

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD



WORLD INVESTMENT REPORT **2021**

INVESTING IN SUSTAINABLE RECOVERY

OVERVIEW



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PREFACE

Global flows of foreign direct investment have been severely hit by the COVID-19 pandemic. In 2020, they fell by one third to \$1 trillion, well below the low point reached after the global financial crisis a decade ago. Greenfield investments in industry and new infrastructure investment projects in developing countries were hit especially hard.

This is a major concern, because international investment flows are vital for sustainable development in the poorer regions of the world. Increasing investment to support a sustainable and inclusive recovery from the pandemic is now a global policy priority. This entails promoting investment in infrastructure and the energy transition, in resilience and in health care.

The World Investment Report supports policymakers by monitoring global and regional investment trends and national and international policy developments. This year's report reviews investment in the Sustainable Development Goals (SDGs) and shows the influence of investment policies on public health and economic recovery from the pandemic.

A concerted global effort is needed to increase SDG investment leading up to 2030. The package of recommendations put forward by UNCTAD for promoting investment in sustainable recovery provides an important tool for policymakers and the international development community.

I commend this report to all engaged in building a sustainable and inclusive future.



António Guterres
Secretary-General of the United Nations

FOREWORD

The COVID-19 pandemic caused a dramatic fall in global Foreign Direct Investment (FDI) in 2020, bringing FDI flows back to the level seen in 2005. The crisis has had an immense negative impact on the most productive types of investment, namely, greenfield investment in industrial and infrastructure projects. This means that international production, an engine of global economic growth and development, has been seriously affected.

The crisis has rolled back progress made in bridging the investment gap achieved following the adoption of the SDGs. This demands a renewed commitment and a big push for investment and financing in the SDGs.

The main focus now is on the recovery process. But the issue is not only about reigniting the economy, it is about making the recovery more sustainable and more resilient to future shocks.

Given the scale and multitude of the challenges, we need a coherent policy approach to promote investment in resilience, balance stimulus between infrastructure and industry, and address the implementation challenges of recovery plans.

This report looks at investment priorities for the recovery phase. It shows that for developing and transition economies, and LDCs in particular, the development of productive capacity is a helpful guide in setting investment priorities and showing where international investment can most contribute but also where it has been hit hardest during the pandemic.

The report argues that five factors will determine the impact of investment packages on sustainable and inclusive recovery: additionality, orientation, spillovers, implementation and governance.

The report also points at specific challenges that will arise with the roll-out of recovery investment plans and proposes a framework for policy action to address them. The policy framework presents innovative actions and tools for strategic priority setting. For policymakers, the starting point is the strategic perspective, in the form of industrial development approaches. Industrial policy will shape the extent to which firms in different industries will be induced to rebalance international production networks for greater supply chain resilience and greater economic and social resilience.

Our task today is to build forward differently. This will not be possible without reigniting international investment as an engine of growth, and ensuring that the recovery is inclusive and thus that its benefits extend to all countries.

I hope that the policy framework for investing in sustainable recovery will inspire and reinvigorate efforts towards this goal.

A handwritten signature in black ink, appearing to read 'Isabelle Durant', with a period at the end.

Isabelle Durant
Acting Secretary-General of UNCTAD

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OVERVIEW

GLOBAL INVESTMENT TRENDS AND PROSPECTS

The COVID-19 crisis caused a dramatic fall in FDI

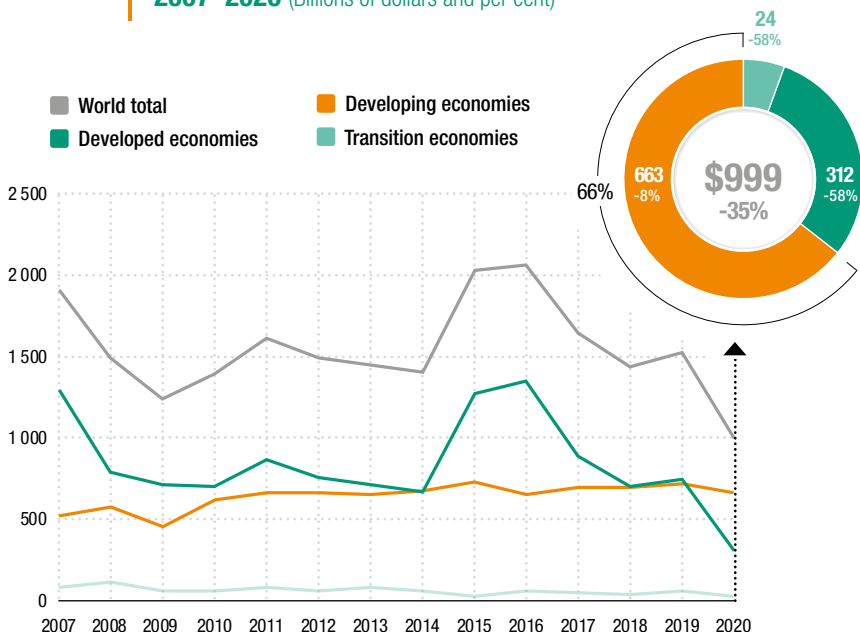
Global foreign direct investment (FDI) flows fell by 35 per cent in 2020, to \$1 trillion from \$1.5 trillion the previous year. The lockdowns around the world in response to the COVID-19 pandemic slowed down existing investment projects, and the prospects of a recession led multinational enterprises (MNEs) to re-assess new projects. The fall was heavily skewed towards developed economies, where FDI fell by 58 per cent, in part due to corporate restructuring and intrafirm financial flows. FDI in developing economies decreased by a more moderate 8 per cent, mainly because of resilient flows in Asia. As a result, developing economies accounted for two thirds of global FDI, up from just under half in 2019 (figure 1).

