion agencies (IPAs) in host countries for the purpose of marketing SDG investment opportunities in home countries, provision of investment incentives and facilitation services for SDG projects, and joint monitoring and impact assessment. Concrete tools that might support joint SDG investment business development services could include online tools with pipelines of bankable projects, and opportunities for linkages programmes in developing countries. A multi-agency technical assistance consortium could help to support LDCs.
- *Enabling innovative financing mechanisms and a reorientation of financial markets.* Innovative financial instruments to raise funds for investment in SDGs deserve support to achieve scale. Options include innovative tradable financial instruments and dedicated SDG funds, seed funding mechanisms, and new "go-to-market" channels for SDG projects. Reorientation of financial markets also requires integrated reporting. This is a fundamental tool for investors to make informed decisions on responsible allocation of capital, and it is at the heart of Sustainable Stock Exchanges.
- *Changing the business mindset and developing SDG investment expertise.* Developing a curriculum for business schools that generates awareness of investment opportunities in poor countries and that teaches students the skills needed to successfully operate in developing-country environments. This can be extended to inclusion of relevant modules in existing training and certification programmes for financial market actors.

The *Action Plan for Private Investment in the SDGs* is meant to serve as a point of reference for policymakers at national and international levels in their discussions on ways and means to implement the SDGs. It has been designed as a "living document" and incorporates an online version that aims to establish an interactive, open dialogue, inviting the international community to exchange views, suggestions and experiences. It thus constitutes a basis for further stakeholder engagement. UNCTAD aims to provide the platform for such engagement through its biennial *World Investment Forum*, and online through the *Investment Policy Hub*.

OVERVIEW

GLOBAL INVESTMENT TRENDS

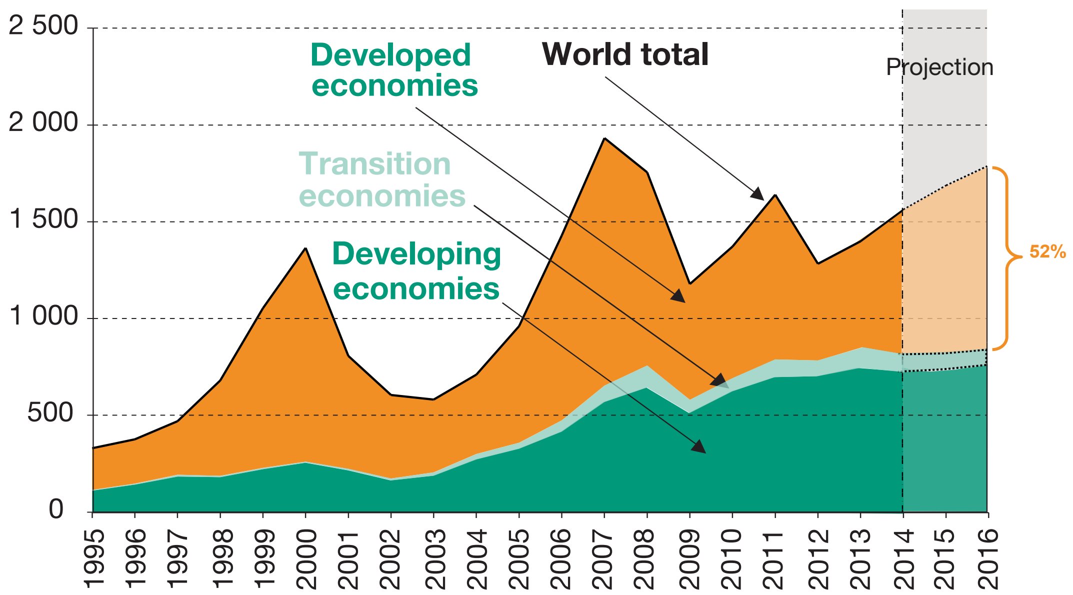
Cautious optimism returns to global FDI

In 2013, FDI flows returned to an upward trend. Global FDI inflows rose by 9 per cent to $1.45 trillion in 2013. FDI inflows increased in all major economic groupings – developed, developing, and transition economies. Global FDI stock rose by 9 per cent, reaching $25.5 trillion.

UNCTAD projects that global FDI flows could rise to $1.6 trillion in 2014, $1.75 trillion in 2015 and $1.85 trillion in 2016. The rise will be mainly driven by investments in developed economies as their economic recovery starts to take hold and spread wider. The fragility in some emerging markets and risks related to policy uncertainty and regional conflict could still derail the expected upturn in FDI flows.

As a result of higher expected FDI growth in developed countries, the regional distribution of FDI may tilt back towards the "traditional pattern" of a higher share of developed countries in global inflows (figure 1). Nevertheless, FDI flows to developing economies will remain at a high level in the coming years.

Figure 1. FDI inflows, global and by group of economies, 1995–2013 and projections, 2014-2016
(Billions of dollars)



Developing economies maintain their lead

FDI flows to developing economies reached a new high at $778 billion (table 1), accounting for 54 per cent of global inflows, although the growth rate slowed to 7 per cent, compared with an average growth rate over the past 10 years of 17 per cent. Developing Asia continues to be the region with the highest FDI inflows, significantly above the EU, traditionally the region with the highest share of global FDI. FDI inflows were up also in the other major developing regions, Africa (up 4 per cent) and Latin America and the Caribbean (up 6 per cent, excluding offshore financial centres).

Table 1. FDI flows, by region, 2011–2013
(Billions of dollars and per cent)

Region	FDI inflows			FDI outflows		
	2011	2012	2013	2011	2012	2013
World	**1 700**	**1 330**	**1 452**	**1 712**	**1 347**	**1 411**
Developed economies	880	517	566	1 216	853	857
European Union	490	216	246	585	238	250
North America	263	204	250	439	422	381
Developing economies	725	729	778	423	440	454
Africa	48	55	57	7	12	12
Asia	431	415	426	304	302	326
East and South-East Asia	333	334	347	270	274	293
South Asia	44	32	36	13	9	2
West Asia	53	48	44	22	19	31
Latin America and the Caribbean	244	256	292	111	124	115
Oceania	2	3	3	1	2	1
Transition economies	95	84	108	73	54	99
Structurally weak, vulnerable and small economies[a]	**58**	**58**	**57**	**12**	**10**	**9**
LDCs	22	24	28	4	4	5
LLDCs	36	34	30	6	3	4
SIDS	6	7	6	2	2	1
Memorandum: percentage share in world FDI flows						
Developed economies	51.8	38.8	39.0	71.0	63.3	60.8
European Union	28.8	16.2	17.0	34.2	17.7	17.8
North America	15.5	15.3	17.2	25.6	31.4	27.0
Developing economies	42.6	54.8	53.6	24.7	32.7	32.2
Africa	2.8	4.1	3.9	0.4	0.9	0.9
Asia	25.3	31.2	29.4	17.8	22.4	23.1
East and South-East Asia	19.6	25.1	23.9	15.8	20.3	20.7
South Asia	2.6	2.4	2.4	0.8	0.7	0.2
West Asia	3.1	3.6	3.0	1.3	1.4	2.2
Latin America and the Caribbean	14.3	19.2	20.1	6.5	9.2	8.1
Oceania	0.1	0.2	0.2	0.1	0.1	0.1
Transition economies	5.6	6.3	7.4	4.3	4.0	7.0
Structurally weak, vulnerable and small economies[a]	**3.4**	**4.4**	**3.9**	**0.7**	**0.7**	**0.7**
LDCs	1.3	1.8	1.9	0.3	0.3	0.3
LLDCs	2.1	2.5	2.0	0.4	0.2	0.3
SIDS	0.4	0.5	0.4	0.1	0.2	0.1

Source: UNCTAD, FDI-TNC-GVC Information System, FDI/TNC database (www.unctad.org/fdistatistics).
[a]Without double counting.

Although FDI to developed economies resumed its recovery after the sharp fall in 2012, it remained at a historically low share of total global FDI flows (39 per cent), and still 57 per cent below its peak in 2007. Thus, developing countries maintained their lead over developed countries by a margin of more than $200 billion for the second year running.

Developing countries and transition economies now also constitute half of the top 20 economies ranked by FDI inflows (figure 2). Mexico moved into tenth place. China recorded its largest ever inflows and maintained its position as the second largest recipient in the world.

FDI by transnational corporations (TNCs) from developing countries reached $454 billion – another record high. Together with transition economies, they accounted for 39 per cent of global FDI outflows, compared with only 12 per cent at the beginning of the 2000s. Six developing and transition economies ranked among the 20 largest investors in the world in 2013 (figure 3). Increasingly, developing-country TNCs are acquiring foreign affiliates of developed-country TNCs in the developing world.

Megaregional groupings shape global FDI

The share of APEC countries in global inflows increased from 37 per cent before the crisis to 54 per cent in 2013 (figure 4). Although their shares are smaller, FDI inflows to ASEAN and the Common Market of the South (MERCOSUR) in 2013 were at double their pre-crisis level, as were inflows to the BRICS (Brazil, the Russian Federation, India, China and South Africa).

