



WORLD INVESTMENT REPORT 2016

INVESTOR NATIONALITY: POLICY CHALLENGES

KEY MESSAGES AND OVERVIEW



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NOTE

The Division on Investment and Enterprise of UNCTAD serves as the focal point for all matters related to foreign direct investment and multinational enterprises in the United Nations System. It builds on more than four decades of experience and international expertise in research and policy analysis on investment and enterprise development, fosters intergovernmental consensus-building, and provides technical assistance to over 160 countries.

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PREFACE

In 2015, global flows of foreign direct investment rose by about 40 per cent, to \$1.8 trillion, the highest level since the global economic and financial crisis began in 2008. However, this growth did not translate into an equivalent expansion in productive capacity in all countries. This is a troubling development in light of the investment needs associated with the newly adopted Sustainable Development Goals and the ambitious action envisaged in the landmark Paris Agreement on climate change. This latest *World Investment Report* presents an Investment Facilitation Action Package to further enhance the enabling environment for investment in sustainable development.

The Addis Ababa Action Agenda calls for reorienting the national and international investment regime towards sustainable development. UNCTAD plays an important role within the United Nations system in supporting these endeavours. Its Investment Policy Framework and the Road Map for International Investment Agreements Reform have been used by more than 100 countries in reviewing their investment treaty networks and formulating a new generation of international investment policies.

Regulations on the ownership and control of companies are essential in the investment regime of most countries. But in an era of complex multinational ownership structures, the rationale and effectiveness of this policy instrument needs a comprehensive re-assessment. This Report provides insights on the ownership structures of multinational enterprises (MNEs), and maps the global network of corporate entities using data on millions of parents and affiliates. It analyses national and international investment policy practices worldwide, and proposes a new framework for handling ownership issues.

This latest edition of the *World Investment Report* is being issued as the world embarks on the crucial work of implementing the landmark 2030 Agenda for Sustainable Development and the Paris Agreement on climate change. The key findings and policy recommendations of the Report are far reaching and can contribute to our efforts to uphold the promise to leave no one behind and build a world of dignity for all. I therefore commend this Report to a wide global audience.



BAN Ki-moon
Secretary-General of the United Nations

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KEY MESSAGES

GLOBAL INVESTMENT TRENDS

Recovery in FDI was strong in 2015. Global foreign direct investment (FDI) flows jumped by 38 per cent to \$1.76 trillion, their highest level since the global economic and financial crisis of 2008–2009. A surge in cross-border mergers and acquisitions (M&As) to \$721 billion, from \$432 billion in 2014, was the principal factor behind the global rebound. The value of announced greenfield investment remained at a high level, at \$766 billion.

Part of the growth in FDI was due to corporate reconfigurations. These transactions often involve large movements in the balance of payments but little change in actual operations. Discounting these large-scale corporate reconfigurations implies a more moderate increase of around 15 per cent in global FDI flows.

Inward FDI flows to developed economies almost doubled to \$962 billion. As a result, developed economies tipped the balance back in their favour with 55 per cent of global FDI, up from 41 per cent in 2014. Strong growth in inflows was reported in Europe. In the United States FDI almost quadrupled, albeit from a historically low level in 2014.

Developing economies saw their FDI inflows reach a new high of \$765 billion, 9 per cent higher than in 2014. Developing Asia, with FDI inflows surpassing half a trillion dollars, remained the largest FDI recipient region in the world. Flows to Africa and Latin America and the Caribbean faltered. Developing economies continue to comprise half of the top 10 host economies for FDI flows.

Outward FDI flows from developed economies jumped by 33 per cent to \$1.1 trillion. The increase notwithstanding, their outward FDI remained 40

per cent short of its 2007 peak. With flows of \$576 billion, Europe became the world's largest investing region. FDI by MNEs from North America stayed close to their 2014 levels.

Primary sector FDI activity decreased, manufacturing increased. A flurry of deals raised the share of manufacturing in cross-border M&As above 50 per cent in 2015. FDI in the primary sector declined because of reductions in planned capital expenditures in response to declining commodity prices, as well as a sharp fall in reinvested earnings as profit margins shrank. Services continue to hold over 60 per cent of global FDI stock.

Looking ahead, FDI flows are expected to decline by 10–15 per cent in 2016, reflecting the fragility of the global economy, persistent weakness of aggregate demand, sluggish growth in some commodity exporting countries, effective policy measures to curb tax inversion deals and a slump in MNE profits. Over the medium term, global FDI flows are projected to resume growth in 2017 and to surpass \$1.8 trillion in 2018, reflecting an expected pick up in global growth.

REGIONAL INVESTMENT TRENDS

FDI flows to Africa fell to \$54 billion in 2015, a decrease of 7 per cent over the previous year. An upturn in FDI into North Africa was more than offset by decreasing flows into Sub-Saharan Africa, especially to West and Central Africa. Low commodity prices depressed FDI inflows in natural-resource-based economies. FDI inflows to Africa are expected to increase moderately in 2016 due to liberalization measures and planned privatizations of state-owned enterprises.

Developing Asia saw FDI inflows increase by 16 per cent to \$541 billion – a new record. The significant growth was driven by the strong performance of East and South Asian economies. FDI inflows are expected to slow down in 2016 and revert to their 2014 level. Outflows from the region dropped by about 17 per cent to \$332 billion – the first decline since 2012.

FDI flows to Latin America and the Caribbean – excluding offshore financial centres – remained flat in 2015 at \$168 billion. Slowing domestic demand and worsening terms of trade caused by falling commodity prices hampered FDI mainly in South America. In contrast, flows to Central America made gains in 2015 due to FDI in manufacturing. FDI flows to the region may slow down in 2016 as challenging macroeconomic conditions persist.

FDI flows to transition economies declined further, to levels last seen almost 10 years ago, owing to a combination of low commodity prices, weakening domestic markets and the impact of restrictive measures/geopolitical tensions. Outward FDI from the region also slowed down, hindered by the reduced access to international capital markets. After the slump of 2015, FDI flows to transition economies are expected to increase modestly.

After three successive years of contraction, FDI inflows to developed countries bounced back sharply to the highest level since 2007. Exceptionally high cross-border M&A values among developed economies were the principal factor. Announced greenfield investment also remained high. Outward FDI from the group jumped. Barring another wave of cross-border M&A deals and corporate reconfigurations, the recovery of FDI activity is unlikely to be sustained in 2016 as the growth momentum in some large developed economies weakened towards the end of 2015.

FDI flows to structurally weak and vulnerable economies as a group increased moderately by 2 per cent to \$56 billion. Developing economies are now major sources of investments in all of these groupings. Flows to least developed countries (LDCs) jumped by one third to \$35 billion; landlocked developing countries (LLDCs) and small island developing States (SIDS) saw a decrease in their FDI inflows of 18 per cent and 32 per cent respectively. Divergent trends are also reflected in their FDI prospects for 2016. While LLDCs are expected to see increased inflows, overall FDI prospects for LDCs and SIDS are subdued.

INVESTMENT POLICY TRENDS

Most new investment policy measures continue to be geared towards investment liberalization and promotion. In 2015, 85 percent of measures were favourable to investors. Emerging economies in Asia were most active in investment liberalization, across a broad range of industries. Where new investment restrictions or regulations were introduced, these mainly reflected concerns about foreign ownership in strategic industries. A noteworthy feature in new measures was also the adoption or revision of investment laws, mainly in some African countries.

National security considerations are an increasingly important factor in investment policies. Countries use different concepts of national security, allowing them to take into account key economic interests in the investment screening process. Governments' space for applying national security regulations needs to be balanced with investors' need for transparent and predictable procedures.

The universe of international investment agreements (IIAs) continues to grow. In 2015, 31 new IIAs were concluded, bringing the universe to 3,304 treaties by year-end. Although the annual number of new IIAs continues to decrease, some IIAs involve a large number of parties and carry significant economic and political weight. Recent IIAs follow different treaty models and regional agreements often leave existing bilateral treaties between the parties in force, increasing complexity. By the end of May 2016, close to 150 economies were engaged in negotiating at least 57 new IIAs.

With 70 cases initiated in 2015, the number of new treaty-based investor-State arbitrations set a new annual high. Following the recent trend, a high share of cases (40 per cent) was brought against developed countries. Publicly available arbitral decisions in 2015 had a variety of outcomes, with States often prevailing at the jurisdictional stage of proceedings, and investors winning more of the cases that reached the merits stage.

IIA reform is intensifying and yielding the first concrete results. A new generation of investment treaties is emerging. UNCTAD's Investment Policy Framework and its Road Map for IIA Reform are shaping key reform activities at all levels of policymaking. About 100 countries have used these policy instruments to review their IIA networks and about 60 have used them to design treaty clauses. During this first phase of IIA reform, countries have built consensus on the need for reform, identified reform areas and approaches, reviewed their IIA networks, developed new model treaties and started to negotiate new, more modern IIAs.

Despite significant progress, much remains to be done. Phase two of IIA reform will require countries to focus more on the existing stock of treaties. Unlike the first phase of IIA reform, where most activities took place at the national level, phase two of IIA reform will require enhanced collaboration and coordination between treaty partners to address the systemic risks and incoherence of the large body of old treaties. The 2016 World Investment Forum offers the opportunity to discuss how to carry IIA reform to the next phase.