FDI patterns contrasted sharply with those in new project activity, where developing countries are bearing the brunt of the investment downturn. In those countries, the number of newly announced greenfield projects fell by 42 per cent and the number of international project finance deals – important for infrastructure – by 14 per cent. This compares to a 19 per cent decline in greenfield investment and an 8 per cent increase in international project finance in developed economies. Greenfield and project finance investments are crucial for productive capacity and infrastructure development, and thus for sustainable recovery prospects.

All components of FDI were down. The overall contraction in new project activity, combined with a slowdown in cross-border mergers and acquisitions (M&As), led to a drop in equity investment flows of more than 50 per cent. With profits of MNEs down 36 per cent on average, reinvested earnings of foreign affiliates – an important part of FDI in normal years – were also down.

The impact of the pandemic on global FDI was concentrated in the first half of 2020. In the second half, cross-border M&As and international project

Figure 1. FDI inflows, global and by group of economies, 2007–2020 (Billions of dollars and per cent)



Source: UNCTAD.

finance deals largely recovered. But greenfield investment – more important for developing countries – continued its negative trend throughout 2020 and into the first quarter of 2021.

FDI trends varied significantly by region

Developing economies weathered the storm better than developed ones. However, in developing regions and transition economies, FDI inflows were relatively more affected by the impact of the pandemic on investment in GVC-intensive, tourism and resource-based activities. Asymmetries in fiscal space available for the rollout of economic support measures also drove regional differences.

The fall in FDI flows across developing regions was uneven, at -45 per cent in Latin America and the Caribbean, and -16 per cent in Africa. In contrast, flows

to Asia rose by 4 per cent, leaving the region accounting for half of global FDI in 2020. FDI to the transition economies plunged by 58 per cent.

The pandemic further deteriorated FDI in structurally weak and vulnerable economies. Although inflows in the least developed countries (LDCs) remained stable, greenfield announcements fell by half and international project finance deals by one third. FDI flows to small island developing States (SIDS) also fell, by 40 per cent, as did those to landlocked developing countries (LLDCs), by 31 per cent.

FDI flows to Europe dropped by 80 per cent while those to North America fell less sharply (-42 per cent). The United States remained the largest host country for FDI, followed by China (figure 2).