Figure 2. FDI inflows: top 20 host economies, 2012 and 2013
(Billions of dollars)

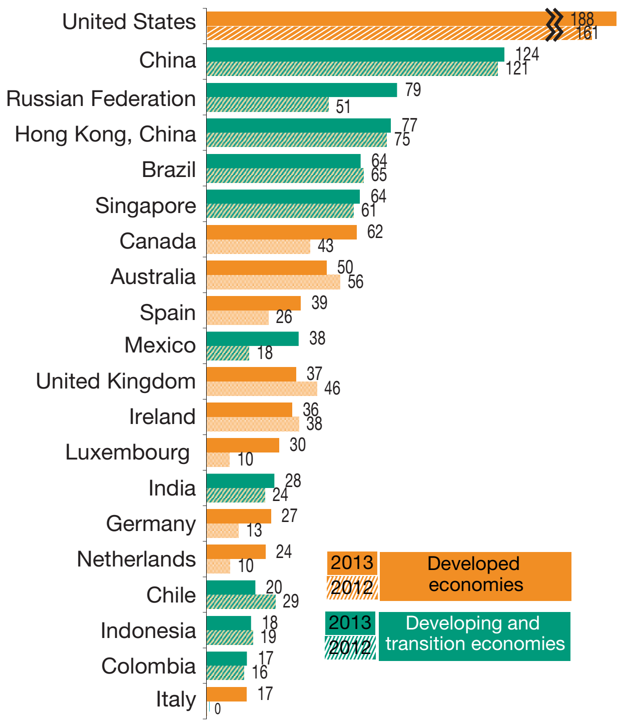
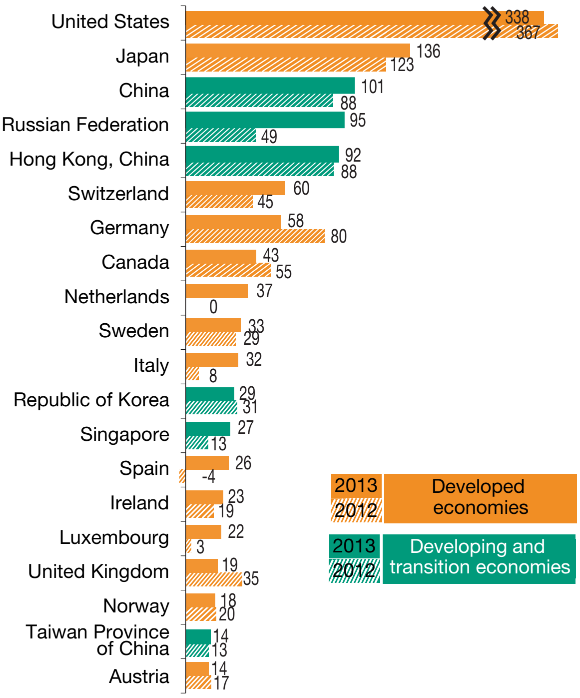


Figure 3. FDI outflows: top 20 home economies, 2012 and 2013
(Billions of dollars)



The three megaregional integration initiatives currently under negotiation – TTIP, TPP and RCEP – show diverging FDI trends. The United States and the EU, which are negotiating the formation of TTIP, saw their combined share of global FDI inflows cut nearly in half, from 56 per cent pre-crisis to 30 per cent in 2013. In TPP, the declining share of the United States is offset by the expansion of emerging economies in the grouping, helping the aggregate share increase from 24 per cent before 2008 to 32 per cent in 2013. The Regional Comprehensive Economic Partnership (RCEP), which is being negotiated between the 10 ASEAN member States and their 6 free trade agreement (FTA) partners, accounted for more than 20 per cent of global FDI flows in recent years, nearly twice as much as the pre-crisis level.

Figure 4. FDI inflows to selected regional and interregional groups, average 2005–2007 and 2013
(Billions of US dollars and per cent)

Regional/inter-regional groups	Average 2005–2007		2013		Change in share (percentage point)
	FDI Inflows ($ billion)	Share in world	FDI Inflows ($ billion)	Share in world	
G-20	878	59%	791	54%	-5
APEC	560	37%	789	54%	17
TPP	363	24%	458	32%	8
TTIP	838	56%	434	30%	-26
RCEP	195	13%	343	24%	11
BRICS	157	11%	304	21%	10
NAFTA	279	19%	288	20%	1
ASEAN	65	4%	125	9%	5
MERCOSUR	31	2%	85	6%	4

Poorest developing economies less dependent on natural resources

Although historically FDI in many poor developing countries has relied heavily on extractive industries, the dynamics of greenfield investment over the last 10 years reveals a more nuanced picture. The share of the extractive industry in the cumulative value of announced cross-border greenfield projects is substantial in Africa (26 per cent) and in LDCs (36 per cent). However, looking at project numbers the share drops to 8 per cent of projects in Africa, and 9 per cent in LDCs, due to the capital intensive nature of the industry. Moreover, the share of the extractive industry is rapidly decreasing. Data on announced greenfield investments in 2013 show that manufacturing and services make up about 90 per cent of the total value of projects both in Africa and in LDCs.

Shale gas is affecting FDI patterns in the Unites States and beyond

The shale gas revolution is now clearly visible in FDI patterns. In the United States oil and gas industry, the role of foreign capital is growing as the shale market consolidates and smaller domestic players need to share development and production costs. Shale gas cross-border M&As accounted for more than 80 per cent of such deals in the oil and gas industry in 2013. United States firms with necessary expertise in the exploration and development of shale gas are also becoming acquisition targets or industrial partners of energy firms based in other countries rich in shale resources.

Beyond the oil and gas industry, cheap natural gas is attracting new capacity investments, including greenfield FDI, to United States manufacturing industries, in particular chemicals and chemical products.

The United States share in global announced greenfield investments in these sectors jumped from 6 per cent in 2011, to 16 per cent in 2012, to 25 per cent in 2013, well above the average United States share across all industries (7 per cent). Some reshoring of United States manufacturing TNCs is also expected.

As the cost advantage of petrochemicals manufacturers in other oil and gas rich countries is being eroded, the effects on FDI are becoming visible also outside the United States, especially in West Asia. TNCs like Chevron Phillips Chemical, Dow Chemical and ExxonMobil Chemical are returning their focus to the United States. Even Gulf Cooperation Council (GCC) petrochemical enterprises such as NOVA chemicals (United Arab Emirates) and Sabic (Saudi Arabia) – are investing in North America.

Pharmaceutical FDI driven by the “patent cliff” and emerging market opportunities

Pharmaceutical TNCs have been divesting non-core business segments and outsourcing R&D activities in recent years, while engaging in M&A activity to secure new revenue streams and low-cost production bases. Global players in this industry have sought access to high-quality, low-cost generic drugs through acquisitions of producers based in developing economies, in response to growing demand. They have also targeted successful research firms and start-ups there. The share of cross-border M&A deals in the sector targeting developing and transition economies increased from less than 4 per cent before 2006, to 10 per cent between 2010 and 2012, jumping to more than 18 per cent in 2013.

The availability of vast reserves of overseas held retained earnings in the top pharmaceutical TNCs facilitates such deals, and signals further activity. During the first quarter of 2014, the transaction value of cross-border M&As ($23 billion in 55 deals) already surpassed the value recorded for all of 2013.

Private equity FDI keeps its powder dry

In 2013, outstanding funds of private equity firms increased further to a record level of $1.07 trillion, an increase of 14 per cent over the previous year. However, their cross-border investment – typically through M&As – was $171 billion ($83 billion on a net basis), a decline of 11 per cent. Private equity accounted for 21 per cent of total gross cross-border M&As in 2013, 10 percentage points lower than at its peak in 2007. With the increasing amount of outstanding funds available for investment (dry powder), and their relatively subdued activity in recent years, the potential for increased private equity FDI is significant.

Most private equity acquisitions are still concentrated in Europe (traditionally the largest market) and the United States. Deals are on the increase in Asia. Though relatively small, developing-country-based private equity firms are beginning to emerge and are involved in deal makings not only in developing countries but also in more mature markets.

FDI by SWFs remains small, State-owned TNCs are heavyweights

Sovereign wealth funds (SWFs) continue to expand in terms of assets, geographical spread and target industries. Assets under management of SWFs approach $6.4 trillion and are invested worldwide, including in sub-Saharan African countries. Oil-producing countries in sub-Saharan Africa have themselves recently created SWFs to manage oil proceeds. Compared to the size of their assets, the level of FDI by SWFs is still small, corresponding to less than 2 per cent of assets under management, and limited to a few major SWFs. In 2013, SWF FDI flows were worth $6.7 billion with cumulative stock reaching $130 billion.

The number of State-owned TNCs (SO-TNCs) is relatively small, but the number of their foreign affiliates and the scale of their foreign assets are significant. According to UNCTAD’s estimates, there are at least 550 SO-TNCs – from both developed and developing countries – with more than 15,000 foreign affiliates and estimated foreign assets of over $2 trillion. Some are among the largest TNCs in the world. FDI by State-owned TNCs is estimated to have reached more than $160 billion in 2013, a slight increase after four consecutive years of decline. At that level, although their number constitutes less than 1 per cent of the universe of TNCs, they account for over 11 per cent of global FDI flows.

International production continues its steady growth

International production continued to expand in 2013, rising by 9 per cent in sales, 8 per cent in assets, 6 per cent in value added, 5 per cent in employment, and 3 per cent in exports (table 2). TNCs from developing and transition economies expanded their overseas operations faster than their developed-country counterparts, but at roughly the same rate of their domestic operations, thus maintaining – overall – a stable internationalization index.