Investment facilitation: a policy gap that needs to be closed. Promoting and facilitating investment is crucial for the post-2015 development agenda. At the national level, many countries have set up schemes to promote and facilitate investment, but most efforts relate to promotion (marketing a location and providing incentives) rather than facilitation (making it easier to invest). In IIAs, concrete facilitation measures are rare.

UNCTAD's Global Action Menu for Investment Facilitation provides policy options to improve transparency and information available to investors, ensure efficient and effective administrative procedures, and enhance predictability of the policy environment, among others. The Action Menu consists of 10 action lines and over 40 policy options. It includes measures that countries can implement unilaterally, and options that can guide international collaboration or that can be incorporated in IIAs.

INVESTOR NATIONALITY: POLICY CHALLENGES

More than 40 per cent of foreign affiliates worldwide have multiple “passports”. These affiliates are part of complex ownership chains with multiple cross-border links involving on average three jurisdictions. The nationality of investors in and owners of foreign affiliates is becoming increasingly blurred.

“Multiple passport affiliates” are the result of indirect foreign ownership, transit investment through third countries, and round-tripping. About 30 per cent of foreign affiliates are indirectly foreign owned through a domestic entity; more than 10 per cent are owned through an intermediate entity in a third country; about 1 per cent are ultimately owned by a domestic entity. These types of affiliates are much more common in the largest MNEs: 60 per cent of their foreign affiliates have multiple cross-border ownership links to the parent company.

The larger the MNEs, the greater is the complexity of their internal ownership structures. The top 100 MNEs in UNCTAD’s Transnationality Index have on average more than 500 affiliates each, across more than 50 countries. They have 7 hierarchical levels in their ownership structure (i.e. ownership links to affiliates could potentially cross 6 borders), they have about 20 holding companies owning affiliates across multiple jurisdictions, and they have almost 70 entities in offshore investment hubs.

Rules on foreign ownership are ubiquitous: 80 per cent of countries restrict majority foreign ownership in at least one industry. The trend in ownership-related measures is towards liberalization, through the lifting of restrictions, increases in allowed foreign shareholdings, or easing of approvals and admission procedures for foreign investors. However, many ownership restrictions remain in place in both developing and developed countries.

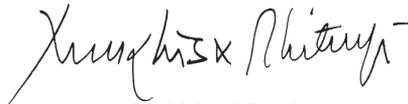
The blurring of investor nationality has made the application of rules and regulations on foreign ownership more challenging. Policymakers in some countries have developed a range of mechanisms to safeguard the effectiveness of foreign ownership rules, including anti-dummy laws, general anti-abuse rules to prevent foreign control, and disclosure requirements.

Indirect ownership structures and mailbox companies have the potential to significantly expand the reach of IIAs. About one third of ISDS claims are filed by claimant entities that are ultimately owned by a parent in a third country (not party to the treaty on which the claim is based). Some recent IIAs try to address the challenges posed by complex ownership structures through more restrictive definitions, denial of benefits clauses and substantial business activity requirements, but the vast majority of existing treaties does not have such devices.

Policymakers should be aware of the de facto multilateralizing effect of complex ownership on IIAs. For example, up to a third of apparently intra-regional foreign affiliates in major (prospective) megaregional treaty areas, such as the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP), and the Regional Comprehensive Economic Partnership (RCEP), are ultimately owned by parents outside the region, raising questions about the ultimate beneficiaries of these treaties and negotiations. Policymakers should aim to avoid uncertainty for both States and investors about the coverage of the international investment regime.

Rethinking ownership-based investment policies means safeguarding the effectiveness of ownership rules and considering alternatives. On the one hand, policymakers should test the “fit-for-purpose” of ownership rules compared to mechanisms in investment-related policy areas such as competition, tax, and industrial development. On the other, policymakers can strengthen the assessment of ownership chains and ultimate ownership and improve disclosure requirements. However, they should be aware of the administrative burden this can impose on public institutions and on investors.

Overall, it is important to find a balance between liberalization and regulation in pursuing the ultimate objective of promoting investment for sustainable development.



Mukhisa Kituyi
Secretary-General of UNCTAD

TABLE OF CONTENTS

PREFACE	iii
ACKNOWLEDGEMENTS	iv
KEY MESSAGES	v
OVERVIEW	1
GLOBAL INVESTMENT TRENDS	1
REGIONAL INVESTMENT TRENDS	11
INVESTMENT POLICY TRENDS	19
INVESTOR NATIONALITY: POLICY CHALLENGES	27

OVERVIEW

GLOBAL INVESTMENT TRENDS

The recovery in global FDI was strong in 2015

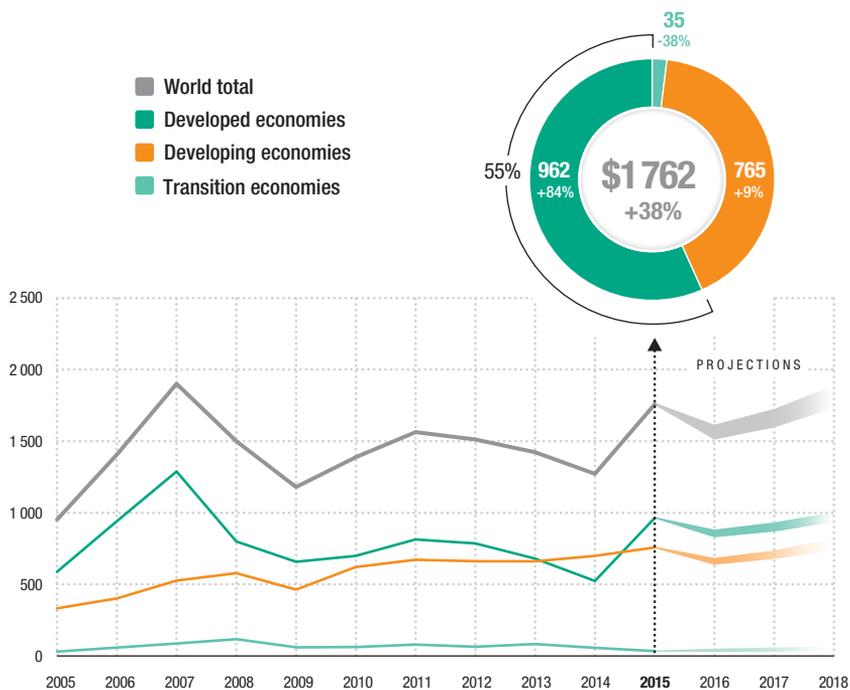
Global foreign direct investment (FDI) flows jumped by 38 per cent to \$1,762 billion, their highest level since the global economic and financial crisis of 2008–2009 (figure 1). A surge in cross-border mergers and acquisitions (M&As) to \$721 billion, from \$432 billion in 2014, was the principal factor behind the global rebound. These acquisitions were partly driven by corporate reconfigurations, including tax inversions. Discounting these large-scale corporate reconfigurations implies a more moderate increase of about 15 per cent in global FDI flows. The value of announced greenfield investment remained at a high level, at \$766 billion.

Buoyant cross-border M&As tilted FDI patterns back towards developed economies

Flows to developed economies nearly doubled (up 84 per cent) to \$962 billion, up from \$522 billion in 2014. Strong growth in inflows was reported in Europe. In the United States FDI almost quadrupled, albeit from a historically low level in 2014. The share of developed economies in world FDI inflows therefore leapt from 41 per cent in 2014 to 55 per cent in 2015 (figure 1), reversing a five-year trend during which developing and transition regions had become the main recipients of global FDI.

Much of this shift to developed economies was due to cross-border M&A activity, which recorded a 67 per cent increase in value to \$721 billion – the highest level since 2007. Activity was particularly pronounced in the United States where net sales rose from \$17 billion in 2014 to \$299 billion. Deal making in Europe also rose significantly (up 36 per cent). While FDI through cross-border M&As can contribute to productive investments, a number of deals concluded in 2015 can be attributed to corporate reconfigurations,

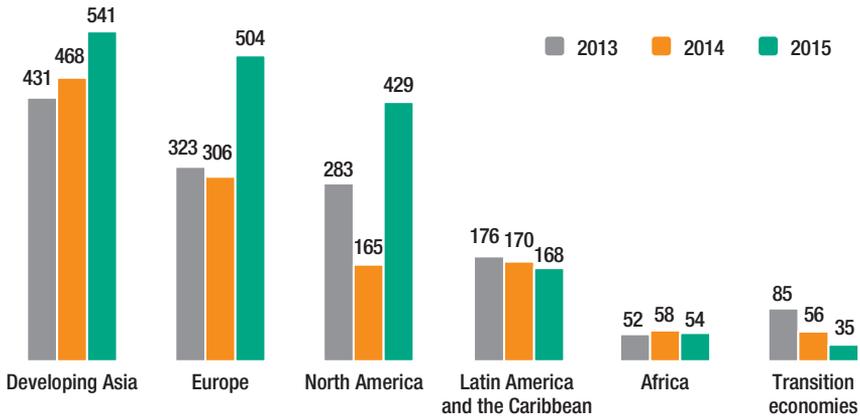
Figure 1. Global FDI inflows by group of economies, 2005–2015, and projections, 2016–2018 (Billions of dollars and per cent)



Source: ©UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

including tax inversions. This trend was especially apparent in the United States and Europe, with several mega-deals concluded to transfer the tax domicile of an MNE to jurisdictions that offer lower corporate tax rates, and do not levy tax on global earnings.