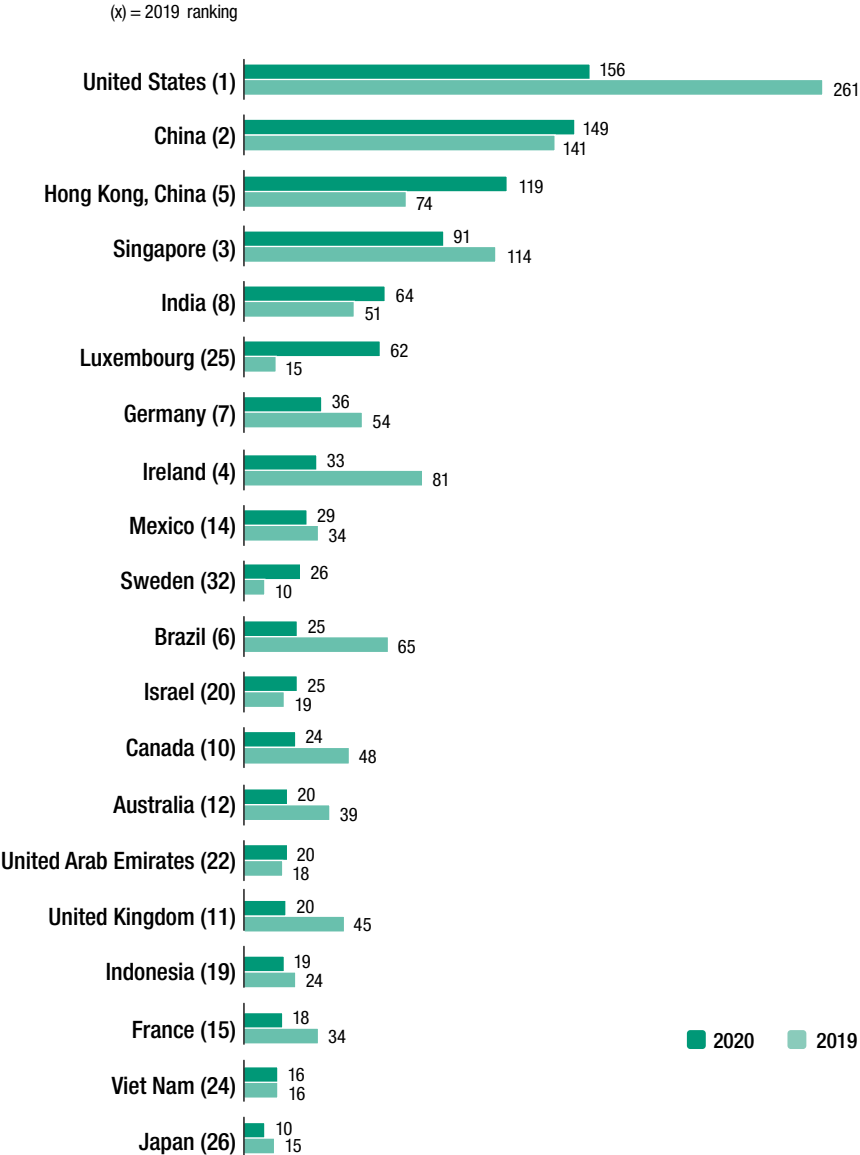
Outward investment plunges across the world, except from Asia

In 2020, MNEs from developed countries reduced their investment abroad by 56 per cent, to \$347 billion – the lowest value since 1996. As a result, their share in global outward FDI dropped to a record low of 47 per cent. As with inflows, the decline in investment from major investor economies was exacerbated by high volatility in conduit flows. Aggregate outward investment by European MNEs fell by 80 per cent to \$74 billion. The Netherlands, Germany, Ireland and the United Kingdom saw their outflows decline. Outflows from the United States remained flat at \$93 billion. Investment by Japanese MNEs – the largest outward investors in the last two years – dropped by half, to \$116 billion.

Outflows from transition economies, based largely on the activities of Russian natural-resource-based MNEs, also suffered, plummeting by three quarters.

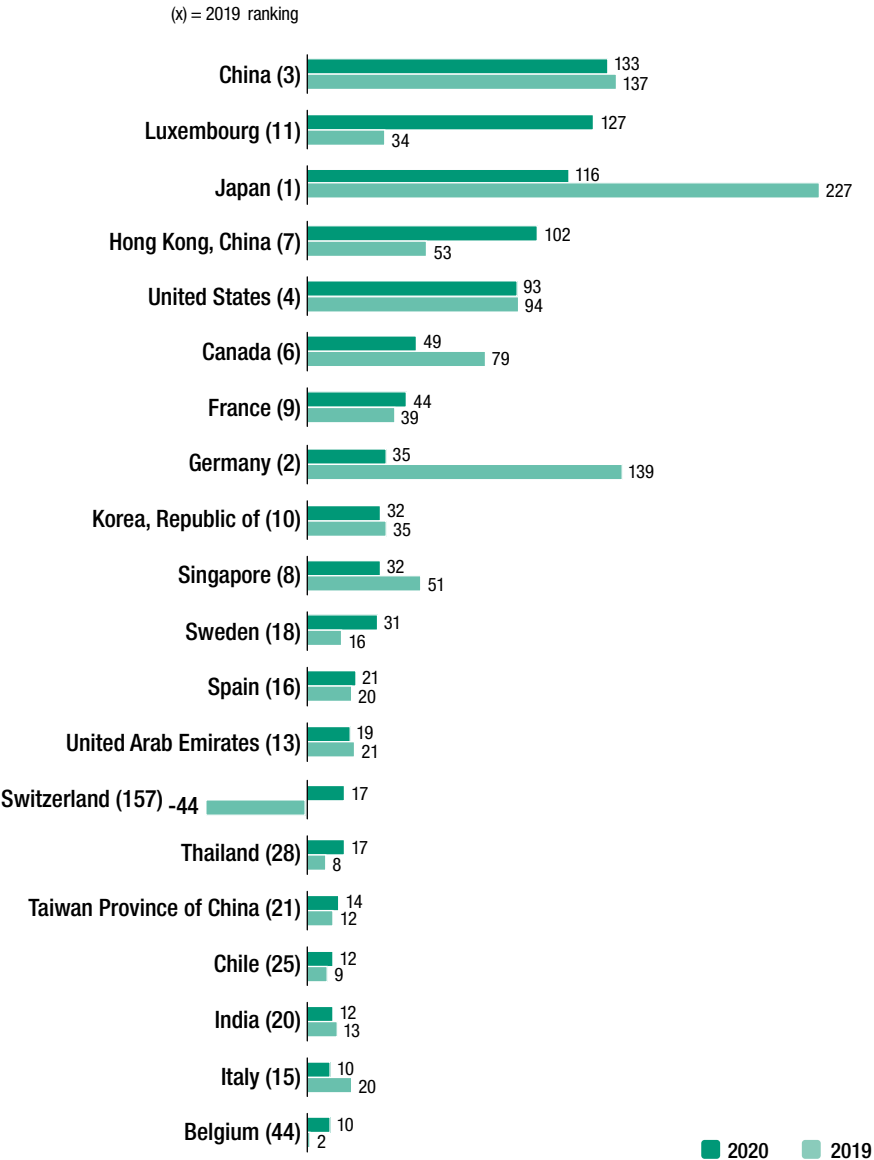
The value of investment activity abroad by developing-economy MNEs declined by 7 per cent, reaching \$387 billion. Outward investment by Latin American MNEs turned negative at \$3.5 billion, due to negative outflows from Brazil and lower investments from Mexico and Colombia. FDI outflows from Asia, however, increased 7 per cent to \$389 billion, making it the only region to record an expansion in outflows. Growth was driven by strong outflows from Hong Kong (China) and from Thailand. Outward FDI from China stabilized at \$133 billion, making the country the world's largest investor (figure 3). Continued expansion of Chinese MNEs and ongoing Belt and Road Initiative projects underpinned outflows in 2020.