Cash holdings by the top 5,000 TNCs remained high in 2013, accounting for more than 11 per cent of their total assets. Cash holdings (including short-term investments) by developed-country TNCs were estimated at $3.5 trillion, while TNCs from developing and transition economies held $1.0 trillion. Developing-country TNCs have held their cash-to-assets ratios relatively constant over the last five years, at about 12 per cent. In contrast, the cash-to-assets ratios of developed-country TNCs increased in recent years, from an average of 9 per cent before the financial crisis to more than 11 per cent in 2013. This increase implies that, at the end of 2013, developed-country TNCs held $670 billion more cash than they would have before – a significant brake on investment.

Table 2. Selected indicators of FDI and international production, 2013 and selected years

	Value at current prices (Billions of dollars)				
Item	**1990**	**2005–2007 pre-crisis average**	**2011**	**2012**	**2013**
FDI inflows	208	1 493	1 700	1 330	1 452
FDI outflows	241	1 532	1 712	1 347	1 411
FDI inward stock	2 078	14 790	21 117	23 304	25 464
FDI outward stock	2 088	15 884	21 913	23 916	26 313
Income on inward FDI	79	1 072	1 603	1 581	1 748
Rate of return on inward FDI	3.8	7.3	6.9	7.6	6.8
Income on outward FDI	126	1 135	1 550	1 509	1 622
Rate of return on outward FDI	6.0	7.2	6.5	7.1	6.3
Cross-border M&As	111	780	556	332	349
Sales of foreign affiliates	4 723	21 469	28 516	31 532	34 508
Value added (product) of foreign affiliates	881	4 878	6 262	7 089	7 492
Total assets of foreign affiliates	3 893	42 179	83 754	89 568	96 625
Exports of foreign affiliates	1 498	5 012	7 463	7 532	7 721
Employment by foreign affiliates (thousands)	20 625	53 306	63 416	67 155	70 726
Memorandum:					
GDP	22 327	51 288	71 314	72 807	74 284
Gross fixed capital formation	5 072	11 801	16 498	17 171	17 673
Royalties and licence fee receipts	29	161	250	253	259
Exports of goods and services	4 107	15 034	22 386	22 593	23 160

REGIONAL TRENDS IN FDI

FDI to Africa increases, sustained by growing intra-African flows

FDI inflows to Africa rose by 4 per cent to $57 billion, driven by international and regional market-seeking and infrastructure investments. Expectations for sustained growth of an emerging middle class attracted FDI in consumer-oriented industries, including food, IT, tourism, finance and retail.

The overall increase was driven by the Eastern and Southern African subregions, as others saw falling investments. In Southern Africa flows almost doubled to $13 billion, mainly due to record-high flows to South Africa and Mozambique. In both countries, infrastructure was the main attraction, with investments in the gas sector in Mozambique also playing a role. In East Africa, FDI increased by 15 per cent to $6.2 billion as a result of rising flows to Ethiopia and Kenya. Kenya is becoming a favoured business hub, not only for oil and gas exploration but also for manufacturing and transport; Ethiopian industrial strategy may attract Asian capital to develop its manufacturing base. FDI flows to North Africa decreased by 7 per cent to $15 billion. Central and West Africa saw inflows decline to $8 billion and $14 billion, respectively, in part due to political and security uncertainties.

Intra-African investments are increasing, led by South African, Kenyan, and Nigerian TNCs. Between 2009 and 2013, the share of announced cross-border greenfield investment projects originating from within Africa increased to 18 per cent, from less than 10 per cent in the preceding period. For many smaller, often landlocked or non-oil-exporting countries in Africa, intraregional FDI is a significant source of foreign capital.

Increasing intra-African FDI is in line with leaders' efforts towards deeper regional integration. However, for most subregional groupings, intra-group FDI represent only a small share of intra-African flows. Only in two regional economic cooperation (REC) initiatives does intra-group FDI make up a significant part of intra-African investments – in EAC (about half) and SADC (more than 90 per cent) – largely due to investments in neighbouring countries of the dominant outward investing economies in these RECs, South Africa and Kenya. RECs have thus so far been less effective for the promotion of intraregional investment than a wider African economic cooperation initiative could be.

Intra-African projects are concentrated in manufacturing and services. Only 3 per cent of the value of announced intraregional greenfield projects is in the extractive industries, compared with 24 per cent for extra-regional greenfield projects (during 2009-2013). Intraregional investment could contribute to the build-up of regional value chains. However, so far, African global value chain (GVC) participation is still mostly limited to downstream incorporation of raw materials in the exports of developed countries.

Developing Asia remains the number one investment destination

With total FDI inflows of $426 billion in 2013, developing Asia accounted for nearly 30 per cent of the global total and remained the world's number one recipient region.

FDI inflows to ***East Asia*** rose by 2 per cent to $221 billion. The stable performance of the subregion was driven by rising FDI inflows to China as well as to the Republic of Korea and Taiwan Province of China. With inflows at $124 billion in 2013, China again ranked second in the world. In the meantime, FDI outflows from China swelled by 15 per cent, to $101 billion, driven by a number of megadeals in developed countries. The country's outflows are expected to surpass its inflows within two to three years. Hong Kong (China) saw its inflows rising slightly to $77 billion. The economy has been highly successful in attracting regional headquarters of TNCs, the number of which reached nearly 1,400 in 2013.

Inflows to ***South-East Asia*** increased by 7 per cent to $125 billion, with Singapore – another regional headquarters economy – attracting half. The 10 Member States of ASEAN and its 6 FTA partners (Australia, China, India, Japan, the Republic of Korea and New Zealand) have launched negotiations for the RCEP.

In 2013, combined FDI inflows to the 16 negotiating members of RCEP amounted to $343 billion, 24 per cent of world inflows. Over the last 15 years, proactive regional investment cooperation efforts in East and South-East Asia have contributed to a rise in total and intraregional FDI in the region. FDI flows from RCEP now makes up more than 40 per cent of inflows to ASEAN, compared to 17 per cent before 2000. Intraregional FDI in infrastructure and manufacturing in particular is bringing development opportunities for low-income countries, such as the Lao People's Democratic Republic and Myanmar.

Inflows to ***South Asia*** rose by 10 per cent to $36 billion in 2013. The largest recipient of FDI in the subregion, India, experienced a 17 per cent increase in FDI inflows to $28 billion. Defying the overall trend, investment in the retail sector did not increase, despite the opening up of multi-brand retail in 2012.

Corridors linking South Asia and East and South-East Asia are being established – the Bangladesh-China-India-Myanmar Economic Corridor and the China-Pakistan Economic Corridor. This will help enhance connectivity between Asian subregions and provide opportunities for regional economic cooperation. The initiatives are likely to accelerate infrastructure investment and improve the overall business climate in South Asia.

FDI flows to ***West Asia*** decreased in 2013 by 9 per cent to $44 billion, failing to recover for the fifth consecutive year. Persistent regional tensions and political uncertainties are holding back investors, although there are differences between countries. In Saudi Arabia and Qatar FDI flows continue to follow a downward trend; in other countries FDI is slowly recovering, although flows remain well below earlier levels, except in Kuwait and Iraq where they reached record levels in 2012 and 2013, respectively.

FDI outflows from West Asia jumped by 64 per cent in 2013, driven by rising flows from the GCC countries. A quadrupling of outflows from Qatar and a near tripling of flows from Kuwait explained most of the increase. Outward FDI could increase further given the high levels of GCC foreign exchange reserves.

Uneven growth of FDI in Latin America and the Caribbean

FDI flows to Latin America and the Caribbean reached $292 billion in 2013. Excluding offshore financial centres, they increased by 5 per cent to $182 billion. Whereas in previous years FDI was driven largely by South America, in 2013 flows to this subregion declined by 6 per cent to $133 billion, after three consecutive years of strong growth. Among the main recipient countries, Brazil saw a slight decline by 2 per cent, despite an 86 per cent increase in flows to the primary sector. FDI in Chile and Argentina declined by 29 per cent and 25 per cent to $20 billion and $9 billion, respectively, due to lower inflows in the mining sector. Flows to Peru also decreased, by 17 per cent to $10 billion. In contrast, FDI flows to Colombia increased by 8 per cent to $17 billion, largely due to cross-border M&As in the electricity and banking industries.

Flows to Central America and the Caribbean (excluding offshore financial centres) increased by 64 per cent to $49 billion, largely due to the $18 billion acquisition of the remaining shares in Grupo Modelo by Belgian brewer AB InBev – which more than doubled inflows to Mexico to $38 billion. Other increases were registered in Panama (61 per cent), Costa Rica (14 per cent), Guatemala and Nicaragua (5 per cent each).

FDI outflows from Latin America and the Caribbean (excluding offshore financial centres) declined by 31 per cent to $33 billion, because of stalled acquisitions abroad and a surge in loan repayments to parent companies by foreign affiliates of Brazilian and Chilean TNCs.

Looking ahead, new opportunities for foreign investors in the oil and gas industry, including shale gas in Argentina and sectoral reform in Mexico, could signal positive FDI prospects. In manufacturing, automotive TNCs are also pushing investment plans in Brazil and Mexico.

