Global Investment: Salient Features and Policy Challenges

by

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The views expressed are those of the author and do not necessarily reflect views of the United Nations.
Chair

Distinguished delegates,
Ladies and Gentlemen,

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A presentation in 4 parts:

I. Global FDI Trends
II. Investment Policy developments
III. International Standards of Accounting and Reporting (ISAR)
IV. Trends in Entrepreneurship and SME development

My presentation today will be structured in 4 parts. It will hopefully give you a global overview of the current state of play with regards to investment and enterprise trends and policies, for which DIAE is the focal point within the UN-system.

Amid all the turmoil in the global economy in recent years, today's international investment landscape is characterized by changes that offer both new challenges and new opportunities for investment in sustainable development.

Allow me to begin my presentation by highlighting some of the latest developments in FDI trends that illustrate these changes.
I. Global Investment Trends

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Global FDI recovery is moving from a steady to a bumpy road; it is taking longer than expected.

Global FDI inflows, 2000–2012

(billions of dollars)

Global FDI recovery is moving from a steady to a bumpy road; it is taking longer than expected. The recovery in momentum of FDI flows weakened in 2012; at best, we now predict that FDI will reach the same level as in 2011. UNCTAD’s latest Global Investment Trends Monitor estimates that global FDI inflows were down 8% in the first half of 2012. While historically FDI flows normally increase in the second half of the year, it will be difficult to exceed 2011 levels. We have also observed lackluster activity in cross border M&A and greenfield investment projects. Both of these leading indicators of FDI flows show a year-on year decline of over 2/5 in the first 3 quarters of this year.
In contrast with recent forecasts for 2012 for the growth of real GDP (3.3 percent) and volume of trade (2.5 percent), FDI recovery is proving a tougher nut to crack. The risks to FDI recovery include the fragile global economy, European sovereign debt crisis, slow-down in Asian growth, and the so-called US fiscal cliff.

Multinationals are understandably cautious about their expansion plans at the moment. They are currently retaining global cash holdings in the range of $5-6 trillion. This is driven by various factors, not least because of their experience during the crisis when credit lines dried up and they found themselves short of liquidity. They now want to maintain higher levels of self-financing capability, also in the light of the deleveraging in the banking sector. They may also be more risk averse in their assessment of investment opportunities.

Cash holdings suggest significant pent-up FDI firepower. In WIR12 we looked at the higher levels of liquid assets on the balance sheets of multinationals compared to their pre-crisis cash holding behaviour, and concluded that they amounted to upwards of $500 billion in investable funds, or one-third of global FDI flows. A significant amount of these liquid assets are held overseas, in foreign affiliates, where they may earn higher returns or can avoid tax liabilities that occur upon repatriation (e.g. in the
US). For the moment, international investors are staying put and waiting for the right moment to invest.

**However, longer term prospects for FDI are promising.** Once the global economy is on the right track, FDI recovery will follow fast and a new FDI boom could be likely. There are a number of factors that can drive the next FDI boom and that cause us to be cautiously optimistic for the longer term:

- post-crisis sell-offs of public stakes in ailing firms in developed countries;
- possible further sales of publicly owned assets to restructure sovereign debt;
- historically high cash holdings by TNCs;
- capital expenditures to replenish capital stock in preparation for economic expansion;