FDI to developing economies – excluding Caribbean financial centres – increased to a new high of \$765 billion (up 9 per cent). Developing Asia, with its FDI inflows surpassing half a trillion dollars remained the largest FDI recipient region in the world (figure 2). Developing economies continued to comprise half of the top 10 host economies for FDI flows (figure 3).

Figure 2. | FDI inflows, by region, 2013–2015 (Billions of dollars)

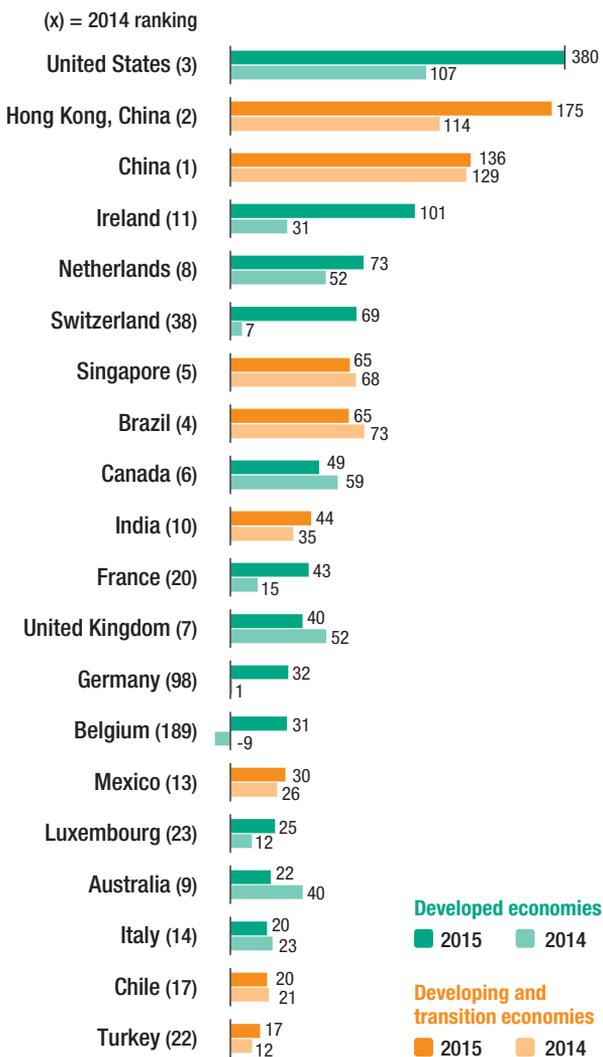
Source: ©UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

Developed economies also led a rebound in FDI outflows

Following three years of decline, FDI outflows from developed economies increased by 33 per cent to \$1.1 trillion. As a result, developed countries accounted for 72 per cent of global FDI outflows in 2015, up from 61 per cent in 2014. This 11 percentage point increase broke the nearly uninterrupted decline that began in 2007. The increase notwithstanding, the level of outward FDI from developed economies remained 40 per cent short of its 2007 peak. Europe became the world's largest investing region in 2015, with FDI outflows of \$576 billion. Foreign investment by North American MNEs, in contrast, remained flat, with a significant gain in Canada being offset by a moderate decline in the United States. Nevertheless, the United States remains the largest investor in the world, followed by Japan (figure 4).

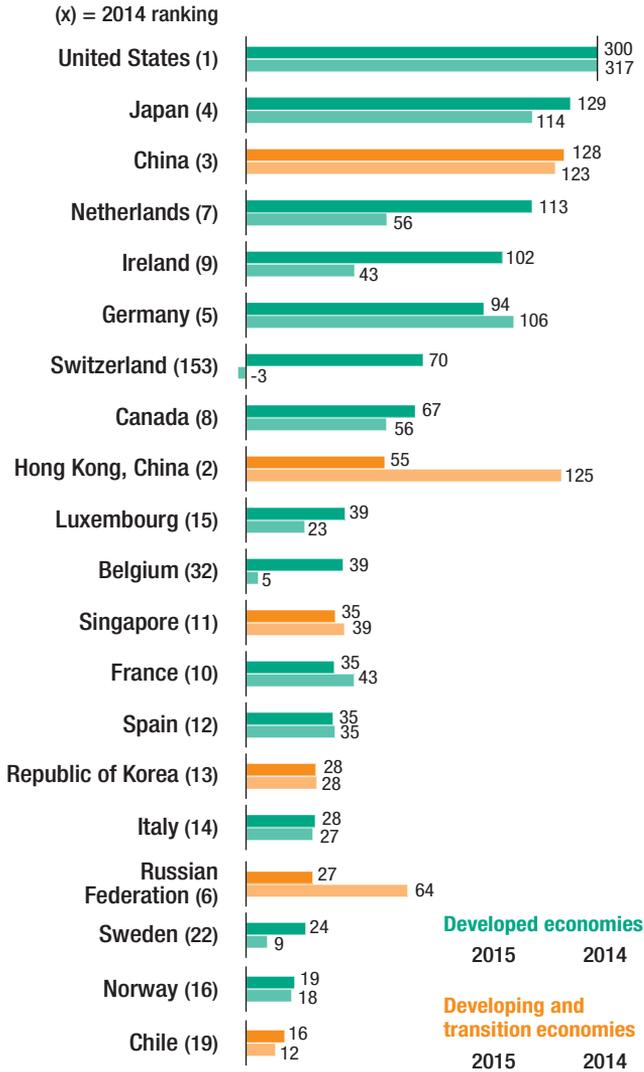
By contrast, FDI outflows declined in most developing and transition regions. A combination of challenges, including declining commodity prices and depreciating national currencies, and geopolitical risks were contributing factors. Against the general downward trend in FDI outflows

Figure 3. FDI inflows, top 20 host economies, 2014 and 2015 (Billions of dollars)



Source: ©UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

Figure 4. FDI outflows, top 20 home economies, 2014 and 2015 (Billions of dollars)



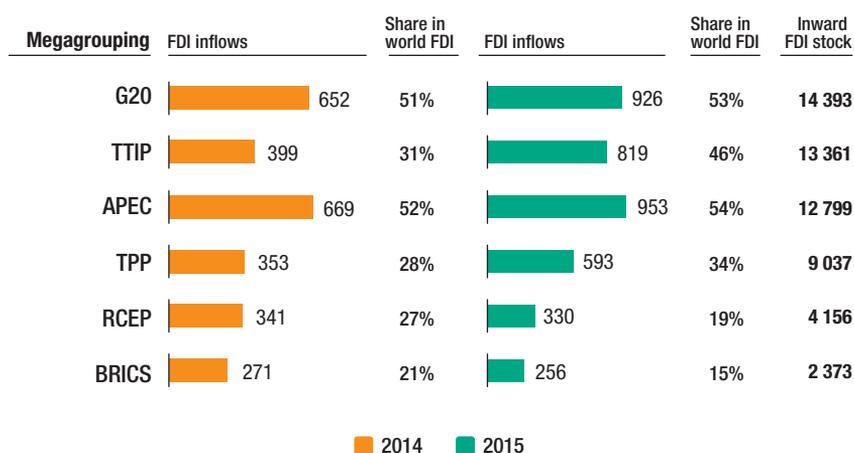
Source: ©UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

from developing and transition economies, China was a notable exception: its outward FDI remained high, rising from \$123 billion to \$128 billion, as a result of which it held its position as the third largest investor in the world.

Major economic groups or initiatives account for a significant share of global FDI

The G20, Transatlantic Trade and Investment Partnership, Asia-Pacific Economic Cooperation, Trans-Pacific Partnership, Regional Comprehensive Economic Partnership and the BRICS account for a significant share of global FDI flows (figure 5). With the exception of the BRICS, intra-group FDI is significant, accounting for some 30 per cent to 63 per cent of inflows in these groups. Although the actual impact on FDI patterns of these

Figure 5. FDI inflows in selected megagroupings, 2014 and 2015
(Billions of dollars and per cent)



Source: ©UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

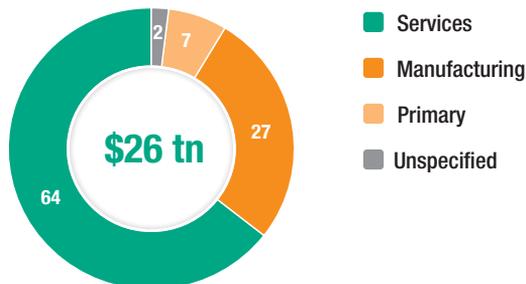
Note: In descending order of 2015 inward FDI stock. G20 = only the 19 member countries of the G20 (excludes the European Union); TTIP = Transatlantic Trade and Investment Partnership (under negotiation); APEC = Asia-Pacific Economic Cooperation; TPP = Trans-Pacific Partnership; RCEP = Regional Comprehensive Economic Partnership (under negotiation); BRICS = Brazil, Russian Federation, India, China and South Africa.

overlapping partnerships varies, a majority of MNE executives expect the emergence of mega economic groups to influence their companies' investment decisions over the next few years.

Primary sector FDI down, manufacturing up

Cross-border M&A sales in manufacturing reached a historical high in absolute terms (\$388 billion in 2015), surpassing the previous record set in 2007. This raised the share of manufacturing to more than 50 per cent of cross-border M&As in 2015. FDI in the primary sector, in contrast, suffered from sluggish commodity prices, which resulted not only in reductions in planned capital expenditures but also in a sharp fall in reinvested earnings. At the global level, reduced FDI in extractive industries has affected the total amount of FDI flows, especially in developing countries. In 2014, the services sector accounted for 64 per cent of the world's total FDI stock (figure 6).