The growth potential of the automotive industry appears promising in both countries, with clear differences between the two in government policies and TNC responses. This is reflected in their respective levels and forms of GVC participation. In Mexico, automotive exports are higher, with greater downstream participation, and higher imported value added. Brazil's producers, many of which are TNCs, serve primarily the local market. Although its exports are lower, they contain a higher share of value added produced domestically, including through local content and linkages.

FDI to transition economies at record levels, but prospects uncertain

FDI inflows to transition economies increased by 28 per cent to reach $108 billion in 2013. In South-East Europe, flows increased from $2.6 billion in 2012 to $3.7 billion in 2013, driven by the privatization of remaining State-owned enterprises in the services sector. In the Commonwealth of Independent States (CIS), the 28 per cent rise in flows was due to the significant growth of FDI to the Russian Federation. Although developed countries were the main investors, developing-economy FDI has been on the rise. Prospects for FDI to transition economies are likely to be affected by uncertainties related to regional instability.

In 2013, outward FDI from the region jumped by 84 per cent, reaching a record $99 billion. As in past years, Russian TNCs accounted for the bulk of FDI projects. The value of cross-border M&A purchases by TNCs from the region rose more than six-fold, and announced greenfield investments rose by 87 per cent to $19 billion.

Over the past decade, transition economies have been the fastest-growing host and home region for FDI. EU countries have been the most important partners in this rapid FDI growth, both as investors and recipients. The EU has the largest share of inward FDI stock in the region, with more than two thirds of the total. In the CIS, most of their investment went to natural resources, consumer sectors, and other selected industries as they were liberalized or privatized. In South-East Europe, EU investments have also been driven by privatizations and by a combination of low production costs and the prospect of association with, or membership of the EU. In the same way, the bulk of outward FDI stock from transition economies, mainly from the Russian Federation, is in EU countries. Investors look for strategic assets in EU markets, including downstream activities in the energy industry and value added production activities in manufacturing.

Inflows to developed countries resume growth

After a sharp fall in 2012, inflows to developed economies recovered in 2013 to $566 billion, a 9 per cent increase. Inflows to the European Union were $246 billion (up 14 per cent), less than 30 per cent of their 2007 peak. Among the major economies, inflows to Germany – which had recorded an exceptionally low volume in 2012 – rebounded sharply, but France and the United Kingdom saw a steep decline. In many cases, large swings in intra-company loans were a significant contributing factor. Inflows to Italy and Spain rebounded sharply with the latter becoming the largest European recipient in 2013. Inflows to North America recovered to $250 billion, with the United States – the world's largest recipient – recording a 17 per cent increase to $188 billion.

Outflows from developed countries were $857 billion in 2013 – virtually unchanged from a year earlier. A recovery in Europe and the continued expansion of investment from Japan were weighed down by a contraction of outflows from North America. Outflows from Europe increased by 10 per cent to $329 billion. Switzerland became Europe's largest direct investor. Against the European trend, France, Germany and the United Kingdom registered a large decline in outward FDI. Outflows from North America shed another 10 per cent to $381 billion, partly because United States TNCs transferred funds from Europe, raised in local bond markets, back to the United States. Outflows from Japan grew for the third successive year, rising to $136 billion.

Both inflows and outflows remained at barely half the peak level seen in 2007. In terms of global share, developed countries accounted for 39 per cent of total inflows and 61 per cent of total outflows – both historically low levels.

Although the share of transatlantic FDI flows has declined in recent years, the EU and the United States are important investment partners – much more so than implied by the size of their economies or by volumes of bilateral trade. For the United States, 62 per cent of inward FDI stock is held by EU countries and 50 per cent of outward stock is located in the EU. For the EU, the United States accounts for one third of FDI flows into the region from non-EU countries.

FDI inflows to LDCs up, but LLDCs and SIDS down

FDI inflows to ***least developed countries*** (LDCs) rose to $28 billion, an increase of 14 per cent. While inflows to some larger host LDCs fell or stagnated, rising inflows were recorded elsewhere. A nearly $3 billion reduction in divestment in Angola contributed most, followed by gains in Bangladesh, Ethiopia, Mozambique, Myanmar, the Sudan and Yemen. The share of inflows to LDCs in global inflows remains small at 2 per cent.

The number of announced greenfield investment projects in LDCs reached a record high, and in value terms they reached the highest level in three years. The services sector, driven by large-scale energy projects, contributed 70 per cent of the value of announced greenfield projects. External sources of finance constitute a major part of the funding behind a growing number of infrastructure projects in LDCs. However, a substantial portion of announced investments has so far not generated FDI inflows, which can be due to structured finance solutions that do not translate into FDI, long gestation periods spreading outlays over many years, or actual project delays or cancellations.

FDI flows to the ***landlocked developing countries*** (LLDCs) in 2013 fell by 11 per cent to $29.7 billion. The Asian group of LLDCs experienced the largest fall in FDI flows of nearly 50 per cent, mainly due to a decline in investment in Mongolia. Despite a mixed picture for African LLDCs, 8 of the 15 LLDC economies increased their FDI inflows, with Zambia attracting most at $1.8 billion.

FDI remains a relatively more important factor in capital formation and growth for LLDCs than developing countries as a whole. In developing economies the size of FDI flows relative to gross fixed capital formation has averaged 11 per cent over the past decade but in the LLDCs it has averaged almost twice this, at 21 per cent.

FDI inflows to the ***small island developing States*** (SIDS) declined by 16 per cent to $5.7 billion in 2013, putting an end to two years of recovery. Mineral extraction and downstream-related activities, business and finance, and tourism are the main target industries for FDI in SIDS. Tourism is attracting increasing interest by foreign investors, while manufacturing industries – such as apparel and processed fish – that used to be a non-negligible target for FDI, have been negatively affected by erosion of trade preferences.

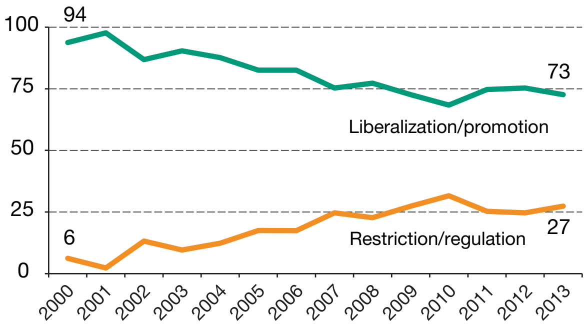
INVESTMENT POLICY TRENDS AND KEY ISSUES

New government efforts to prevent divestment and promote reshoring

UNCTAD monitoring shows that, in 2013, 59 countries and economies adopted 87 policy measures affecting foreign investment. National investment policymaking remained geared towards investment promotion and liberalization. At the same time, the overall share of regulatory or restrictive investment policies further increased from 25 to 27 per cent (figure 5).

Investment liberalization measures included a number of privatizations in transition economies. The majority of foreign-investment-specific liberalization measures reported were in Asia; most related to the telecommunications industry and the energy sector. Newly introduced FDI restrictions and regulations included

Figure 5. Changes in national investment policies, 2000–2013
(Per cent)



a number of non-approvals of foreign investment projects.

A recent phenomenon is the effort by governments to prevent divestments by foreign investors. Affected by economic crises and persistently high domestic unemployment, some countries have introduced new approval requirements for relocations and lay-offs. In addition, some home countries have started to promote reshoring of overseas investment by their TNCs.

More effective use of investment incentives requires improved monitoring

Incentives are widely used by governments as a policy instrument for attracting investment, despite persistent criticism that they are economically inefficient and lead to misallocations of public funds. In 2013, more than half of new liberalization, promotion or facilitation measures related to the provision of investment incentives.

According to UNCTAD's most recent survey of investment promotion agencies (IPAs), the main objective of investment incentives is job creation, followed by technology transfer and export promotion, while the most important target industry is IT and business services, followed by agriculture and tourism. Despite their growing importance in national and global policy agendas, environmental protection and development of disadvantaged regions do not rank high in current promotion strategies of IPAs.

Linking investment incentives schemes to the SDGs could make them a more effective policy tool to remedy market failures and could offer a response to the criticism raised against the way investment incentives have traditionally been used. Governments should also carefully assess their incentives strategies and strengthen their monitoring and evaluation practices.

Some countries scale up IIA treaty negotiations, others disengage

With the addition of 44 new treaties, the global IIA regime reached close to 3,240 at the end of 2013 (figure 6). The year brought an increasing dichotomy in investment treaty making. An increasing number of developing countries are disengaging from the regime in Africa, Asia and Latin America. At the same time, there is an "up-scaling" trend in treaty making, which manifests itself in increasing dynamism (with more countries participating in ever faster sequenced negotiating rounds) and in an increasing depth and breadth of issues addressed. Today, IIA negotiators increasingly take novel approaches to existing IIA provisions and add new issues to the negotiating agenda. The inclusion of sustainable development features and provisions that bring a liberalization dimension to IIAs and/or strengthen certain investment protection elements are examples in point.