Once the current uncertainties in the global investment climate recede, **companies will want to invest in "re-profiling" at the global level.** In other words, multinationals will be drawn to opportunities in new emerging markets and nascent consumer markets in poorer countries than to relatively slow-growing emerging markets where they already have a strong presence. Changing international industrial patterns and policy changes in different countries are also part of the drive to "re-profile". This will lead to a relocation of different segments of their global value chains (GVCs), in much the same way as we see shifts in production patterns in the global pharmaceutical industry; or the continuing relevance of the flying geese pattern of production in Asia.
TNCs have been an engine of the global economy, even though they are in a low gear at the moment. We have to put the current global financial flows into perspective, noting the difference between trade and investment. That is, although the global investment recovery is bumpy and slow (flat), FDI is different from trade because of the accumulated stock of investment over time. Even if there is a decline in FDI flows, they still add net to the capital stock. In other words, international production does not stop; it is just growing more slowly than before, after a period of rapid growth.
Today, international production by multinational enterprises, through their networks of cross-border investments, accounts for around one-third of global private sector GDP. In value terms, they have $20 trillion of FDI stock, $7 trillion of value-added, $28 trillion of sales, and manage $82 trillion of assets. And multinationals tend to operate in the faster growing sectors of the economy. That is why a "re-awakening" of multinationals is so important to get the engine of growth going again.
Trade and Investment are inextricably intertwined. Overall, about 80 percent of global trade takes place within the integrated international production networks under the common governance of TNCs (intra-firm, through NEMs, and at arms-length). TNCs play a major role in determining trade patterns and the distribution of value added in Global Value Chains. Close to 50 per cent of global trade is carried out through GVCs. So GVCs imply a new role for trade and FDI in development strategies: it is no longer about developing whole industries, but about developing tasks and activities that fit into production patterns. Overall, it is becoming easier for countries to integrate into GVCs.
The growing importance of the South’s share in inward FDI rose from 20% in 2000 to over 50% in 2012, and outward FDI from less than 10% to more than a quarter in 2012. Developing countries (without transition economies) for the first time absorbed more than half of global FDI inflows in first half of 2012. China took up top position as the largest FDI recipient country in the first half of 2012.

However, while recognizing the growing importance of these countries as recipients and as investors, we have to bear in mind that their growing share in FDI flows is partly because of the decline in flows to and from developed countries during the crisis. Also, their higher shares in flows do not yet make a big dent in their share in stocks, where they have a long way to catch up. Thus, developing countries' significance should be viewed in a nuanced way.
In contrast to 2011, the first half of 2012 exhibited a marked decline in FDI inflows, globally and in many regions, as the economic recovery experienced further setbacks in the second quarter of 2012.

The recovery of FDI flows to developed countries since 2010 lost its momentum in 2012. While inflows to the EU for the first half of the year declined slightly compared to the same period in 2011, inflows to North America were down by more than one third due to a dramatic fall in flows to the United States (down 39 per cent). Elsewhere, Australia and Switzerland saw solid increases in their inflows.

The trend of net divestment (negative inflows) continued in Japan. Overall, inflows to developed countries declined by 9.5 per cent. Among the eurozone countries hit by the sovereign debt crisis, inflows recovered in Portugal and Spain, partly because of the recapitalization of banking affiliates by their foreign parent banks in Spain and China’s investment in state-owned assets in Portugal (e.g. EDP-Energias de Portugal). On the other hand, Italy saw a net divestment of US$1.6 billion, compared with
Inflows of US$13.9 billion in the same period of 2011. In Greece, FDI inflows remained at a very low level.

In developing economies, while flows to developing Asia declined, those to Latin America and Africa rose. In the first half of 2012, FDI inflows declined by 11 per cent in developing Asia, despite a strong recovery after the global financial crisis. This reflects a protracted period of weak external demand with consequent strong negative effects on exports and increasing uncertainty about high-growth emerging countries.

As a result of declines in China and Hong Kong (China), total FDI inflows to East Asia fell by about 11 per cent. Half-year inflows to China amounted to US$59 billion — a 3 per cent decline from US$61 billion in the first half of last year. China is experiencing structural adjustments in their FDI flows, including the relocation of labor-intensive and low-end market-oriented FDI to neighboring countries. Inflows to Hong Kong (China) declined much more significantly, by 26 per cent to US$41 billion.

Similarly, FDI flows to South-East Asia decreased by 5 per cent to US$52 billion. Member States of ASEAN demonstrated diverging trends: inflows to Cambodia, the Philippines and Thailand rose in the first half of 2012, while those to Indonesia, Malaysia and Singapore declined.

South Asia also saw its inflows fall by 40 per cent as a result of declines across nearly all countries in the subcontinent. Inflows to India, which accounts for the lion’s share of inward FDI to the subregion, fell from US$18 billion to US$10 billion, partly as a result of shrinking market-seeking FDI to the country.