Figure 6. Global inward FDI stock, by sector, 2014 (Trillions of dollars and per cent)



Source: ©UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

Investment flows through offshore financial hubs remain significant

Investment flows to offshore financial hubs – including those to special purpose entities (SPEs) and offshore financial centres – declined in 2015 but remain high (these flows are excluded from UNCTAD’s FDI statistics).

The magnitude of quarterly flows through SPEs rose sharply compared with 2014, reaching the levels registered in 2012–2013. Pronounced volatility, with flows swinging from large-scale net investment in the first three quarters to drastic net divestment in the last quarter, tempered the annual total, which dipped to \$221 billion. Investment flows to offshore financial centres were down to an estimated \$72 billion in 2015, a retreat from their anomalous peak of \$132 billion in 2013. They include growing flows from MNEs located in developing and transition economies, sometimes in the form of round-tripping and transit FDI.

The proportion of investment income booked in low tax, often offshore, jurisdictions is high despite the slowdown in offshore financial flows. The disconnect between the locations of income generation and productive investment which results in substantial fiscal losses is a key concern for policy makers.

The persistence of financial flows routed through offshore financial hubs and the potential fiscal losses due to the disconnect between income generation and productive investment underscore the pressing need to create greater coherence among tax and investment policies at the global level. The international investment and tax policy regimes are both the object of separate reform efforts. Better managing their interactions would help to make them coherent and mutually supportive. UNCTAD has proposed a set of guidelines for coherent international tax and investment policies (*WIR15*).

International production continues to expand

International production by foreign affiliates of MNEs expanded in 2015. Sales and value added rose by 7.4 per cent and 6.5 per cent, respectively.

Employment of foreign affiliates reached 79.5 million (table 1). However, the return on FDI of foreign affiliates in host economies worsened, falling from 6.7 per cent in 2014 to 6.0 per cent in 2015.

Table 1.

Selected indicators of FDI and international production, 2015 and selected years

Item	Value at current prices (Billions of dollars)				
	1990	2005–2007 (pre-crisis average)	2013	2014	2015
FDI inflows	207	1 418	1 427	1 277	1 762
FDI outflows	242	1 445	1 311	1 318	1 474
FDI inward stock	2 077	14 500	24 533	25 113	24 983
FDI outward stock	2 091	15 104	24 665	24 810	25 045
Income on inward FDI	75	1 025	1 526	1 595	1 404
<i>Rate of return on inward FDI</i>	4.4	7.3	6.5	6.7	6.0
Income on outward FDI	122	1 101	1 447	1 509	1 351
<i>Rate of return on outward FDI</i>	5.9	7.5	6.1	6.3	5.6
Cross-border M&As	98	729	263	432	721
Sales of foreign affiliates	5 101	20 355	31 865	34 149	36 668
Value added (product) of foreign affiliates	1 074	4 720	7 030	7 419	7 903
Total assets of foreign affiliates	4 595	40 924	95 671	101 254	105 778
Exports of foreign affiliates	1 444	4 976	7 469	7 688	7 803
Employment by foreign affiliates (thousands)	21 454	49 565	72 239	76 821	79 505
Memorandum					
GDP	22 327	51 288	75 887	77 807	73 152
Gross fixed capital formation	5 072	11 801	18 753	19 429	18 200
Royalties and licence fee receipts	29	172	298	311	299
Exports of goods and services	4 107	15 034	23 158	23 441	20 861

Source: ©UNCTAD.

FDI flows are expected to decline by 10–15 per cent in 2016, but to pick up over the medium term

FDI flows are expected to decline in 2016 in both developed and developing economies, barring another wave of cross-border megadeals and corporate reconfigurations. UNCTAD forecasts that FDI flows are likely to contract by 10–15 per cent in 2016, reflecting the fragility of the global economy,

the persistent weakness of aggregate demand, sluggish growth in some commodity exporting countries, effective policy measures to curb tax inversion deals and a slump in MNE profits in 2015 to the lowest level since the global economic and financial crisis of 2008–2009. Elevated geopolitical risks and regional tensions could further amplify the expected downturn. Over the medium term, FDI flows are projected to resume growth in 2017 and to surpass \$1.8 trillion in 2018.

Cross-border M&A activity in early 2016 confirms the projected decline of FDI flows. The value of transactions announced during the first four months (including divestments) was 32 per cent lower than during the same period in 2015. This decline reflects new measures imposed by the United States Treasury Department to rein in corporate inversions, which have already resulted in the cancellation of the \$160 billion merger of pharmaceutical company Pfizer (United States) with Ireland-based Allergan Plc.

This year's UNCTAD business survey of MNE executives reveals muted overall expectations for 2016, improving over the following two years. In particular, 45 per cent of top MNEs expect to spend less in 2016, compared with 32 per cent spending more; by 2018 this trend will reverse with 44 per cent expecting to spend more.

REGIONAL INVESTMENT TRENDS

Global FDI inflows rose in 2015 but with considerable variance between country groups and regions (table 2).

Low commodity prices hold back FDI to Africa

FDI flows to Africa fell to \$54 billion in 2015, a decrease of 7 per cent over the previous year. Dynamic flows into Egypt boosted FDI to **North Africa**, which rose by 9 per cent to \$12.6 billion in 2015. Yet this was offset by decreasing flows into Sub-Saharan Africa, as lower commodity prices depressed FDI inflows in natural-resource-based economies. FDI inflows to **West Africa** declined by 18 per cent to \$9.9 billion, largely because of a slump in FDI to Nigeria. FDI flows to **Central Africa** fell by 36 per cent to \$5.8 billion, as FDI flows to commodity-rich Congo and the Democratic Republic of the Congo declined significantly. **East Africa** received \$7.8 billion in FDI – a 2 per cent decrease from 2014. FDI flows to Kenya, however, reached a record level of \$1.4 billion in 2015, resulting from renewed investor interest and confidence in the country's business climate and booming domestic consumer market. In **Southern Africa**, FDI flows increased by 2 per cent to \$17.9 billion, mainly driven by a record \$8.7 billion inflows in Angola, largely due to intracompany loans. Lacklustre economic performance, low commodity prices and higher electricity costs pushed FDI in South Africa to \$1.8 billion – the lowest level in 10 years.

FDI outflows from Africa fell by 25 per cent to \$11.3 billion. Investors from South Africa, Nigeria and Angola reduced their investment abroad owing to factors such as lower commodity prices, weaker demand from main trading partners, and depreciating national currencies.

FDI inflows to Africa are expected to return to a growth path in 2016, increasing to \$55–60 billion. This increase is already becoming apparent in announced greenfield projects in the first quarter of 2016, particularly

Table 2. FDI flows, by region, 2013–2015
(Billions of dollars and per cent)

Region	FDI inflows			FDI outflows		
	2013	2014	2015	2013	2014	2015
World	1 427	1 277	1 762	1 311	1 318	1 474
Developed economies	680	522	962	826	801	1 065
Europe	323	306	504	320	311	576
North America	283	165	429	363	372	367
Developing economies	662	698	765	409	446	378
Africa	52	58	54	16	15	11
Asia	431	468	541	359	398	332
East and South-East Asia	350	383	448	312	365	293
South Asia	36	41	50	2	12	8
West Asia	46	43	42	45	20	31
Latin America and the Caribbean	176	170	168	32	31	33
Oceania	3	2	2	2	1	2
Transition economies	85	56	35	76	72	31
Structurally weak, vulnerable and small economies	52	55	56	14	14	8
LDCs	21	26	35	8	5	3
LLDCs	30	30	24	4	7	4
SIDS	6	7	5	3	2	1
Memorandum: percentage share in world FDI flows						
Developed economies	47.7	40.9	54.6	63.0	60.7	72.3
Europe	22.7	24.0	28.6	24.4	23.6	39.1
North America	19.8	12.9	24.3	27.7	28.2	24.9
Developing economies	46.4	54.7	43.4	31.2	33.8	25.6
Africa	3.7	4.6	3.1	1.2	1.2	0.8
Asia	30.2	36.6	30.7	27.4	30.2	22.5
East and South-East Asia	24.5	30.0	25.4	23.8	27.7	19.9
South Asia	2.5	3.2	2.9	0.2	0.9	0.5
West Asia	3.2	3.4	2.4	3.4	1.5	2.1
Latin America and the Caribbean	12.3	13.3	9.5	2.5	2.4	2.2
Oceania	0.2	0.2	0.1	0.2	0.1	0.1
Transition economies	5.9	4.4	2.0	5.8	5.5	2.1
Structurally weak, vulnerable and small economies	3.6	4.3	3.2	1.1	1.1	0.5
LDCs	1.5	2.1	2.0	0.6	0.4	0.2
LLDCs	2.1	2.3	1.4	0.3	0.5	0.2
SIDS	0.4	0.6	0.3	0.2	0.1	0.1

Source: ©UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

in North Africa, but also in Mozambique, Ethiopia, Rwanda and United Republic of Tanzania. FDI flows are expected to increase in Kenya and the United Republic of Tanzania which now allow 100 per cent foreign ownership of companies listed on their stock exchanges. Furthermore, privatization of State-owned commodity assets in countries such as Algeria and Zambia should also provide a boost to inflows.