"Megaregional agreements" – systemic implications expected

Negotiations of megaregional agreements have become increasingly prominent in the public debate, attracting both criticism and support from different stakeholders. Key concerns relate to their potential impact on contracting parties' regulatory space and sustainable development. Megaregionals are broad economic agreements among a group of countries that have a significant combined economic weight and

Figure 6. Trends in IIAs signed, 1983–2013

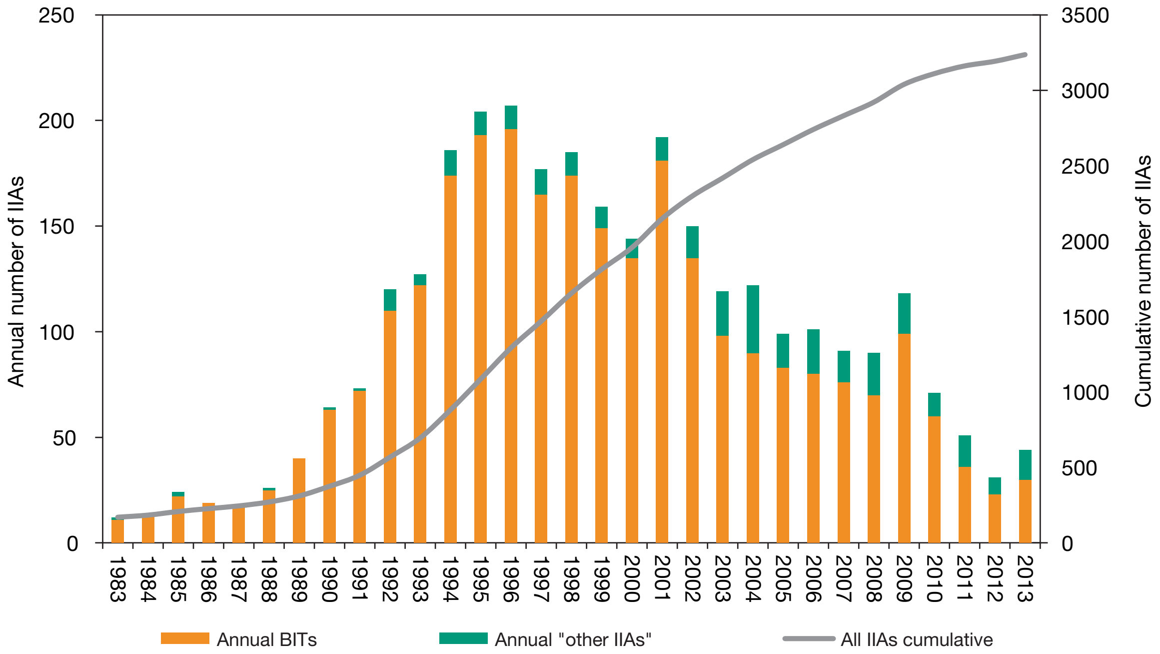
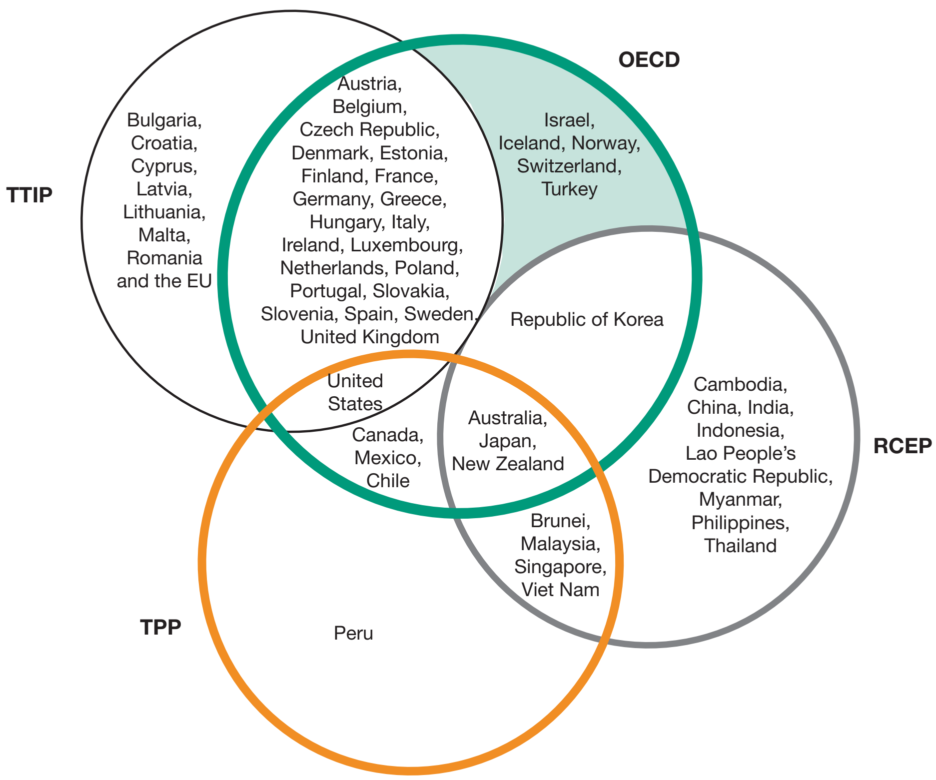


Figure 7. Participation in key megaregionals and OECD membership



in which investment is one of the key subject areas covered. Taking seven of these negotiations together, they involve a total of 88 developed and developing countries. If concluded, they are likely to have important implications for the current multi-layered international investment regime and global investment patterns.

Megaregional agreements could have systemic implications for the IIA regime: they could either contribute to a consolidation of the existing treaty landscape or they could create further inconsistencies through overlap with existing IIAs – including those at the plurilateral level (figure 7). For example, six major megaregional agreements overlap with 140 existing IIAs but would create 200 new bilateral investment-treaty relationships. Megaregional agreements could also marginalize non-participating third parties. Negotiators need to give careful consideration to these systemic implications. Transparency in rule making, with broad stakeholder engagement, can help in finding optimal solutions and ensure buy-in from those affected by a treaty.

Growing concerns about investment arbitration

The year 2013 saw the second largest number of known investment arbitrations filed in a single year (56), bringing the total number of known cases to 568. Of the new claims, more than 40 per cent were brought against member States of the European Union (EU), with all but one of them being *intra-EU* cases. Investors continued to challenge a broad number of measures in various policy areas, particularly in the renewable energy sector.

The past year also saw at least 37 arbitral decisions – 23 of which are in the public domain – and the second highest known award so far ($935 million plus interest). With the potential inclusion of investment arbitration in "megaregional agreements", investor-State dispute settlement (ISDS) is at the centre of public attention.

A call for reform of the IIA regime

While almost all countries are parties to one or several IIAs, many are dissatisfied with the current regime. Concerns relate mostly to the development dimension of IIAs; the balance between the rights and obligations of investors and States; and the systemic complexity of the IIA regime.

Countries' current efforts to address these challenges reveal four different paths of action: (i) some aim to maintain the status quo, largely refraining from changes in the way they enter into new IIA commitments; (ii) some are disengaging from the IIA regime, unilaterally terminating existing treaties or denouncing multilateral arbitration conventions; and (iii) some are implementing selective adjustments, modifying models for future treaties but leaving the treaty core and the body of existing treaties largely untouched. Finally, (iv) there is the path of systematic reform that aims to comprehensively address the IIA regime's challenges in a holistic manner.

While each of these paths has benefits and drawbacks, systemic reform could effectively address the complexities of the IIA regime and bring it in line with the sustainable development imperative. Such a reform process could follow a gradual approach with carefully sequenced actions: (i) defining the areas for reform (identifying key and emerging issues and lessons learned, and building consensus on what could and should be changed, and on what should and could not be changed), (ii) designing a roadmap for reform (identifying different options for reform, assessing pros and cons, and agreeing on the sequencing of actions), and (iii) implementing it at the national, bilateral and regional levels. A multilateral focal point like UNCTAD could support such a holistic, coordinated and sustainability-oriented approach to IIA reform through its policy analysis, technical assistance and consensus building. The *World Investment Forum* could provide the platform, and the *Investment Policy Framework for Sustainable Development (IPFSD)* the guidance.

Investing in the SDGs: an action plan for promoting private sector contributions

The United Nations' Sustainable Development Goals need a step-change in investment

Faced with common global economic, social and environmental challenges, the international community is defining a set of Sustainable Development Goals (SDGs). The SDGs, which are being formulated by the United Nations together with the widest possible range of stakeholders, are intended to galvanize action worldwide through concrete targets for the 2015–2030 period for poverty reduction, food security, human health and education, climate change mitigation, and a range of other objectives across the economic, social and environmental pillars.

Private sector contributions can take two main forms; good governance in business practices and investment in sustainable development. This includes the private sector's commitment to sustainable development; transparency and accountability in honouring sustainable development practices; responsibility to avoid harm, even if it is not prohibited; and partnership with government on maximizing co-benefits of investment.

The SDGs will have very significant resource implications across the developed and developing world. Estimates for total investment needs in developing countries alone range from $3.3 trillion to $4.5 trillion per year, for basic infrastructure (roads, rail and ports; power stations; water and sanitation), food security (agriculture and rural development), climate change mitigation and adaptation, health and education.