In the first half of 2012, West Asia saw FDI inflows remaining at almost the same level as in the corresponding period of the previous year, increasing by 1 per cent. This reflects difficulty in recovering after three successive years of significant decline, in a region entangled with political crisis. Turkey — where FDI began its recovery in 2010 then strongly increased in 2011 — remained an exception, with FDI inflows increasing by 21 per cent in the first half of 2012. FDI to the other West Asian
countries declined. Both the global economic crisis and the deepening regional crisis continue to weigh on private investors' capacity and propensity to invest in West Asia.

FDI inflows to *Latin America and the Caribbean* increased by 8 per cent in the first half of 2012, compared with the same period of the previous year, as a result of increases in South America (11 per cent) and the Caribbean (14 per cent). FDI growth in South America mainly resulted from strong FDI rises in Chile, Colombia, Peru and Argentina. Flows to Brazil declined by 9 per cent although they remained at a high level. Offshore financial centres were the main drivers of FDI growth to the Caribbean, while the 19 per cent decline of FDI flows to Mexico largely explains the FDI fall in Central America. FDI continued to be attracted into South America by natural resource endowments, relatively higher economic growth, and high interest rate differentials (that boost the amount of reinvested earnings and intra-company loans — two of the three components of FDI flows).

Transition economies experienced a slump in FDI flows of 28 per cent, reaching US$33 billion. As developed economies — traditionally the dominant source of FDI in the region.— have encountered increasingly strong headwinds, the transition economies have suffered from weak external demand.
In the poorest countries, **Africa and the LDCs**, there have been three consecutive years of FDI recession during which their share in global FDI flows declined further from already marginal levels. However, there are many bright spots within the group that we believe will drive the FDI recovery in the years to come. Also, there appears to be a kind of flying geese pattern, with the geese flying further from countries like China to selected spots in Africa than to some South and South East Asian countries.

There is also some reason for optimism regarding the development impact of investment in the poorest countries:

- FDI plays a bigger role compared with other regions in driving the industrial restructuring and upgrading in these countries.
- Although traditional sectors such as extractives predominate in the value of FDI flows, in terms of numbers of projects manufacturing is larger and more widespread.
- Low-technology manufacturing sometimes also captures certain segments of global value chains (garments, simple electric appliances, travel goods, footwear, toys, etc.)
- FDI in the services sector is growing fast, especially in banking and telecoms.
FDI flows to Africa showed signs of recovery in the first half of 2012, with year-on-year growth reaching 5 per cent, after three consecutive years of decline. North Africa led the way — Egypt, in particular — as FDI flows to the region increased by three-quarters with a gradual return of investor confidence to the region.

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FDI flows in 2011 rose in all three sectors of production – primary, manufacturing and services. In services, FDI rebounded to some $570 billion after falling sharply in 2009 and 2010. Primary sector investment also reversed the negative trend of the previous two years, reaching $200 billion. The shares of both sectors rose slightly at the expense of manufacturing. The top five industries contributing to the rise in FDI projects were extractive industries (mining, quarrying and petroleum), chemicals, utilities (electricity, gas and water), transportation and communications, and other services (largely driven by oil and gas field services).
Let me now turn now to the second part of presentation on recent *policy developments and trends* related to FDI.

## II. Global Investment Policy Trends

Let me now turn to recent policy trends. I would like to highlight four salient features in investment policymaking at the national and international level:

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Firstly, there is an ongoing *dichotomy between investment liberalization and promotion, on the one hand, and investment restrictions and regulations, on the other hand*. Many countries continue to liberalize and promote foreign investment, but we also observe the move towards more regulatory or restrictive policy measures. In the previous two decades, on average more than 95 percent of the investment policy changes were related to improving the entry conditions and treatment for foreign investors – i.e. more liberalization, promotion and facilitation of FDI. The share of national policy measures directed at more investment regulations and restrictions increased significantly during the same period and reached 25 percent in 2011 – it had been 32 percent in 2010. This reflects an adjustment of FDI entry policies, more State
influence in "sensitive" industries – such as extractive industries, financial services and agriculture – and a more critical approach towards outward FDI. This trend also reflects an increasing recognition that **liberalization policies must be accompanied by proper regulatory and institutional frameworks** to ensure more sustainable outcomes.