FDI flows to Developing Asia hit new records

Developing Asia, with FDI inflows reaching \$541 billion – a 16 per cent increase – remained the largest FDI recipient region in the world. The growth was primarily driven by increased FDI in East and South Asian economies. In **East Asia**, FDI rose by 25 per cent to \$322 billion, reflecting large equity investments related to a corporate restructuring in Hong Kong (China) and dynamic FDI flows to China's services sector. In **South-East Asia**, FDI to low-income economies such as Myanmar and Viet Nam soared, but this was offset by the lacklustre performance of higher-income countries, including Singapore, Indonesia and Malaysia. India's and Bangladesh's FDI performance pushed inflows to **South Asia** to \$50 billion, an increase of 22 per cent from 2014. India became the fourth largest recipient of investment in developing Asia and the tenth largest in the world. In **West Asia**, rising inflows to Turkey partly offset the negative impact of commodity prices and geopolitical challenges on FDI to oil-producing economies, resulting in an overall 2 per cent decline to \$42 billion.

After the jump in values recorded in 2015, FDI inflows are expected to revert to their 2014 level. Data on cross-border M&A sales in the first quarter of 2016 and announced greenfield investment projects support the expected slowdown.

Despite the decline in outflows from developing Asia by 17 per cent to \$332 billion, the region's outward FDI in 2015 remained the third highest ever. Outward FDI from a number of Asian economies, including China and

Thailand, increased. With outflows worth \$128 billion, China remained the third largest investing country worldwide. After a surge of outward FDI in 2014, flows from Hong Kong (China) more than halved to \$55 billion, due to a large corporate restructuring. **South-East Asia's** outward FDI decreased by 11 per cent to \$67 billion, due to a decline in outflows from Singapore. Outward FDI from India, **South Asia's** dominant investor, dropped by more than one third which resulted in an overall 36 per cent decline of outflows from the region to \$8 billion. Outflows from **West Asia**, in contrast, soared by 54 per cent to \$31 billion mainly due to a turnaround by Kuwait – a major investor in the region.

FDI flows to Latin America and the Caribbean remain flat

FDI to Latin America and the Caribbean – excluding the Caribbean offshore financial centres – stayed flat in 2015 at \$168 billion. There were contrasting performances in Central and South America, however. FDI flows to **Central America** rose by 14 per cent to \$42 billion, thanks to strong flows to Mexico and higher FDI in manufacturing across the subregion. FDI flows to **South America**, on the other hand, contracted by 6 per cent to \$121 billion, reflecting slowing domestic demand and worsening terms of trade caused by falling commodity prices. FDI flows to Brazil, the region's principal recipient, fell 12 per cent to \$65 billion. The decline in commodity prices also significantly affected flows to the Plurinational of State of Bolivia, Chile, Colombia, and Peru. In Argentina, FDI surged, albeit compared with abnormally low flows in 2014.

FDI outflows from the region rose by 5 per cent to \$33 billion in 2015. In Brazil, outward FDI expanded by a strong 38 per cent, an increase predominantly reflecting a significant reduction in reverse investment by Brazilian foreign affiliates. In Chile, outflows rose 31 per cent to \$16 billion.

FDI flows to the region may slow down further in 2016 as challenging macroeconomic conditions persist. In 2015, the value of announced greenfield projects dropped 17 per cent from their 2014 level, led by an 86 per cent decline in the extractive industry. Lower announced project values were also registered in the services sector. On the upside, national currency depreciation may motivate the acquisitions of assets. Cross-border M&As in the first quarter of 2016 were sharply up thanks to higher sales in Brazil, Chile and Colombia.

FDI flows in transition economies declined further in 2015

In 2015, FDI flows to transition economies fell by 38 per cent to \$35 billion. The FDI performance of transition subgroups differed: in **South-East Europe**, FDI inflows increased by 6 per cent to \$4.8 billion, as better macroeconomic conditions and the EU accession process continue to improve investors' risk perception. In contrast, FDI flows to the **Commonwealth of Independent States (CIS) and Georgia** declined by 42 per cent to \$30 billion in a situation of low commodity prices, weakening domestic markets, regulatory changes, and the direct and indirect impact of restrictive measures/geopolitical tensions. Flows to the Russian Federation slumped to \$9.8 billion as new FDI almost dried up due to the scaling back of operations and a string of divestment deals. The economic crisis and regulatory changes in the country have also reduced the scale and scope of round-tripping FDI.

MNEs from transition economies more than halved their FDI flows abroad. Geopolitical tensions, sharp currency depreciation and constraints in capital markets reduced outward FDI to \$31 billion in 2015 – a value last recorded in 2005.

After the significant decline recorded in 2015, FDI flows to transition economies are expected to increase modestly in 2016, barring any further escalation of geopolitical tensions in the region. In the CIS, several

countries, including Kazakhstan, the Russian Federation and Uzbekistan, have announced large privatization plans, which if realized, will open new avenues for foreign investment.

FDI inflows to developed countries increased sharply

Flows to developed economies nearly doubled to \$962 billion due to buoyant cross-border M&As sales. Inflows to **Europe** rose to \$504 billion, accounting for 29 per cent of global inflows. This rebound was driven by large increases in Ireland, Switzerland and Netherlands. Other major recipients were France and Germany, both of which recovered sharply from the low points in 2014. Inflows into the United Kingdom fell to \$40 billion but remained among the largest in Europe. In 2015, FDI inflows to **North America** reached \$429 billion, surpassing the record high of 2000. In the United States FDI almost quadrupled, albeit from a historically low level in 2014.

In 2015, MNEs from developed economies invested \$1.1 trillion abroad – a 33 per cent increase from the previous year. **Europe** became the world's largest investing region owing to a strong rebound in their cross-border M&A purchases. Foreign investment by MNEs from **North America** remained flat, with a significant increase in outflows from Canada being offset by a moderate decline of flows from the United States. Japanese MNEs continued to seek growth opportunities abroad, investing more than \$100 billion for the fifth consecutive year.

Barring another wave of cross-border M&A deals and corporate reconfigurations, the recovery of FDI activity recorded in 2015 is unlikely to be sustained at the same level in 2016. Recent regulatory measures meant to curb tax inversion deals are likely to discourage cross-border M&A deals and corporate reconfigurations. In addition, the economic growth momentum observed in some large developed economies weakened towards the end of 2015.

FDI to structurally weak and vulnerable economies remains concentrated in extractives industries

FDI flows to the **least developed countries** (LDCs) rose by 33 per cent to a record high of \$35 billion. In Asia, prospects of deeper economic integration in the ASEAN region spurred FDI in the Lao People's Democratic Republic and Myanmar. FDI flows to Bangladesh hit a record high. Firms from China have become the largest holders of FDI stock in the LDCs, ahead of the United States.

FDI to LDCs as a whole is expected to decrease in 2016, reflecting the continuing lull in FDI to a large number of African economies relying heavily on natural resources. Nevertheless, some major FDI recipients in the group, such as Bangladesh, Ethiopia and Myanmar, are likely to see a rise in their FDI inflows in 2016.

In the **landlocked developing countries** (LLDCs), FDI flows fell for the fourth consecutive year to \$24.5 billion – a drop of 18 per cent. Transition economy LLDCs accounted for the fall, particularly Kazakhstan, where flows halved. Inflows to the African subgroup also declined, while FDI flows to Asian LLDC economies increased by more than a quarter. In spite of low commodity prices, Asian State-owned firms have been increasingly involved in Central Asia's primary sector. Developing country investors, in particular from China, are holding an increasing share of FDI stock in LLDCs, as they do in LDC economies.

Looking ahead, a surge in the value of announced greenfield investments in the LLDCs provides grounds for optimism. FDI flows to LLDCs, in particular the transition economy subgroup, are expected to increase if large privatization plans materialize.

FDI flows to the ***small island developing States*** (SIDS) dipped by 32 per cent to a five-year low of \$4.8 billion. Reduced investment by energy firms contributed to a contraction in FDI flows to Trinidad and Tobago, the largest FDI host in the group. In Africa, FDI flows to Mauritius fell by 50 per cent, while in Asia and Oceania, the drop in FDI to Maldives and Fiji was less significant. Developing and transition economies now account for the majority of the top 10 investors in SIDS.

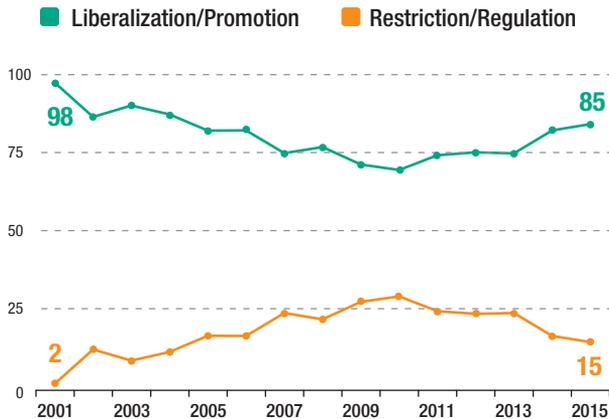
FDI prospects in SIDS remain subdued, owing to the lack of large-scale investments in extractive industries and construction. This, however, can be easily overturned by a single investment in, for example, liquefied natural gas or a resort complex project.