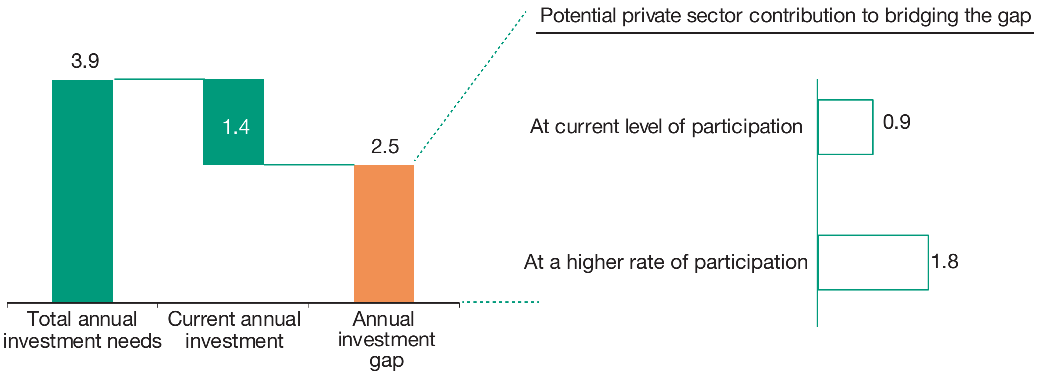
Reaching the SDGs will require a step-change in both public and private investment. Public sector funding capabilities alone may be insufficient to meet demands across all SDG-related sectors. However, today, the participation of the private sector in investment in these sectors is relatively low. Only a fraction of the worldwide invested assets of banks, pension funds, insurers, foundations and endowments, as well as transnational corporations, is in SDG sectors, and even less in developing countries, particularly the poorest ones (LDCs).

At current levels of investment in SDG-relevant sectors, developing countries face an annual gap of $2.5 trillion

At today's level of investment – public and private – in SDG-related sectors in developing countries, an annual funding shortfall of some $2.5 trillion remains (figure 8). Bridging such a gap is a daunting task, but it is achievable. Part of the gap could be covered by the private sector (in a "business as usual scenario") if the current growth rate of private investment continues. For developing countries as a group, including fast-growing emerging economies, the current growth of private investment could be sufficient, approximately, to cover the part of total SDG-related investment needs corresponding to the private sector's current participation in SDG investments. However, at the aggregate level that would still leave a gap of about $1.6 trillion per year, and the relative size of this gap would be far more important in least developing countries and vulnerable economies. Increasing the participation of the private sector in SDG financing in developing countries could potentially cover a larger part of the gap.

At a disaggregated level, the relative size of investment gaps will vary by SDG sector – private sector participation in some sectors is low and likely to remain so – and for different groups of developing countries. The starting levels and growth rates of private investment in SDG sectors in less developed countries are such that the private sector will not even cover the part of investment needs to 2030 that corresponds to its current level of participation.

Figure 8. Estimated annual investment needs and potential private sector contribution
(Trillions of dollars)



Structurally weak economies need special attention, LDCs require a doubling of the growth rate of private investment

Investment and private sector engagement across SDG sectors are highly variable across developing countries. Emerging markets face entirely different conditions to vulnerable economies such as LDCs, LLDCs and SIDS. In LDCs, official development assistance (ODA) – currently their largest external source of finance and often used for direct budget support and public spending – will remain of fundamental importance.

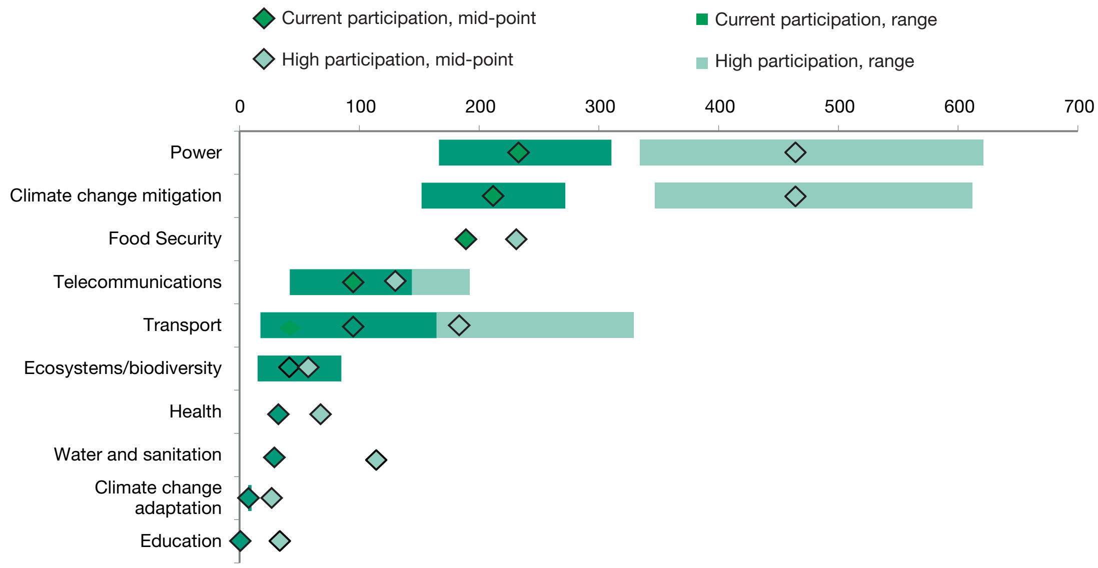
At the current rate of private sector participation in investment in SDG sectors, and at current growth rates, a "business as usual" scenario in LDCs will leave a shortfall that would imply a nine-fold increase in public sector funding requirements to 2030. This scenario, with the limited funding capabilities of LDC governments and the fact that much of ODA in LDCs is already used to support current (not investment) spending by LDC governments, is not a viable option. Without higher levels of private sector investment, the financing requirements associated with the prospective SDGs in LDCs may be unrealistic.

A target for the promotion of private sector investment in SDGs in LDCs could be to double the current growth rate of such investment. The resulting contribution would give private investment a meaningful complementary financing role next to public investment and ODA. Public investment and ODA would continue to be fundamental, as covering the remaining funding requirements would still imply trebling their current levels to 2030.

The potential for increased private sector investment contributions is significant, especially in infrastructure, food security and climate change mitigation

The potential for increasing private sector participation is greater in some sectors than in others (figure 9). Infrastructure sectors, such as power and renewable energy (under climate change mitigation), transport and water and sanitation, are natural candidates for greater private sector participation, under the right conditions and with appropriate safeguards. Other SDG sectors are less likely to generate significantly higher amounts of private sector interest, either because it is difficult to design risk-return models attractive to private investors (e.g. climate change adaptation), or because they are at the core of public service responsibilities and highly sensitive to private sector involvement (e.g. education and health care). Therefore, public investment remains fundamental and pivotal. However, because it is unrealistic to expect the public sector to meet all funding demands in many developing countries, the SDGs have to be accompanied by strategic initiatives to increase private sector participation.

Figure 9. Potential private sector contribution to investment gaps at current and high participation levels
(Billions of dollars)



Increasing the involvement of private investors in SDG-related sectors, many of which are sensitive or of a public service nature, leads to policy dilemmas

A first dilemma relates to the risks involved in increased private sector participation in sensitive sectors. Private sector service provision in health care and education in developing countries, for instance, can have negative effects on standards unless strong governance and oversight is in place, which in turn requires capable institutions and technical competencies. Private sector involvement in essential infrastructure industries, such as power or telecommunications can be sensitive in developing countries where this implies the transfer of public sector assets to the private sector. Private sector operations in infrastructure such as water and sanitation are particularly sensitive because of the basic-needs nature of these sectors.

A second dilemma stems from the need to maintain quality services affordable and accessible to all. The fundamental hurdle for increased private sector contributions to investment in SDG sectors is the inadequate risk-return profile of many such investments. Many mechanisms exist to share risks or otherwise improve the risk-return profile for private sector investors. Increasing returns, however, must not lead to the services provided by private investors ultimately becoming inaccessible or unaffordable for the poorest in society. Allowing energy or water suppliers to cover only economically attractive urban areas while ignoring rural needs, or to raise prices of essential services, is not a sustainable outcome.

A third dilemma results from the respective roles of public and private investment. Despite the fact that public sector funding shortfalls in SDG sectors make it desirable that private sector investment increase to achieve the prospective SDGs, public sector investment remains fundamental and pivotal. Governments – through policy and rule making – need to be ultimately accountable with respect to provision of vital public services and overall sustainable development strategy.

A fourth dilemma is the apparent conflict between the particularly acute funding needs in structurally weak economies, especially LDCs, necessitating a significant increase in private sector investment, and the fact that especially these countries face the greatest difficulty in attracting such investment. Without targeted policy intervention and support measures there is a real risk that investors will continue to see operating conditions and risks in LDCs as prohibitive.