Figure 2. Foreign direct investment inflows, top 20 host economies, 2019 and 2020 (Billions of dollars)



Source: UNCTAD.

Figure 3. Foreign direct investment outflows, top 20 home economies, 2019 and 2020 (Billions of dollars)



Source: UNCTAD.

Prospects: FDI expected to bottom out in 2021

Global FDI flows are expected to bottom out in 2021 and recover some lost ground with an increase of 10–15 per cent. This would still leave FDI some 25 per cent below the 2019 level and more than 40 per cent below the recent peak in 2016. Current forecasts show a further increase in 2022 which, at the upper bound of the projections, could bring FDI back to the 2019 level of \$1.5 trillion.

The relatively modest recovery in global FDI projected for 2021 reflects lingering uncertainty about access to vaccines, the emergence of virus mutations and delays in the reopening of economic sectors. Increased expenditures on both fixed assets and intangibles will not translate directly into a rapid FDI rebound, as confirmed by the sharp contrast between rosy forecasts for capital expenditures and still depressed forecasts for greenfield project announcements.

The FDI recovery will be uneven. Developed economies are expected to drive global growth in FDI, with 2021 growth projected at 15 per cent (from a baseline excluding conduit flows), both because of strong cross-border M&A activity and large-scale public investment support. FDI inflows to Asia will remain resilient (8 per cent); the region has stood out as an attractive destination for international investment throughout the pandemic. A substantial recovery of FDI to Africa and to Latin America and the Caribbean is unlikely in the near term. These regions have more structural weaknesses, less fiscal space and greater reliance on greenfield investment, which is expected to remain at a low level in 2021.

Early indicators – FDI projects in the first months of 2021 – confirm diverging trajectories between cross-border M&As and greenfield projects. Cross-border M&A activity remained broadly stable in the first quarter of 2021 and the number of announced M&A deals is increasing, suggesting a potential surge later in the year. In contrast, announced greenfield investment remains weak.

IPAs cautiously optimistic for 2021

Despite the continuation of the pandemic, 68 per cent of investment promotion agencies (IPAs) expect investment to rise in their countries in 2021, according to UNCTAD's recently conducted IPA Survey. Close to half of the respondents expects a significant rise in global FDI in 2021. However, IPAs acknowledge the continued difficult global environment for investment promotion. IPAs rank food and agriculture, information and communication technologies (ICT) and pharmaceuticals as the three most important industries for attracting foreign

investment in 2021. While food and agriculture has always been considered important for attracting FDI, especially by developing and transition economies, ICT and pharmaceuticals are seeing an increase in interest because of the pandemic.

International production: large MNEs are weathering the storm

Facing falling revenues, MNEs doubled corporate debt issuance in 2020. At the same time, acquisitions decreased and capital expenditures remained stable, leading to higher cash balances. In 2020 the top 5,000 non-financial listed MNEs increased their cash holdings by more than 25 per cent.

