
The COVID-19 crisis will cause a dramatic fall in FDI. Global FDI flows are forecast to decrease by up to 40 per cent in 2020, from their 2019 value of $1.54 trillion. This would bring FDI below $1 trillion for the first time since 2005. FDI is projected to decrease by a further 5 to 10 per cent in 2021. The outlook is highly uncertain. Prospects depend on the duration of the crisis and on the effectiveness of policy response to mitigate the economic effects of the pandemic. Geopolitical and financial risks and continuing trade tensions add to the uncertainty.
The pandemic is a supply, demand, and policy shock for FDI. The lockdown measures are slowing down existing investment projects. The prospect of a deep recession will lead MNEs to re-assess new projects. Policy measures taken by governments during the crisis include new investment restrictions. Starting in 2022, investment flows will slowly recover, led by GVC restructuring for resilience, replenishment of capital stock and recovery of the global economy.

MNE profit alerts are an early warning sign. The top 5,000 MNEs worldwide, which account for most of global FDI, have seen expected earnings for the year revised down by 37 per cent on average, with some industries plunging into heavy losses. Lower profits will hurt reinvested earnings, which on average account for more than 50 per cent of FDI.

The impact, although severe everywhere, varies by region. Developing economies are expected to see the biggest fall in FDI (up to 45 per cent). This is because they rely more on investment in global value chains and extractive industries, which have been severely hit, and because they are not able to put in place the same economic support measures as developed economies.

Preliminary data for the first 6 months on FDI, Greenfield investment, project finance and M&As largely confirm our earlier projections. Greenfield investment – the most important type from a development perspective, is down by more than one-third. The drop in Developing countries is significantly worse. Our October Global Investment Trends Monitor will provide more detail.
Despite the drastic decline in global FDI flows during the crisis, the international production system will continue to play an important role in economic growth and development. Global FDI flows will remain positive and continue to add to the existing FDI stock, which stood at $36 trillion at the end of 2019 (42 per cent of global GDP). In the case of developing economies as a whole, FDI stock stood at $11 trillion, accounting for 33 per cent of their GDP.
The World Investment Report has monitored FDI and the activities of MNEs for 30 years, during which international production saw two decades of rapid growth followed by one of stagnation. Flows of cross-border investment in physical productive assets stopped growing in the 2010s, the growth of trade slowed down, and GVC trade declined.

The 2010s were only the quiet before the storm. The crisis caused by the COVID-19 pandemic arrives on top of existing challenges to the system of international production arising from the new industrial revolution (NIR), growing economic nationalism and the sustainability imperative. These challenges were already reaching an inflection point; the pandemic sets to tip the scales. The decade to 2030 is likely to be a decade of transformation for international production.
Three key technology trends will shape international production going forward: robotics-enabled automation, enhanced supply chain digitalization and additive manufacturing. Each will have distinct effects on the length, geographical distribution, and governance of GVCs. Each technology, depending on industry-specific deployment, will flatten, stretch or bend the “smile curve” of international production in its own way.

The pace and extent of adoption of these technologies will depend in part on the policy environment for trade and investment, which is trending towards more interventionism, rising protectionism and a shift away from multilateral to regional and bilateral frameworks. They will also depend on sustainability concerns, including differences in approach between countries and regions on environmental, social and governance (ESG) standards, market-driven changes in products and processes, and supply chain resilience measures.
The effects on international production of the technology, policy and sustainability trends are multifaceted. They are at times mutually reinforcing, they occasionally push in opposite directions and they will play out differently across industries and geographies. Depending on the starting point of individual industries – their archetypical international production configurations – they will tend to favour one of four trajectories.

1) **Reshoring** will lead to shorter, less fragmented value chains and a higher geographical concentration of value added. It will primarily affect higher-technology GVC-intensive industries. The implications of this trajectory include increased divestment and a shrinking pool of efficiency-seeking FDI.