This dichotomy in investment policy making continues up to the present day. Our latest Investment Policy Monitor shows that during the review period, June – October 2012, some countries took partial liberalisation steps in sensitive sectors, such as certain services. On the other hand, some governments strengthened their control over key domestic industries, and others took administrative decisions to restrict foreign investment for national security reasons or because it did not pass an “economic benefit” test.

In light of continuing economic crises, there is a risk that investment restrictions are misused for protectionist purposes. UNCTAD is monitoring the latest developments through its Investment Policy Monitors and, together with the OECD, it does the same for G-20 countries in two joint annual reports. When following these developments, one must also take into account the accumulative effect of restrictive investment measures over the last couple of years and the more assertive attitude of governments in the implementation of existing laws and regulations.

One challenge in this context is how to define investment protectionism, since governments can have legitimate reasons to restrict FDI, for instance when it comes to national security concerns, sovereignty over natural resources or development purposes. More international cooperation is needed to clarify the borderline between legitimate investment restrictions and protectionism and to assist countries in designing high quality legislation that does not unnecessarily create hindrances for foreign investors.
A second salient feature of current investment policies concerns the international investments regime. We are witnessing a move from bilateralism towards regionalism, and a move towards more complex treaties. In the last couple of years, bilateral investment treaty making has been slowing down. Rather, negotiations have shifted to regional investment treaty-making, with the participation of almost all economic powers. Recent prominent examples of regional agreements are the Trilateral agreement between China, Japan and the Republic of Korea, and the Mexico–Central America FTA, involving Costa Rica, El Salvador, Guatemala, Honduras, Mexico and Nicaragua. The Gulf Cooperation Council Countries signed two Framework Agreements on Trade, Economic, Investment, and Technical Cooperation with the United States and Peru individually. Meanwhile, negotiations are ongoing on the Trans-Pacific Partnership Agreement (TPP). At the European Union level, the EU Commission is currently negotiating comprehensive FTAs with Canada, India, Singapore, Egypt, Jordan, Morocco and Tunisia.

A third salient feature has to do with the systemic problems of the existing IIA universe. Today, there are over 3,160 IIAs (2833 BITs and 331 "other IIAs" by the end of 2011). In addition, there were almost 3,100 DTTs at the end of 2011. The IIA
system is highly atomized, multi-layered and multi-faceted – it has gaps, inconsistencies and overlaps. There are also problems of coherence between the IIAs, on the one hand, and national investment-related policies, on the other hand. The IIA regime is approaching the point where it is too big and complex to handle for governments and investors alike. This feeling is supported by the fact that the system offers protection to only two thirds of global FDI stock and only one fifth of all bilateral investment relationships. Full coverage would require a further 14,100 bilateral treaties.

There is also growing discontent with the existing investor-State dispute system (ISDS). ISDS is meant to reinforce the rule of law. However, the significant increase in investment disputes in recent years – 450 by the end of 2011 – and an often broad and unexpected interpretation of individual treaty provisions by arbitration tribunals have aggravated the risk that core domestic policy decisions, such as health policy or energy policies, violate IIA provisions. This is substantially different from previous years, when investment disputes dealt almost exclusively with the narrow issue of how much compensation an investor can claim in the event of expropriation. At a time when the role of the state increases in many policy areas, governments need to ensure that they are not unduly restrained by international commitments related to investment.