MNEs are more and more adopting policies on diversity and inclusiveness. The attention of MNEs to gender equality, as proxied by the existence of a diversity policy, is growing – especially in emerging economies, where the number of such policies doubled in the last five years.

The number of State-owned MNEs (SO-MNEs) grew marginally in 2020, by 7 per cent, to about 1,600 worldwide. Several new ones resulted from new State equity participations as part of rescue programmes. Rescue packages involving the acquisition of equity stakes have focused on airlines and, with the exception of a few cases in emerging Asian economies, all took place in developed economies. In many cases, capital injections went to State-owned carriers, leaving the number of new SO-MNEs at about a dozen.

SO-MNEs from emerging markets reduced their international acquisitions in 2020, from \$37 billion to \$24 billion. The decrease followed a longer-term trend of a fall in overseas activity by such SO-MNEs.

SDG investment: collapse in several sectors

The fall in cross-border flows affected investment in sectors relevant for the SDGs. SDG-relevant greenfield investment in developing regions is 33 per cent lower than before the pandemic and international project finance is down by 42 per cent.

All but one SDG investment sector registered a double-digit decline from pre-pandemic levels (figure 4). The shock exacerbated declines in sectors that were already weak before the pandemic – such as power, food and agriculture, and health. The gains observed in investment in renewable energy and digital infrastructure in developed economies reflect the asymmetric effect that public support packages could have on global SDG investment trends. The sharp decline in foreign investment in SDG-related sectors may slow down the progress achieved in SDG investment promotion in recent years, posing a risk to delivering the 2030 agenda for sustainable development and to sustained post-pandemic recovery.

Figure 4. The impact of COVID-19 on international private investment in SDGs, 2019-2020 (Per cent change)



Source: UNCTAD.

Intraregional investment: smaller than it seems but expected to gain growth momentum

The momentum towards regional FDI is expected to grow over the coming years. Policy pressures for strategic autonomy, business resilience considerations and economic cooperation will strengthen regional production networks. A shift towards more intraregional FDI would represent much more of a break with the past than commonly expected; new data on direct and indirect regional FDI links show that, to date, investment links are still more global than regional in scope.

The total value of bilateral FDI stock between economies in the same region in 2019 was about \$18 trillion, equivalent to 47 per cent of total FDI. However, looking through regional investment hubs and counting only links between ultimate owners and final destinations, the total falls to less than \$11 trillion, or only 30 per cent of total FDI. At least one third of intraregional FDI is either double counted or from outside the region.

The growth of intraregional FDI is also relatively slow. Intraregional FDI grew at an average annual rate of 4 per cent in the period 2009–2019, slower than global FDI stock (6 per cent annually). Consequently, the share of intraregional FDI in total FDI stock decreased from 56 per cent in 2009 to 47 per cent in 2019 – and the share of intraregional ultimate-ownership links from 34 per cent to 30 per cent.

Disentangling regional FDI networks also sheds new light on the magnitude of South-South investment. The value of such FDI as a share of total investment in developing economies is less than 20 per cent (instead of some 50 per cent) after removing conduit investment through developing-country investment hubs.

REGIONAL TRENDS

FDI in Africa fell by 16 per cent

FDI flows to Africa declined by 16 per cent in 2020, to \$40 billion – a level last seen 15 years ago – as the pandemic continued to have a persistent and multifaceted negative impact on cross-border investment globally and regionally. Greenfield project announcements, key to industrialization prospects in the region, dropped by 62 per cent to \$29 billion, while international project finance plummeted by 74 per cent to \$32 billion. Cross-border M&As fell by 45 per cent to \$3.2 billion. The FDI downturn was most severe in resource-dependent economies because of both low prices of and dampened demand for energy commodities.

FDI inflows to North Africa contracted by 25 per cent to \$10 billion, down from \$14 billion in 2019, with major declines in most countries. Egypt remained the largest recipient in Africa, although inflows fell by 35 per cent to \$5.9 billion in 2020. Inflows to sub-Saharan Africa decreased by 12 per cent to \$30 billion. Despite a slight increase in inflows to Nigeria from \$2.3 billion in 2019 to \$2.4 billion, FDI to West Africa decreased by 18 per cent to \$9.8 billion in 2020. Central Africa was the only region in Africa to register stable FDI in 2020, with inflows of \$9.2 billion, as compared with \$8.9 billion in 2019. Increasing inflows in the Republic of Congo (by 19 per cent to \$4 billion) helped prevent a decline. FDI to East Africa dropped to \$6.5 billion, a 16 per cent decline from 2019. Ethiopia, which accounts for more than one third of foreign investment to East Africa, registered a 6 per cent reduction in inflows to \$2.4 billion. FDI to Southern Africa decreased by 16 per cent to \$4.3 billion even as the repatriation of capital by MNEs in Angola slowed down. Mozambique and South Africa accounted for most inflows in Southern Africa.