INVESTMENT POLICY TRENDS

National investment policies continue to be geared towards investment liberalization and promotion

UNCTAD data show that, in 2015, 46 countries and economics adopted at least 96 policy measures affecting foreign investment. Of these measures, 71 related to the liberalization and promotion of investment, while 13 introduced new restrictions or regulations on investment (the remaining 12 measures are of a neutral nature). Liberalization and promotion accounted for 85 per cent of investment policy changes, which is above the average of the last five years (2010–2014) (figure 7).

Figure 7. Changes in national investment policies, 2001–2015 (Per cent)



Source: ©UNCTAD, Investment Policy Monitor Database.

Entry restrictions for foreign investment were eased or eliminated in a broad range of industries (e.g. aviation, financial services, mining, real estate). Some countries pursued privatization policies, in particular in infrastructure

sectors. Others improved business licensing procedures, established special economic zones or provided other forms of investment incentives. Another noteworthy feature was the adoption or revision of investment laws, mainly in African countries. Newly adopted investment restrictions or regulations largely reflected concerns about foreign ownership in strategic industries or agricultural land. There is a trend towards tightening screening procedures for investments in these sectors.

National security considerations are increasingly part of investment policies; they often cover broader national economic interests

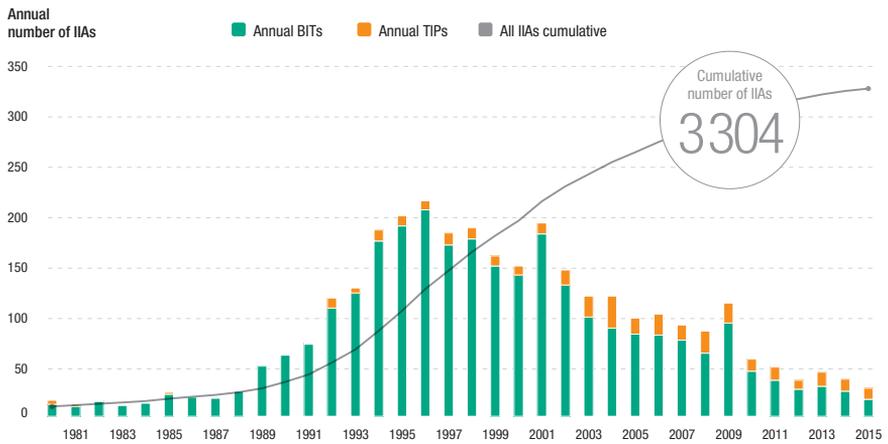
In recent years, national security considerations have gained prominence in investment policies. More countries have adopted legislation in this area or have reviewed foreign investment projects on grounds related to national security. This has a number of policy implications. First, countries use different concepts of national security, ranging from a relatively narrow definition to broader interpretations that extend investment review procedures to critical infrastructure, strategic industries and/or national-interest considerations. Second, countries follow different approaches when restricting foreign investment due to national-security considerations, ranging from formal restrictions in specific sectors to complex review mechanisms that provide the review bodies with ample discretion. Third, review procedures can differ substantially in their disclosure requirements for foreign investors. Governments' space for applying national security regulations needs to be balanced with investors' need for transparent and predictable procedures.

The IIA universe continues to grow

With the addition of 31 new international investment agreements (IIAs) – 20 bilateral investment treaties (BITs) and 11 treaties with investment provisions (TIPs) – the IIA universe grew to 3,304 agreements (2,946 BITs and 358 TIPs) by year-end (figure 8). Although the annual number of new IIAs continues to decrease, some treaties involve a large number of parties and carry significant economic and political weight. Recent IIAs follow different

treaty models, and regional agreements often leave existing bilateral treaties between the parties in force, increasing complexity.

Figure 8. | Trends in IIAs signed, 1980–2015



Source: ©UNCTAD, IIA Navigator.

Countries most active in concluding IIAs in 2015 were Brazil with six, Japan and the Republic of Korea with four each, and China with three. Brazil is taking a new approach to BITs, focusing on investment promotion and facilitation, and on dispute prevention and alternatives to arbitration.

The first four months of 2016 saw the conclusion of nine new IIAs (seven BITs and two TIPs), including the Trans Pacific-Partnership (TPP) Agreement, which involves 12 countries. By end-May 2016, close to 150 countries and economies were engaged in negotiating at least 57 new IIAs (including megaregional treaties such as the Transatlantic Trade and Investment Partnership (TTIP) and the Regional Comprehensive Economic Partnership (RCEP)).

At the same time, some countries terminated their IIAs in 2015. Typically, however, by virtue of survival clauses, investments made before the termination of these IIAs will remain protected for periods ranging from 10 to 20 years, depending on the relevant provisions of the agreements and the terms of termination.

The number of new treaty-based ISDS cases reached a record high, with a continued large share of cases against developed countries

In 2015, investors initiated 70 known ISDS cases pursuant to IIAs, which is the highest number of cases ever filed in a single year (figure 9). As arbitrations can be kept confidential under certain circumstances, the actual number of disputes filed for this and previous years is likely to be higher. As of 1 January 2016, the total number of publicly known ISDS claims had reached 696. One hundred and seven countries have been respondents to one or more known ISDS claims.

Figure 9. | Known ISDS cases, annual and cumulative, 1987–2015



Source: ©UNCTAD, ISDS Navigator.

Following the recent trend, a high share of cases (40 per cent) was brought against developed countries, including many cases by European investors against European Union member States. The majority of new cases were brought under BITs; the Energy Charter Treaty was invoked in about one third of cases. Publicly available arbitral decisions in 2015 indicated that States often prevailed at the jurisdictional stage of proceedings, and investors won more of the cases that reached the merits stage.

IIA reform is intensifying and yielding the first concrete results

Reform to bring the IIA regime in line with today's sustainable development imperative is gaining momentum. A new generation of investment treaties is emerging. In 2015, UNCTAD's *WIR* laid out a road map for IIA reform, providing six guidelines, addressing five reform areas, and outlining options for action at four levels of policymaking. UNCTAD's Investment Policy Framework and its Road Map for IIA Reform are shaping key reform activities.

At the national level, numerous countries are reviewing their IIA network and/or developing a new treaty model. About 100 countries (including those that undertook a review as part of the Regional Economic Integration Organization (REIO)) have used the UNCTAD's Investment Policy Framework to reassess their IIA networks. About 60 of these have used the Framework to design treaty clauses.

At the bilateral level, the reform drive is most prominently reflected in the negotiation of new IIAs. Most of the treaties recently concluded include several sustainable-development-friendly clauses.

At the regional level, IIA reform actions include collective treaty reviews and IIA action plans, which can result in common IIA models, joint interpretations, renegotiations, and/or the consolidation of treaties. Megaregional agreements could consolidate and streamline the IIA regime

and help enhance the systemic consistency of the IIA regime, provided they replace prior bilateral IIAs between the parties (*WIR14*).

IIA reform at the multilateral level is the most challenging path. The UNCTAD Road Map identifies several possible options for multilateral IIA reform with different levels of intensity. The importance of multilateral consultations on IIAs for the pursuit of today's sustainable development agenda has been recognized in the Addis Ababa Action Agenda, the outcome document of the Third UN Conference on Financing for Development, held in July 2015. In the Addis Ababa Action Agenda, Member States asked UNCTAD "to continue its existing programme of meetings and consultations with Member States on investment agreements."

During this first phase of IIA reform, countries have built consensus on the need for reform, identified reform areas and approaches, reviewed their IIA networks, developed new model treaties and started to negotiate new, more modern IIAs. Despite significant progress, much remains to be done.

First, comprehensive reform requires a two-pronged approach: negotiating new, more modern IIAs, but also modernizing the existing stock of treaties. Second, reform has to address the challenge of increasing fragmentation: only a common approach will effectively and efficiently deliver an IIA regime in which stability, clarity and predictability help achieve the objectives of all stakeholders. Unlike the first phase of IIA reform, where most activities took place at the national level, phase two of IIA reform will require countries to intensify collaboration and coordination among treaty partners to address the systemic risks and incoherence of the large body of old treaties. The 2016 World Investment Forum offers the opportunity to discuss how to carry IIA reform to the next phase.

Filling a systemic gap in investment facilitation

Facilitating investment is crucial for the post-2015 development agenda. Facilitation is different from investment promotion. Promotion is about

marketing a location as an investment destination and is therefore often country-specific and competitive in nature. Facilitation is about making it easier for investors to establish or expand their investments and to conduct their day-to-day business.

Investment facilitation can include improvements in transparency and information available to investors; work towards efficient and effective administrative procedures for investors; enhancing the consistency and predictability of the policy environment for investors through consultation procedures; and mitigating investment disputes through ombudspersons.

To date, national and international investment policies pay relatively little attention to investment facilitation. From the 173 new investment promotion and facilitation policies that were introduced around the world between 2010 and 2015, only a minority relate to investment facilitation. At the international level, concrete investment promotion and facilitation actions are either absent or weak in the great majority of the existing 3,304 IIAs.

UNCTAD's Global Action Menu for Investment Facilitation, which builds on UNCTAD's 2012 Policy Framework and its rich experience and practices of investment promotion and facilitation efforts worldwide over the past decades, responds to this systemic gap in investment policies. It consists of 10 action lines that provide over 40 options for investment policymakers to adapt and adopt for national and international policy needs.