2) **Diversification** will lead to a wider distribution of economic activities. It will primarily affect services and GVC-intensive manufacturing industries. This trajectory will increase opportunities for new entrants (economies and firms) to participate in GVCs, but its reliance on supply chain digitalization will cause those GVCs to be more loosely governed, platform-based and asset-light.

3) **Regionalization** will reduce the physical length but not the fragmentation of supply chains. The geographical distribution of value added will increase. This trajectory will affect regional processing industries, some GVC-intensive industries and even the primary sector.

4) **Replication** will lead to shorter value chains and a rebundling of production stages. It will lead to more geographically distributed activities, but more concentrated value added. It will be especially relevant for hub-and-spoke and regional processing industries.
Key implications of the transformation

1. Shorter and less fragmented value chains
2. More concentrated value added
3. More platform-driven and asset-light value chain governance
4. A shift from global to regional and sub-regional value chains
5. Less global efficiency-seeking FDI; more regional market-seeking FDI
6. Downward pressure on trade in intermediate goods, less on trade in final products
7. A shift in some industries from large-scale investment to smaller-scale distributed manufacturing
8. Continued growth and fragmentation in services value chains
9. Resilience and national security concerns as key drivers of GVC diversification
10. A shift from GVC-investment to cross-border investment in infrastructure, domestic services and in the green and blue economies driven by the sustainability imperative

Although the different trajectories show that the expected transformation of international production is not unidirectional, the overall direction of travel points towards:

1) Shorter and less fragmented value chains
2) More concentrated value added
3) More platform-driven and asset-light value chain governance
4) A shift from global to regional and sub-regional value chains
5) Downward pressure on global efficiency-seeking FDI in favour of regional market-seeking FDI
6) Downward pressure on global trade in intermediate goods, less on trade in final products
7) A shift in some industries from large-scale investment to smaller-scale distributed manufacturing
8) Continued growth and fragmentation in services value chains
9) Resilience and national security concerns as key drivers of GVC diversification
10) A shift from GVC-investment to cross-border investment in infrastructure, domestic services and in the green and blue economies driven by the sustainability imperative
Policymakers need to prepare for the challenges that the transformation of international production will bring and be ready to capture the opportunities.

**Challenges** include increased divestment, relocations, and investment diversion, and a shrinking pool of efficiency-seeking investment implying tougher competition for FDI. Value capture in GVCs and development based on vertical specialization will become more difficult. Industrial infrastructure built for a world of GVCs will see diminishing returns. Changes in locational determinants of investment will often negatively affect the chances of developing countries to attract MNE operations.

**Opportunities** arising from the transformation include attracting investors looking to diversify supply bases and building redundancy and resilience. The pool of regional market-seeking investment will increase. Shorter value chains will bring more investment in distributed manufacturing and final-goods production with broader industrial capacity building and clustering. And digital infrastructure and platforms will enable new applications and services and improve bottom-up access to GVCs. The sustainability imperative will lead to more green and blue investment and value chains.

Confronting the challenges and capturing the opportunities requires a change in the investment-development path. From a focus on export-oriented efficiency-seeking investment in narrowly specialized GVC segments, to a broader expert-led strategy which extends to investment in production for regional markets and industrial clustering. From cost-based competition for single-location investors
to competition for diversified investments based on flexibility and resilience. And from prioritizing large-scale industrial investors with “Big infrastructure” to making room for small-scale manufacturing facilities and services with “Lean infrastructure”.

Finally, a shift in investment promotion strategies towards infrastructure and services is necessary. For the past three decades international production and the promotion of export-oriented manufacturing investment has been the pillar of development and industrialization strategies of most developing countries. Investment geared towards exploiting factors of production, resources and low cost labour will remain important, but the pool of such investment is shrinking. A degree of rebalancing towards growth based on domestic and regional demand and on services. Investment in green economy and blue economy, as well as in infrastructure and domestic services, present a great potential for contributing to achieving the Sustainable Development Goals (SDGs).