Foreign investment in Africa directed towards sectors related to the SDGs fell considerably in 2020. Renewable energy was an outlier, with international project finance deals increasing by 28 per cent to \$11 billion.

Amid the slow roll-out of vaccines and the emergence of new COVID-19 strains, significant downside risks persist for foreign investment to Africa, and the prospects for an immediate substantial recovery are bleak. UNCTAD projects that FDI in Africa will increase in 2021, but only marginally. An expected rise

in demand for commodities, the approval of key projects and the impending finalization of the African Continental Free Trade Area (AfCFTA) agreement's Sustainable Investment Protocol could lead to investment picking up greater momentum beyond 2022.

Developing Asia accounts for half of global FDI

FDI inflows to developing Asia as a whole were resilient, rising by 4 per cent to \$535 billion in 2020; however, excluding sizeable conduit flows to Hong Kong, China, flows to the region were down 6 per cent. Inflows in China actually increased, by 6 per cent, to \$149 billion. South-East Asia saw a 25 per cent decline, with its reliance on GVC-intensive FDI an important factor. FDI flows to India increased, driven in part by M&A activity. Elsewhere in the region, FDI shrank. In economies where FDI is concentrated in tourism or manufacturing, contractions were particularly severe. M&A activity was robust across the region, growing 39 per cent to \$73 billion – particularly in technology, financial services and consumer goods. In contrast, the value of announced greenfield investments contracted by 36 per cent, to \$170 billion, and the number of international project finance deals stagnated.

Flows to East Asia rose 21 per cent to \$292 billion, partly due to corporate reconfigurations and transactions by MNEs headquartered in Hong Kong, China. FDI growth in China continued in 2020, with an increase of 6 per cent to \$149 billion, reflecting the country's success in containing the pandemic and its rapid GDP recovery. The growth was driven by technology-related industries, e-commerce and research and development. South-East Asia, an engine of global FDI growth for the past decade, saw FDI contract by 25 per cent to \$136 billion. The largest recipients – Singapore, Indonesia and Viet Nam – all recorded declines. FDI to Singapore fell by 21 per cent to \$91 billion, to Indonesia by 22 per cent to \$19 billion, and to Viet Nam by 2 per cent to \$16 billion.

Investment in South Asia rose by 20 per cent to \$71 billion, driven mainly by a 27 per cent rise in FDI in India to \$64 billion. Robust investment through acquisitions in ICT and construction bolstered FDI inflows. Total cross-border M&As surged by 86 per cent to \$28 billion, with major deals involving ICT, health, infrastructure and energy sectors. FDI fell in South Asian economies that rely to a significant extent on export-oriented garment manufacturing. Inflows in Bangladesh and Sri Lanka contracted by 11 per cent and 43 per cent, respectively.

FDI flows in West Asia increased by 9 per cent to \$37 billion in 2020, driven by an increase in M&A values (60 per cent to \$21 billion) in natural resource-related projects. In contrast, greenfield investment projects were substantially curtailed, because of both the impact of the pandemic and low prices for energy and commodities. FDI in the United Arab Emirates rose by 11 per cent to \$20 billion, driven by acquisitions in the energy sector. Inflows in Turkey decreased by 15 per cent to \$7.9 billion. Investments in Saudi Arabia remained robust, increasing by 20 per cent to \$5.5 billion.

FDI prospects for the region are more positive than those for other developing regions, owing to resilient intraregional value chains and stronger economic growth prospects. Signs of trade and industrial production recovering in the second half of 2020 provide a strong foundation for FDI growth in 2021. Nonetheless, in smaller economies oriented towards services and labour-intensive industries, particularly hospitality, tourism and garments, FDI could remain weak in 2021.

FDI in Latin America and the Caribbean plummeted

FDI flows to Latin America and the Caribbean fell by 45 per cent to \$88 billion, a value only slightly above the one registered in the wake of the global financial crisis in 2009. Many economies on the continent, among the worst affected by the pandemic, are dependent on investment in natural resources and tourism, both of which collapsed, leading to many economies registering record low inflows. International investment in SDG-relevant sectors suffered important setbacks, especially in spending on energy, telecommunication and transport infrastructure.