UNCTAD proposes a Strategic Framework for Private Investment in the SDGs

A Strategic Framework for Private Investment in the SDGs (figure 10) addresses key policy challenges and solutions, related to:

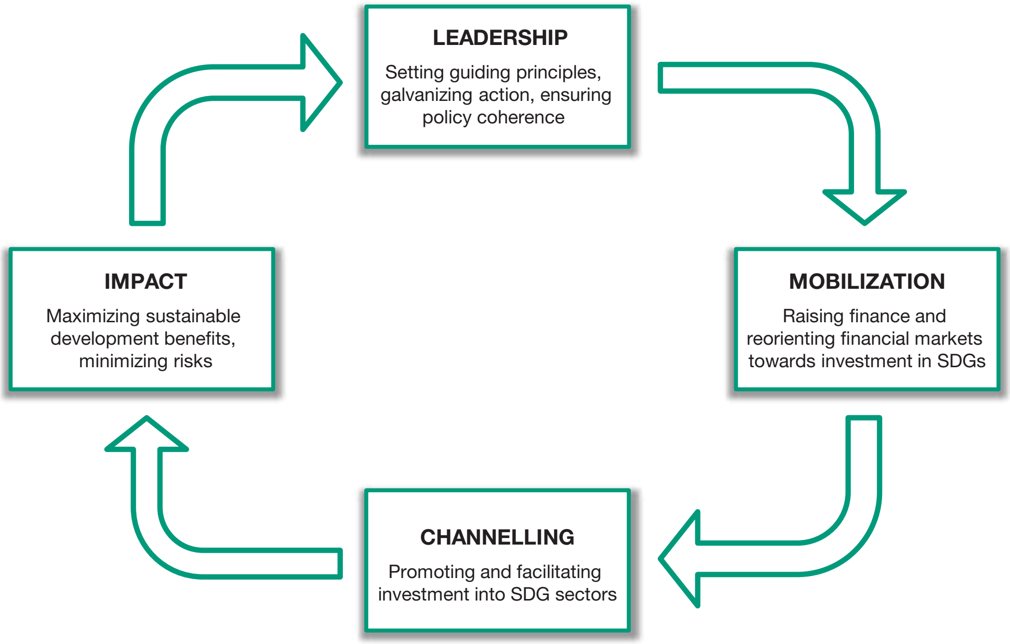
- Providing *Leadership* to define guiding principles and targets, to ensure policy coherence, and to galvanize action.
- *Mobilizing funds for sustainable development* – raising resources in financial markets or through financial intermediaries that can be invested in sustainable development.
- *Channelling funds to sustainable development projects* – ensuring that available funds make their way to concrete sustainable-development-oriented investment projects on the ground in developing countries, and especially LDCs.
- *Maximizing impact and mitigating drawbacks* – creating an enabling environment and putting in place appropriate safeguards that need to accompany increased private sector engagement in often sensitive sectors.

A set of guiding principles can help overcome policy dilemmas associated with increased private sector engagement in SDG sectors

The many stakeholders involved in stimulating private investment in SDGs will have varying perspectives on how to resolve the policy dilemmas inherent in seeking greater private sector participation in SDG sectors. A common set of principles for investment in SDGs can help establish a collective sense of direction and purpose. The following broad principles could provide a framework.

- *Balancing liberalization and the right to regulate.* Greater private sector involvement in SDG sectors may be necessary where public sector resources are insufficient (although selective, gradual or sequenced approaches are possible); at the same time, such increased involvement must be accompanied by appropriate regulations and government oversight.
- *Balancing the need for attractive risk-return rates with the need for accessible and affordable services.* This requires governments to proactively address market failures in both respects. It means placing clear obligations on investors and extracting firm commitments, while providing incentives to improve the risk-return profile of investment. And it implies making incentives or subsidies conditional on social inclusiveness.
- *Balancing a push for private investment with the push for public investment.* Public and private investment are complementary, not substitutes. Synergies and mutually supporting roles between public and private funds can be found both at the level of financial resources – e.g. raising private sector funds with public sector funds as seed capital – and at the policy level, where governments can seek to engage private investors to support economic or public service reform programmes. Nevertheless, it is important for policymakers not to translate a push for private investment into a policy bias against public investment.
- *Balancing the global scope of the SDGs with the need to make a special effort in LDCs.* While overall financing for development needs may be defined globally, with respect to private sector financing contributions special efforts will need to be made for LDCs, because without targeted policy intervention these countries will not be able to attract the required resources from private investors. Dedicated private sector investment targets for the poorest countries, leveraging ODA for additional private funds, and targeted technical assistance and capacity building to help attract private investment in LDCs are desirable.

Figure 10. Strategic Framework for Private Investment in the SDGs



Increasing private investment in SDGs will require leadership at the global level, as well as from national policymakers

Leadership is needed not only to provide guiding principles to deal with policy dilemmas, but also to: *Set investment targets.* The rationale behind the SDGs, and the experience with the Millennium Development Goals, is that targets help provide direction and purpose. Ambitious investment targets are implied by the prospective SDGs. The international community would do well to make targets explicit, and spell out the consequences for investment policies and investment promotion at national and international levels. Achievable but ambitious targets, including for increasing public and private sector investment in LDCs, are desirable.

Ensure policy coherence and creating synergies. Interaction between policies is important – between national and international investment policies, between investment and other sustainable-development-related policies (e.g. tax, trade, competition, technology, and environmental, social and labour market policies), and between micro- and macroeconomic policies. Leadership is required to ensure that the global push for sustainable development and investment in SDGs has a voice in international macroeconomic policy coordination forums and global financial system reform processes, where decisions will have an fundamental bearing on the prospects for growth in SDG financing.

Establish a global multi-stakeholder platform on investing in the SDGs. A global multi-stakeholder body on investing in the SDGs could provide a platform for discussion on overall investment goals and targets, fostering promising initiatives to mobilize finance and spreading good practices, supporting actions on the ground, and ensuring a common approach to impact measurement.

Create a multi-agency technical assistance facility for investment in the SDGs. Many initiatives aimed at increasing private sector investment in SDG sectors are complex, requiring significant technical capabilities and strong institutions. A multi-agency institutional arrangement could help to support LDCs, advising on, for example, the set-up of SDG project development agencies that can plan, package and promote pipelines of bankable projects; design of SDG-oriented incentive schemes; and regulatory frameworks. Coordinated efforts to enhance synergies are imperative.

A range of policy options is available to respond to challenges and constraints in mobilizing funds, channelling them into SDG sectors, and ensuring sustainable impact

Challenges to *mobilizing* funds in financial markets include market failures and a lack of transparency on environmental, social and governance performance, misaligned incentives for market participants, and start-up and scaling problems for innovative financing solutions. Policy responses to build a more SDG-conducive financial system might include:

- *Creating fertile soil for innovative SDG-financing approaches.* Innovative financial instruments and funding mechanisms to raise resources for investment in SDGs deserve support to achieve scale. Promising initiatives include SDG-dedicated financial instruments and Impact Investment, funding mechanisms that use public sector resources to catalyse mobilization of private sector resources, and new "go-to-market" channels for SDG investment projects.
- *Building or improving pricing mechanisms for externalities.* Effective pricing mechanisms for social and environmental externalities – either by attaching a cost to such externalities (e.g. through carbon taxes) or through market-based schemes – are ultimately fundamental to put financial markets and investors on a sustainable footing.
- *Promoting Sustainable Stock Exchanges (SSEs).* SSEs provide listed entities with the incentives and tools to improve transparency on ESG performance, and allow investors to make informed decisions on responsible allocation of capital.
- *Introducing financial market reforms.* Realigning rewards in financial markets to favour investment in SDGs will require action, including reform of pay and performance structures, and innovative rating methodologies that reward long-term investment in SDG sectors.

Key constraints to *channelling* funds into SDG sectors include entry barriers, inadequate risk-return ratios for SDG investments, a lack of information and effective packaging and promotion of projects, and a lack of investor expertise. Effective policy responses may include the following.

- *Reducing entry barriers, with safeguards.* A basic prerequisite for successful promotion of SDG investment is a sound overall policy climate, conducive to attracting investment while protecting public interests, especially in sensitive sectors.
- *Expanding the use of risk-sharing tools for SDG investments.* A number of tools, including public-private partnerships, investment insurance, blended financing and advance market commitments, can help improve the risk-return profile of SDG investment projects.
- *Establishing new incentives schemes and a new generation of investment promotion institutions.* SDG investment development agencies could target SDG sectors and develop and market pipelines of bankable projects. Investment incentives could be reoriented, to target investments in SDG sectors and made conditional on social and environmental performance. Regional initiatives can help spur private investment in cross-border infrastructure projects and regional clusters of firms in SDG sectors.
- *Building SDG investment partnerships.* Partnerships between home countries of investors, host countries, TNCs and multilateral development banks can help overcome knowledge gaps as well as generate joint investments in SDG sectors.

Key challenges in maximizing the positive *impact* and minimizing the risks and drawbacks of private investment in SDG sectors include the weak absorptive capacity in some developing countries, social and environmental impact risks, and the need for stakeholder engagement and effective impact monitoring. Policy responses can include:

- *Increasing absorptive capacity.* A range of policy tools are available to increase absorptive capacity, including the promotion and facilitation of entrepreneurship, support to technology development, human resource and skills development, business development services and promotion of business linkages. Development of linkages and clusters in incubators or economic zones specifically aimed at stimulating businesses in SDG sectors may be particularly effective.
- *Establishing effective regulatory frameworks and standards.* Increased private sector engagement in often sensitive SDG sectors needs to be accompanied by effective regulation. Particular areas of attention include human health and safety, environmental and social protection, quality and inclusiveness of public services, taxation, and national and international policy coherence.
- *Good governance, strong institutions, stakeholder engagement.* Good governance and capable institutions are a key enabler for the attraction of private investment in general, and in SDG sectors in particular. They are also needed for effective stakeholder engagement and management of impact trade-offs.
- *Implementing SDG impact assessment systems.* Monitoring of the impact of investment, especially along social and environmental dimensions, is key to effective policy implementation. A set of core quantifiable impact indicators can help. Impact measurement and reporting by private investors on their social and environmental performance promotes corporate responsibility on the ground and supports mobilization and channelling of investment.