- Action line 1 – Promote accessibility and transparency in the formulation of investment policies, regulations and procedures relevant to investors
- Action line 2 – Enhance predictability and consistency in the application of investment policies
- Action line 3 – Improve the efficiency and effectiveness of investment administrative procedures

- Action line 4 – Build constructive stakeholder relationships in investment policy practice
- Action line 5 – Designate a lead agency or investment facilitator with a specific mandate for disputes prevention and mediation
- Action line 6 – Establish monitoring and review mechanisms for investment facilitation
- Action line 7 – Enhance international cooperation for investment facilitation
- Action line 8 – Strengthen investment facilitation efforts in developing-country partners through technical assistance
- Action line 9 – Enhance investment policy and proactive investment attraction in developing-country partners
- Action line 10 – Enhance international cooperation towards investment for development, including through provisions in IIAs

The Action Menu includes measures that countries can choose to implement unilaterally and options that can guide international collaboration or can be incorporated in IIAs.

Any investment facilitation initiative cannot be considered in isolation from the broader sustainable development agenda. It is important to address weaknesses in investment facilitation capabilities where they exist in developing countries. Effective investment facilitation efforts should be an integral part of the overall investment policy framework (including regulation, liberalization, protection and promotion) aimed at maximizing the benefits of investment and minimizing any negative side effects or externalities.

INVESTOR NATIONALITY: POLICY CHALLENGES

More than 40 per cent of foreign affiliates worldwide have multiple “passports”

Firms, and especially affiliates of multinational enterprises (MNEs), are often controlled through hierarchical webs of ownership involving a multitude of entities. More than 40 per cent of foreign affiliates are owned through complex chains with multiple cross-border links involving on average three jurisdictions (figure 10). That implies that the nationality of investors in, and owners of, foreign affiliates is becoming increasingly blurred.

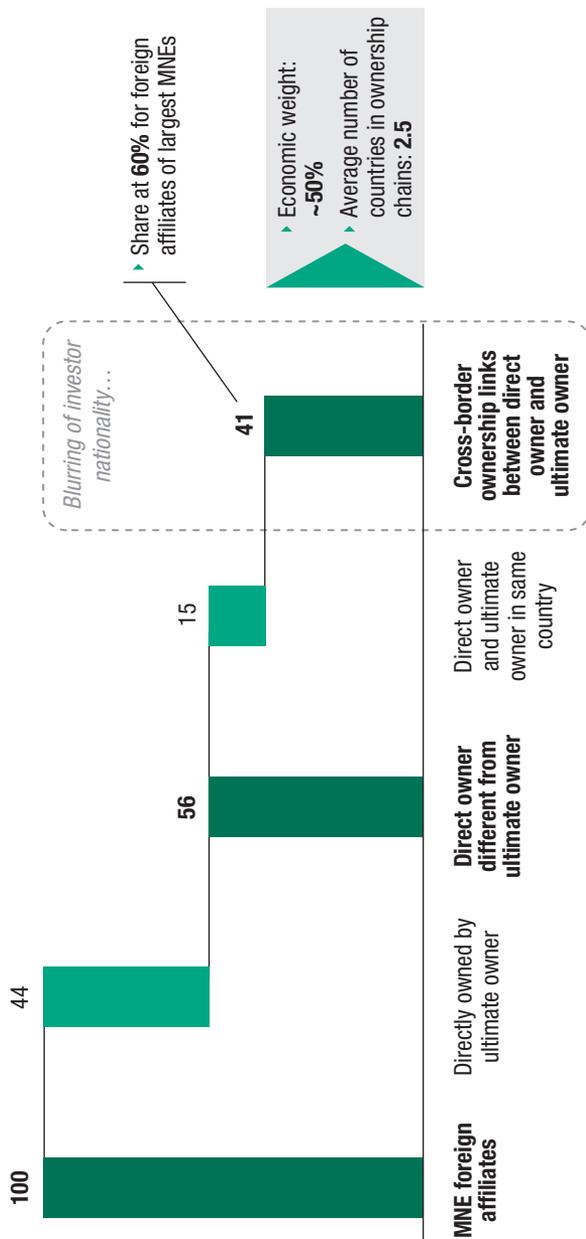
The blurring of investor nationality has important implications for national and international investment policies. Most countries have investment rules and promotion tools that are conditional on ownership and nationality. Almost 80 per cent of countries worldwide prohibit majority foreign ownership in at least one industry. Bilateral and regional investment agreements aim to provide benefits only to investors originating in the jurisdictions of treaty partners.

In designing national investment policies and in negotiating investment agreements, policymakers need to consider carefully the effectiveness and suitability of ownership-based measures, as well as the practical implications for their application and enforcement.

The largest MNEs have ownership networks involving over 500 affiliates across more than 50 countries

Common types of complexity in internal MNE ownership structures are lengthy ownership chains with multiple cross-border links, ownership hubs and shared ownership structures. Ownership of affiliates is expressed in shareholdings, which provide cash-flow rights and voting rights. Control is the ability to exercise voting rights to affect strategic management decisions. In the internal ownership structure of MNEs, control generally coincides with

Figure 10. Complex ownership of MNE foreign affiliates
(Share of foreign affiliates, per cent)



Source: ©UNCTAD analysis based on Orbis data.

(direct or indirect) majority ownership. However, MNEs can exercise control over affiliates even when they have a minority stake.

The universe of MNEs is highly skewed: a very large group of MNEs is simple, with few affiliates directly and fully owned by the parent company. A very small group of MNEs accounts for a large share of foreign affiliates. Less than one per cent of MNEs have more than 100 affiliates, but these account for more than 30 per cent of all foreign affiliates and almost 60 per cent of global MNE value added.

The larger the MNEs, the greater the complexity of their internal ownership structures is. The top 100 MNEs in UNCTAD's Transnationality Index have on average more than 500 affiliates across more than 50 countries, seven hierarchical levels in their ownership structure (i.e. affiliates could potentially have seven "passports"), about 20 holding companies owning affiliates across multiple jurisdictions, and almost 70 entities in offshore investment hubs.

MNE ownership structures are often the result of historical accident or haphazard growth patterns. Even when MNEs wish to simplify ownership structures in "entity reduction programmes", they are often prevented from doing so because of legal and fiscal constraints, or arrangements with banks. Where MNEs deliberately incorporate elements of complexity (e.g. lengthy ownership chains, multiple owners of affiliates, or different locations of direct versus ultimate owners), these are most often dictated by governance rules and risk management, financing, tax, and other institutional or policy-related considerations. Investment policy is one of several policy drivers behind complex ownership structures.

The long-term trends causing an increasing share of international production to be concentrated in the largest MNEs are also likely to result in increasing complex MNE ownership worldwide.

“Multiple passport affiliates” are the result of indirect foreign ownership, transit investment through third countries, and round-tripping

Insights on the ownership structures of MNEs as a whole (top-down perspective) are useful to show overall complexity. However, for investment policymakers, a bottom-up perspective looking at the ownership chain starting from the foreign affiliate, through its direct owners, and up to its ultimate owner can be more helpful. For *WIR16*, UNCTAD has developed a firm-level dataset including some 4.5 million companies that enables a bottom-up approach.

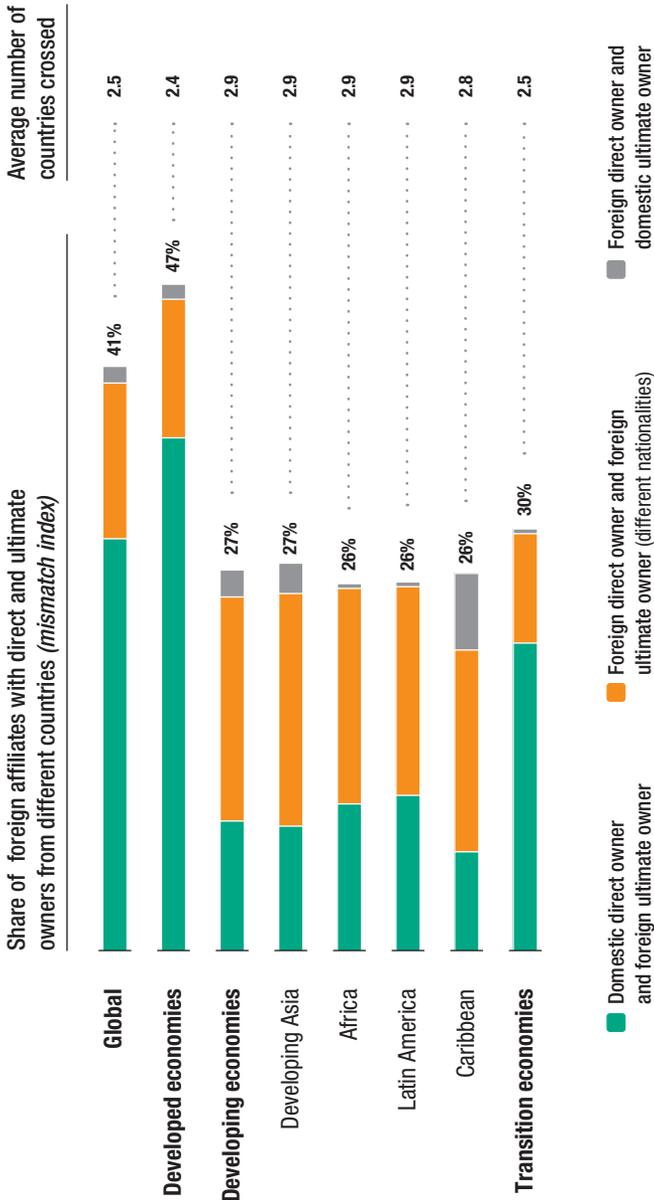
Comparing domestic and foreign direct owners and ultimate owners (in a two-by-two ownership matrix) leads to the identification of ownership scenarios relevant to investment policy in which the direct owners and ultimate owners of an affiliate are based in different jurisdictions. These nationality “mismatch” cases – more than 40 per cent of all foreign affiliates and 50 per cent when measured by revenues – include:

- Indirectly foreign owned companies – about 30 per cent of foreign affiliates are owned through a domestic entity
- Transit investments – just over 10 per cent of foreign affiliates are owned through an intermediate entity in a third country
- Round-tripping – about 1 per cent of foreign affiliates are ultimately owned by a domestic entity

The investor nationality “mismatch index” is considerably higher for the largest MNEs: 60 per cent of their foreign affiliates have multiple cross-border ownership links to the parent company.