In South America, FDI more than halved to \$52 billion. In Brazil, flows plunged by 62 per cent to \$25 billion – the lowest level in two decades, drained by vanishing investments in oil and gas extraction, energy provision and financial services. FDI flows to Chile dropped by 33 per cent to \$8.4 billion, benefitting from a quick recovery in mineral prices in the second half of the year. In Peru, flows crumbled to \$982 million, driven by one of the worst economic slumps in the world, and increased political instability. In Colombia, FDI tumbled by 46 per cent to \$7.7 billion following falling oil prices. Argentina's FDI inflows, already on a downward trajectory since 2018, plummeted by 38 per cent to \$4.1 billion in 2020.

In Central America, FDI inflows declined by 24 per cent to \$33 billion, partly shored up by reinvested earnings in Mexico. In Costa Rica, a sudden pause in investment in special economic zones (SEZs) was responsible for most of the 38 per cent decline in FDI inflows to \$1.7 billion. As international trade in the region halted, flows to Panama shrank 86 per cent to less than \$1 billion.

In the Caribbean, excluding offshore financial centres, flows declined by 36 per cent following the collapse in tourism and the halt in investment in the travel and leisure industry. The contraction was mostly due to lower FDI (\$2.6 billion) in the Dominican Republic, the largest recipient in the subregion.

Investment flows to and from the region are expected to remain stagnant in 2021. The pace of recovery of inflows will vary across countries and industries, with foreign investors set to target clean energy and the minerals critical for that industry, pushed by a worldwide drive towards a sustainable recovery. Other industries showing early signs of a rebound include information and communication, electronics and medical device manufacturing. Yet the region's lower growth projections compared with other developing regions, and the political and social instability in some countries, pose a risk to those prospects.

FDI flows to transition economies continued to slide

FDI flows to economies in transition fell by 58 per cent to just \$24 billion, the steepest decline of all regions outside Europe. Greenfield project announcements fell at the same rate. The fall was less severe in South-East Europe, at 14 per cent, than in the Commonwealth of Independent States (CIS), where a significant part of investment is linked to extractive industries. Only three transition economies recorded higher FDI in 2020 than in 2019. The pandemic exacerbated pre-existing problems and economic vulnerabilities, such as significant reliance on natural-resource-based investment (among some large CIS countries) or GVCs (in South-East Europe). The largest recipients (the Russian Federation, Kazakhstan, Serbia, Uzbekistan and Belarus, in that order) accounted for 83 per cent of the regional total. The Russian Federation, accounting for more than 40 per cent of inflows, experienced a decline of 70 per cent in inbound FDI, to \$10 billion.

A recovery in inflows is not expected to start before 2022. Despite recovery efforts, a return to pre-pandemic levels of inward FDI is unlikely, owing to slow economic growth affecting market-seeking FDI, the constraints of the pandemic

limiting diversification options, economic sanctions and geopolitical instability in parts of the region. The value of greenfield project announcements fell by 58 per cent to \$20 billion in 2020, the lowest level on record, and the number of announced cross-border project finance deals almost halved.

FDI to developed economies fell sharply

FDI flows to developed economies fell by 58 per cent to \$312 billion – a level last seen in 2003. The decline was inflated by strong fluctuations in conduit and intrafirm financial flows, and by corporate reconfigurations. Among the components of FDI flows, new equity investments were curtailed, as reflected in the decline in cross-border M&As, the largest form of inflows to the group. The value of those sales fell by 11 per cent to \$379 billion. The value of announced greenfield projects in the group declined by 16 per cent. In contrast, international project finance deals continued to target developed economies, increasing 8 per cent.

FDI flows to Europe fell by 80 per cent to \$73 billion. The fall was magnified by large swings in conduit flows in countries such as the Netherlands and Switzerland. However, inflows also fell in large European economies such as the United Kingdom, France and Germany. FDI flows to North America declined by 42 per cent to \$180 billion. Inflows to the United States decreased by 40 per cent to \$156 billion. Lower corporate profits had a direct impact on reinvested earnings, which fell to \$71 billion – a 44 per cent decrease from 2019.

Prospects are moderately positive, with growth of up to 20 per cent expected, mainly due to strong cross-border M&A activity, improved macroeconomic conditions, well-advanced vaccination programmes and large-scale public investment support. FDI is projected to increase by 15 to 20 per cent in Europe following the collapse in 2020 (from a baseline excluding conduit flows). FDI in North America is also projected to increase by about 15 per cent.

FDI fragility in structurally weak and vulnerable economies

Under the strains of the coronavirus pandemic, which amplified the fragilities of their economies, FDI to the 83 structurally weak, vulnerable and small economies declined by 15 per cent to \$35 billion, representing only 3.5 per cent of the global total.

Aggregate FDI inflows to the 46 least developed countries (LDCs) remained practically unchanged at \$24 billion, an increase of 1 per cent. However, the majority of countries registered lower FDI. Inflows to the 33 African LDCs increased by 7 per cent to \$14 billion, accounting for more than 60 per cent of the group total. In the nine Asian LDCs, inflows declined by 6 per cent to \$9.2 billion, or nearly 40 per cent of the group total.