Figure 11 summarizes schematically the key challenges and policy responses for each element of the Strategic Framework. Detailed policy responses are included in UNCTAD's Action Plan for Private Investment in the SDGs.

Figure 11. Key challenges and possible policy responses

	Key challenges	Policy responses
LEADERSHIP *Setting guiding principles, galvanizing action, ensuring policy coherence*	• Need for a clear sense of direction and common policy design criteria • Need for clear objectives to galvanize global action • Need to manage investment policy interactions • Need for global consensus and an inclusive process	• Agree a set of guiding principles for SDG investment policymaking • Set SDG investment targets • Ensure policy coherence and synergies • Multi-stakeholder platform and multi-agency technical assistance facility
MOBILIZATION *Raising finance and re-orienting financial markets towards investment in SDGs*	• Start-up and scaling issues for new financing solutions • Failures in global capital markets • Lack of transparency on sustainable corporate performance • Misaligned investor rewards/pay structures	• Create fertile soil for innovative SDG-financing approaches and corporate initiatives • Build or improve pricing mechanisms for externalities • Promote Sustainable Stock Exchanges • Introduce financial market reforms
CHANNELLING *Promoting and facilitating investment into SDG sectors*	• Entry barriers • Lack of information and effective packaging and promotion of SDG investment projects • Inadequate risk-return ratios for SDG investments • Lack of investor expertise in SDG sectors	• Build an investment policy climate conducive to investing in SDGs, while safeguarding public interests • Expand use of risk sharing mechanisms for SDG investments • Establish new incentives schemes and a new generation of investment promotion institutions • Build SDG investment partnerships
IMPACT *Maximizing sustainable development benefits, minimizing risks*	• Weak absorptive capacity in developing countries • Need to minimize risks associated with private investment in SDG sectors • Need to engage stakeholders and manage impact trade-offs • Inadequate investment impact measurement and reporting tools	• Build productive capacity, entrepreneurship, technology, skills, linkages • Establish effective regulatory frameworks and standards • Good governance, capable institutions, stakeholder engagements • Implement a common set of SDG investment impact indicators and push Integrated Corporate Reporting

A Big Push for private investment in sustainable development

UNCTAD's Action Plan for Private Investment in the SDGs contains a range of policy options to respond to the mobilization, channelling and impact challenges. However, a concerted push by the international community and by policymakers at national levels needs to focus on a few priority actions – or packages. Figure 12 proposes six packages that group actions related to specific segments of the "SDG investment chain" and that address relatively homogenous groups of stakeholders for action. Such a focused set of action packages can help shape a *Big Push* for private investment in sustainable development:

1. *A new generation of investment promotion strategies and institutions.* Sustainable development projects, whether in infrastructure, social housing or renewable energy, require intensified efforts for investment promotion and facilitation. Such projects should become a priority of the work of IPAs and business development organizations.

   The most frequent constraint faced by potential investors in sustainable development projects is the lack of concrete proposals of sizeable, impactful, and bankable projects. Promotion and facilitation of investment in sustainable development should include the marketing of pre-packaged and structured projects with priority consideration and sponsorship at the highest political level. This requires specialist expertise and dedicated units, e.g. government-sponsored "brokers" of sustainable development investment projects. Putting in place such specialist expertise (ranging from project and structured finance expertise to engineering and project design skills) can be supported by technical assistance from a consortium of international organizations and multilateral development banks. Units could also be set up at the regional level to share costs and achieve economies of scale.

   Promotion of investment in SDG sectors should be supported by an international investment policy regime that effectively pursues the same objectives. Currently, IIAs focus on the protection of investment. Mainstreaming sustainable development in IIAs requires, among others, proactive promotion of investment, with commitments in areas such as technical assistance. Other measures include linking investment promotion institutions, facilitating SDG investments through investment insurance and guarantees, and regular impact monitoring.

2. *SDG-oriented investment incentives.* Investment incentive schemes can be restructured specifically to facilitate sustainable development projects. A transformation is needed from purely "location-based" incentives, aiming to increase the competitiveness of a location and provided at the time of establishment, towards "SDG-based" incentives, aiming to promote investment in SDG sectors and conditional upon sustainable performance.

3. *Regional SDG Investment Compacts.* Regional and South-South cooperation can foster SDG investment. Orienting regional cooperation towards the promotion of SDG investment can be especially effective for cross-border infrastructure development and regional clusters of firms operating in SDG sectors (e.g. green zones). This could include joint investment promotion mechanisms, joint programmes to build absorptive capacity, and joint public-private partnership models.

4. *New forms of partnership for SDG investments.* Cooperation between outward investment agencies in home countries and IPAs in host countries could be institutionalized for the purpose of marketing SDG investment opportunities in home countries, provision of investment incentives and facilitation services for SDG projects, and joint monitoring and impact assessment. Outward investment agencies could evolve into genuine business development agencies for investments in SDG sectors in developing countries, raising awareness of investment opportunities, helping investors to bridge knowledge gaps, and practically facilitate the investment process. Concrete tools that might support SDG investment business development services might include online pipelines of bankable projects and opportunities for linkages programmes in developing countries. A multi-agency technical assistance consortium could

Figure 12. A Big Push for private investment in the SDGs: action packages

Action Packages

1 New generation of investment promotion strategies and institutions

- At national level:
  - New investment promotion strategies focusing on SDG sectors
  - New investment promotion institutions: SDG investment development agencies developing and marketing pipelines of bankable projects
- New generation of IIAs:
  - Pro-active SDG investment promotion and facilitation
  - Safeguarding policy space for sustainable development

2 Reorientation of investment incentives

- SDG-oriented investment incentives
  - Targeting SDG sectors
  - Conditional on sustainability contributions
- SDG investment guarantees and insurance schemes

3 Regional SDG Investment Compacts

- Regional/South-South economic cooperation focusing on:
  - Regional cross-border SDG infrastructure development
  - Regional SDG industrial clusters, including development of regional value chains
  - Regional industrial collaboration agreements

4 New forms of partnerships for SDG investment

- Partnerships between outward investment agencies in home countries and IPAs in host countries
- Online pools of bankable SDG projects
- SDG-oriented linkages programmes
- Multi-agency technical assistance consortia
- SVE-TNC-MDG partnerships

5 Enabling innovative financing and a reorientation of financial markets

- New SDG financing vehicles
- SDG investment impact indicators
- Investors' SDG contribution rating
- Integrated reporting and multi-stakeholder monitoring
- Sustainable Stock Exchanges (SSEs)

6 Changing the global business mindset

- Global Impact MBAs
- Training programmes for SDG investment (e.g. fund management/financial market certifications)
- Enrepreneurship programmes in schools

Guiding Principles

Balancing liberalization and regulation

Balancing the need for attractive risk-return rates with the need for accessible and affordable services for all

Balancing a push for private funds with the push for public investment

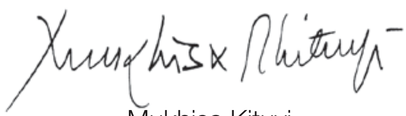
Balancing the global scope of the SDGs with the need to make a special effort in LDCs

help to support LDCs. South-South partnerships could also help spread good practices and lessons learned.

5. *Enabling innovative financing mechanisms and a reorientation of financial markets.* New and existing financing mechanisms, such as green bonds or impact investing, deserve support and an enabling environment to allow them to be scaled up and marketed to the most promising sources of capital. Publicly sponsored seed funding mechanisms and facilitated access to financial markets for SDG projects are further mechanisms that merit attention. Furthermore, reorientation of financial markets towards sustainable development needs integrated reporting on the economic, social and environmental impact of private investors. This is a fundamental step towards responsible investment behavior in financial markets and a prerequisite for initiatives aimed at mobilizing funds for investment in SDGs; integrated reporting is at the heart of Sustainable Stock Exchanges.

6. *Changing the global business mindset and developing SDG investment expertise.* The majority of managers in the world's financial institutions and large multinational enterprises – the main sources of global investment – as well as most successful entrepreneurs tend to be strongly influenced by models of business, management and investment that are commonly taught in business schools. Such models tend to focus on business and investment opportunities in mature or emerging markets, with the risk-return profiles associated with those markets, while they tend to ignore opportunities outside the parameters of these models. Conventional models also tend to be driven exclusively by calculations of economic risks and returns, often ignoring broader social and environmental impacts, both positive and negative. Moreover, a lack of consideration in standard business school teachings of the challenges associated with operating in poor countries, and the resulting need for innovative problem solving, tend to leave managers ill-prepared for pro-poor investments. A curriculum for business schools that generates awareness of investment opportunities in poor countries and that instills in students the problem solving skills needed in developing-country operating environments can have an important long-term impact. Inserting relevant modules in existing training and certification programmes for financial market participants can also help.

The *Action Plan for Private Investment in the SDGs* is meant to serve as a point of reference for policymakers at national and international levels in their discussions on ways and means to implement the SDGs and the formulation of operational strategies for investing in the SDGs. It has been designed as a "living document" and incorporates an online version that aims to establish an interactive, open dialogue, inviting the international community to exchange views, suggestions and experiences. It thus constitutes a basis for further stakeholder engagement. UNCTAD aims to provide the platform for such engagement through its biennial *World Investment Forum*, and online through the *Investment Policy Hub*.



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