These various IIA-related concerns must not be ignored, because the current system already shows first signs of disintegration. For example, Bolivia, Ecuador and Venezuela have denounced their membership in the International Centre for Settlement of Investment Disputes (ICSID). Australia declared it would no longer include investor-State dispute settlement provisions in its IIAs, and South Africa and Ecuador decided to review their BITs with a view to re-negotiate or terminate them. Moreover, a number of countries have reviewed or are reviewing their model investment treaties.
I come to a fourth salient feature: **Sustainable development is gaining prominence in investment policy making.** The need to harness foreign investment for sustainable development is nowadays widely recognized. Countries increasingly factor the goal of sustainable development and inclusive growth into their investment policymaking. This is also the case when it comes to international investment policies. Recent examples are FTAs involving both developed and developing countries, regional groupings and various investment policy instruments developed by international organizations.

The move towards more sustainable development in investment policies receives further impetus from the fact that industrial policies are back in fashion. Against the background of various crises – economic, financial, food, energy crises and climate change - governments take a more pro-active role in supporting and developing individual industries and regulating their activities.
I now turn to my last point: The challenges for future investment policymaking at the national and international level. The international investment community needs to find an answer to the following questions:

- How to address investment issues from both a host and home country perspective?
- How to balance investment liberalization and regulation? How to avoid investment protectionism, while recognizing that countries may have legitimate reasons to restrict foreign investment?
- How to factor in sustainable development and inclusive growth into IIAs?
- How to address the systemic complexity of today’s IIA regime?
- How to ensure coherence between investment policies and other policies in pursuit of wider development goals?
- How to promote multilateral investment cooperation in the absence of a multilateral investment framework?
Let me briefly present UNCTAD’s ideas and suggestions on how to address the existing challenges in future international investment policymaking. In our latest WIR, we have developed a new Investment Policy Framework for Sustainable Development (IPFSD) which seeks to provide answers to some of the questions in my previous slide. The IPFSD consists of:

- A set of 11 Core Principles for investment policymaking,
- Guidelines for national investment policies, and
- Guidance for policymakers on how to engage in the international investment policy regime, in the form of options for the design and use of IIAs.
The IPFSD puts particular emphasis on the relationship between foreign investment and sustainable development, advocating a balanced approach between the pursuit of purely economic growth objectives by means of investment liberalization and promotion, on the one hand, and the need to protect people and the environment, on the other hand. We hope that the IPFSD will contribute in a constructive manner to the future evolution of investment policies, both at the national and international level.

I would like to invite you all to consult the UNCTAD website where you will find further information on the IPFSD and from where you can also freely download the entire document.

In conclusion, let me reiterate that investment policymaking is at a crossroads. Many governments are reviewing and revising their regulatory framework for investment and their IIA negotiation position. As a result, a new generation of investment policies is in the making that places sustainable development and inclusive growth at the core.
We operate in a global economy that transcends national borders, where foreign direct investment accounts for a huge proportion of overall investment. In this respect, the benefit of a universal accounting language is clear: investors and other stakeholders need high quality and internationally comparable information to make informed decisions. In the aftermath of the financial crisis there is an even greater need for convergence towards a single set of high quality global accounting standards (IFRS) as one of the crucial factors in strengthening the international financial regulatory system and global financial stability. Indeed governance and transparency are, in this regard, key concerns.

Over the last ten years, a dominating trend in corporate reporting is a continued proliferation of International Financial Reporting Standards (IFRS). At present over 100 jurisdictions around the world either require or permit enterprises listed in their stock exchanges to use IFRS for preparing their financial statements. Half of all Fortune Global 500 companies now report using IFRS. At the end of 2010, among the largest 5,000 companies by market-capitalization, the share of market capitalization of
entities that prepared their financial statements in accordance with IFRS was 42 percent or close to 18 trillion dollars.

Another important trend is a growing understanding that high quality corporate reporting is not only about standard-setting, but also about the enforcement and monitoring of the consistent application of such standards, and compliance with the requirements. This has given an impetus to a greater focus on strengthening institutional arrangements in the area of reporting, both at international and national levels, as well as better coordination between the public and private sector stakeholders. Also non-financial reporting on environmental, corporate governance and corporate social responsibility issues of enterprise performance is becoming more and more important.