Mismatches involve almost half of foreign affiliates in developed economies, and more than a quarter in developing economies. Whereas most mismatches in developed countries are caused by multi-layered ownership structures within host countries, in developing countries they are more often the result of investments transiting through third countries (figure 11).

Figure 11. | The investor nationality mismatch index by region



Source: ©UNCTAD analysis based on Orbis data.

Rules on foreign ownership are widespread: 80 per cent of countries restrict majority foreign ownership in at least one industry

National and international investment policy measures that differentiate between domestic and foreign companies or between foreign investors of different nationalities include entry restrictions and ownership caps; operating restrictions or performance requirements; investment facilitation and incentives; and investment protection. These measures are most often driven by national security concerns; protection of national and strategic assets; industrial development and competition policies; social, cultural or political concerns; and regional integration policies.

Complex ownership structures and investor nationality mismatches make the application of rules and regulations on foreign ownership more complex. They also raise important questions about the coverage of IIAs. For national investment policies, the distinction between domestic and foreign investment is important. Therefore, the most relevant nationality mismatches are investments that are indirectly foreign owned through a domestic entity, and round-tripping investments. For IIAs, the distinction between different nationalities of investors is important. Therefore, the most relevant mismatch cases are transit investments through third countries and, again, round-tripping investments.

At the national policy level, rules and regulations about foreign ownership are widespread. Services are relatively more affected by foreign equity limitations, in particular in media, transportation, communication, utilities and financial and business services. Extractive industries and agriculture are also frequently regulated through ownership restrictions. The trend in ownership-related measures since 2010 is towards liberalization, through the lifting of restrictions, increases in allowed foreign shareholdings, easing of approvals and admission, and greater access to land for foreign investors. However, many ownership restrictions remain in place in both developing and developed countries.

The blurring of investor nationality has made the application of rules and regulations on foreign ownership more challenging

The determination of investor nationality is part of foreign-investment registration and approval procedures; sector-specific licensing (when foreign ownership restrictions apply); and national-security-related foreign investment reviews. Approval procedures covering all sectors, including those without ownership restrictions, exist in many countries. Disclosure requirements for investors vary by country; not all regulators and authorities require disclosure of ultimate ownership. National-security reviews tend to examine the full ownership structure of MNEs.

Ownership complexity has made the effective implementation and enforcement of ownership restrictions and ownership-based rules and regulations difficult and burdensome. Key challenges for national investment policymakers are (i) how to assess aggregate direct and indirect ownership, (ii) how to prevent de facto foreign control, and (iii) how to avoid undue access to benefits reserved for foreign investors by host State nationals. Policymakers in some countries have developed a range of mechanisms to safeguard the effectiveness of foreign ownership rules, including anti-dummy laws, general anti-abuse rules to prevent foreign control, and disclosure requirements aimed at monitoring ownership- and non-ownership-based control.

Indirect ownership structures and mailbox companies have also raised challenges for IIAs

In international investment policymaking, ownership chains have the potential to significantly expand the reach of IIAs. About one third of investor-State dispute settlement (ISDS) claims in 2010–2015 are filed by claimant entities that are ultimately owned by a parent in a third country (not party to the treaty on which the claim is based). More than a quarter of these claimants do not have substantial operations in the treaty country – this share can increase up to 75 per cent considering claims based on treaties concluded by major ownership hub locations.

IAs increasingly circumscribe their coverage in response to three specific challenges: claims brought (i) by entities controlled by a third-country or host-State entity (round-tripping), (ii) by mailbox companies, or (iii) by entities with ownership links to the investment that were purposely created in anticipation of a claim (time-sensitive restructuring). They can do so through more restrictive definitions and through denial of benefits (DoB) clauses. In addition, IAs can clarify the meaning of effective control, if necessary urging tribunals to ascertain the ultimate owner controlling the relevant investment. To rule out claims by mailbox companies, IAs can require that claimants have substantial business activities (SBA) and provide indicators for what might constitute SBA. Finally, IAs can deny ISDS access to entities that have restructured at a time when a dispute had already arisen or was foreseeable. However, only half of the new IAs (those concluded since 2012) and hardly any of the older IAs include DoB clauses.

Ownership-based investment policies need a re-think to safeguard their effectiveness

The increasing complexity of MNE ownership networks is largely a consequence of globalization. The practical difficulty of determining ultimate ownership of, and control over, foreign affiliates call into question the effectiveness of some ownership-based investment policies. Policymakers should evaluate the rationale for rules and regulations on foreign ownership and assess their relative effectiveness and “fit-for-purpose” compared with alternative policies (such as competition or industrial development policies), where this is feasible and appropriate. Some countries may require assistance, including by international organizations, to build the necessary regulatory and institutional capacity.

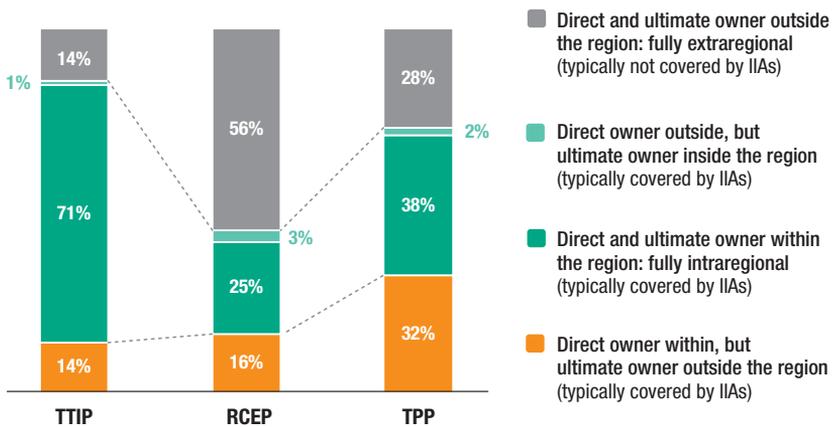
Where ownership-based policies are considered necessary, investment authorities can improve disclosure requirements to assess ownership chains and ultimate ownership. They should be aware of the administrative burden this can impose on public institutions and on investors. Synergies with other agencies in policy areas that investigate ownership chains, such as competition authorities and tax authorities, should be exploited.

Complex MNE ownership structures have a multilateralizing effect on IIAs

At the international level, policymakers should be aware of the *de facto* multilateralizing effect of ownership complexity. The broad definition of investors/investments in investment treaties, combined with large MNEs' extensive networks of affiliates and the ease of establishing legal entities in many jurisdictions, significantly extend the coverage of IIAs. This is highly relevant also for regional treaties and treaty negotiations: between one seventh (TTIP) and one third (TPP) of apparently intra-regional foreign affiliates in major megaregional treaty areas are ultimately owned by parents outside the region, raising questions as to the ultimate beneficiaries of these treaties and negotiations (figure 12).

Policymakers should aim to avoid uncertainty for both States and investors about the coverage of the international investment regime and its multitude

Figure 12. Ownership of foreign affiliates in TTIP, RCEP and TPP
Origin of direct and ultimate owners of foreign affiliates



Source: ©UNCTAD analysis based on Orbis data.

of bilateral, regional and megaregional treaties. International collaboration could aim to build a common understanding of “effective control” and a common set of criteria for substantial business activity and for identifying the origin of investors, as a basis for a more consistent interpretation of investment rules and treaty coverage, and as an integral part of global efforts to facilitate international investment.



In conclusion, the overarching objective of investment policy is to make investment work for sustainable development, maximizing its benefits and minimizing its negative effects. Complex ownership structures call into question the effectiveness of ownership-based policy tools widely used for this purpose, both nationally and internationally. This requires a re-evaluation of these tools for the pursuit of the common goal.

One approach is to enhance the application of ownership-based regulations by improving disclosure requirements and procedures to identify the ultimate owner of an investment. Another approach is to replace, where feasible and appropriate, ownership-based regulations with other policies such as competition, taxation, industrial development, public services or cultural policies. It is important to find the right policy mix, effective and proportionate. Whichever approach is chosen, a balance between liberalization and regulation must be found in pursuing the ultimate objective of promoting investment for sustainable development.

To help policymakers chart a way forward, *WIR16* provides insights on the global map of ownership links in MNEs and on how national and international policymakers around the world can respond to the challenges posed by complex ownership structures. The new data, empirical analysis, and policy responses presented here can inspire further research to support better informed policy decisions. They also make a strong case for targeted technical assistance and capacity building, and for more international consensus building. UNCTAD will continue to support these efforts.

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