These trends are calling for further assistance to developing countries and economies in transition in their efforts towards building regulatory and institutional foundations, as well as strengthening technical expertise for high quality and comparable corporate reporting. With almost 30 years of experience the role of UNCTAD-ISAR in this regard is crucial, hence our development of the Accounting Development Toolkit.
IV. Trends in entrepreneurship

I now turn to the third and final part of my presentation on trends in entrepreneurship and SME development.

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With the onset of the financial and economic crisis, new business registration slowed down, first in developed economies and then in the rest of the world, paralleling the spread of the crisis. Only 20 percent of countries experienced growth in business entry between 2008 and 2009, while more than 70 percent did between 2006 and 2007.
At the same time, however, entrepreneurship offers one of the key solutions to the current crisis. It is a driver of employment generation and a source of innovation.

It is therefore good news that the share of opportunities for entrepreneurship has rebounded strongly in the developing world (as opposed to starting a business out of a lack of alternative employment) returning to its pre-crisis level of close to 50%.

However, this is not yet the case for some developed countries, where the effects of the crisis linger on. As a result, we are seeing low levels of “entrepreneurship out of opportunites” in some crisis-hit European countries; whereas some emerging countries, for example Brazil, are increasingly closing the “opportunity entrepreneurship” gap with the developed world.
The Doha Mandate, which reaffirms and builds on the Accra Accord, recommends that UNCTAD continue its analytical work and technical assistance in the areas of economic diversification and structural transformation to enhance growth, development and the generation of more value addition.

Through its Empretec Programme, UNCTAD has actively promoted developing country entrepreneurs’ abilities to recognize and act upon economic opportunity for over 20 years. To date, more than 240,000 Empretecos have been trained all over the world, out of which 30% are women.
Entrepreneurship as a way forward out of the crisis is also high on the policy agenda, including of the OECD and G20, as well as of many developing country governments. According to the World Bank’s latest Doing Business report, developing countries continue to adopt legislation supportive of a move towards more entrepreneurial economies, with Sub-Saharan Africa and Eastern European and Central Asian economies in transition leading the way in 2012.

However, entrepreneurship needs to be addressed in a systemic manner. UNCTAD’s research and policy analysis show that entrepreneurship development policies often follow an overly narrow approach, overlooking some of the relevant policy areas that have an impact on entrepreneurship and underestimating that a bottleneck in only one area may stifle enterprise development.

In response to this, UNCTAD actively supports Member States in developing a comprehensive national-level entrepreneurship policy through its newly developed Entrepreneurship Policy Framework.
Experts from more than 100 countries have contributed to develop the framework during the series of four Multi-Year Expert Meetings on Enterprise Development and Capacity Building on Science, Technology and Innovation, organized by UNCTAD and held in Geneva from 2009 to 2012.

The policy framework and its toolkit elements include the work of these four meetings. The framework, referred to as EPF, represents a baseline document for UNCTAD to assist policymakers in evaluating the state of entrepreneurship in a specific country, and to make sound policy recommendations.

An On-line Inventory of good practices in entrepreneurship development (www.unctad.org/epf), available on UNCTAD’s web-site at the address shown on the top of this slide, completes the EPF. So far, the inventory:

- includes more than 150 selected policies and programmes
- from more than 50 developing countries and economies in transition
- more than 10% of the selected good practices refer to policies and programmes implemented in Least Developed Countries
Recently, several countries have initiated important steps towards developing national-level entrepreneurship policies. These include Brazil, Nigeria, Panama and Ghana. In these countries, UNCTAD has collaborated with policy makers through the network of established Empretec centres that have facilitated the dialogue between the public and private sectors. As recommended by UNCTAD’s EPF, as a first step, these national governments have initiated a consultation on entrepreneurship through different initiatives including national forums, regional seminars, benchmarking exercises and review mechanisms engaging stakeholders.

Based on our experience in these pilot countries, UNCTAD is currently developing a series of guidelines and lessons learned and actively improving the EPF toolkit, which is intended to remain a best practice “living document”.

We invite all of you to also be part of this initiative.

Ladies and Gentlemen,

I will stop there and answer any questions you may have about our activities in the areas of investment and enterprise. Thanks you.