FDI inflows are forecast to remain sluggish in 2021 and 2022, as LDCs struggle to cope with the shock of the crisis. The number of greenfield project announcements decreased, as did the number of international project finance deals. These declines affected sectors relevant for the SDGs, which is of concern for plans to help the countries graduate from LDC status.

The pandemic caused major disruptions in the economic activities of the 32 landlocked developing countries (LLDCs) and severely hit their FDI inflows, which contracted by 31 per cent to \$15 billion. The drop, to the lowest level of aggregate FDI since 2007, affected practically all economies in the group, with the notable exceptions of Kazakhstan, the Lao People's Democratic Republic and Paraguay. The share of the group in global FDI flows remained stable, though marginal, at 1.5 per cent.

International transportation constraints and dependence on neighbouring countries' infrastructure will continue to affect FDI in LLDCs. Although the measures adopted in the early stages of the pandemic are gradually being lifted or eased, the reorganization of international production and value chains could remain a challenge for LLDCs as investors seek more cost-effective and resilient locations for their new operations. Rescue and recovery packages that would accelerate economic growth and new investment remain limited by resource constraints.

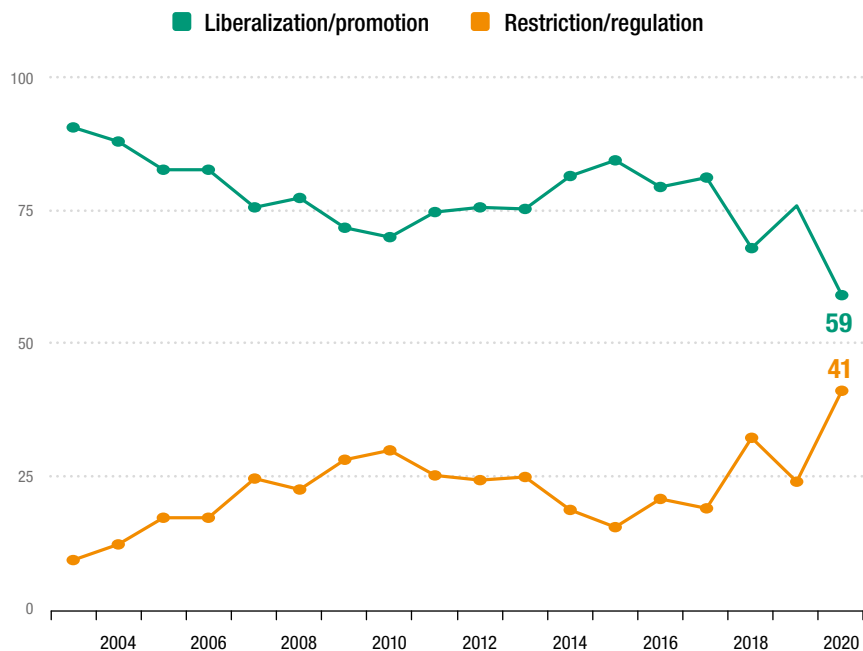
FDI in the small island developing States (SIDS) was down by 40 per cent last year, to \$2.6 billion. The scale of the contraction, which affected all SIDS regions without exception, highlights the multiple challenges that these countries are facing during the pandemic. Vulnerabilities include the concentration of FDI in a handful of activities (such as tourism and natural resources, both hard hit by the pandemic) and poor connectivity with the world economy. FDI flows to the SIDS are expected to remain stagnant in the short to medium term.

INVESTMENT POLICY DEVELOPMENTS

Restrictive or regulatory investment policy measures reach record levels

The policy trend towards more regulatory or restrictive measures affecting FDI accelerated in 2020. Of the 152 new investment policy measures adopted, 50 were designed to introduce new regulations or restrictions. Conversely, the number of new measures aiming to liberalize, promote or facilitate foreign investment remained stable (72 measures). Thirty measures were of a neutral nature. Accordingly, the ratio of restrictive or regulatory measures to measures aimed at liberalization or facilitation of investment reached 41 per cent, the highest on record (figure 5).

Figure 5. Changes in national investment policies, 2003–2020 (Per cent)



Source: UNCTAD, Investment Policy Hub.

Restrictive or regulatory measures were more prevalent in developed countries, where they represented 35 out of 43 policy measures adopted. The crisis caused by the pandemic prompted several developed countries to take precautionary measures to protect sensitive domestic businesses against foreign takeovers. This contrasts sharply with the situation in developing countries, where investment policy measures of a regulatory or restrictive nature corresponded to only 14 per cent of the total (only 15 out of 109 measures adopted).

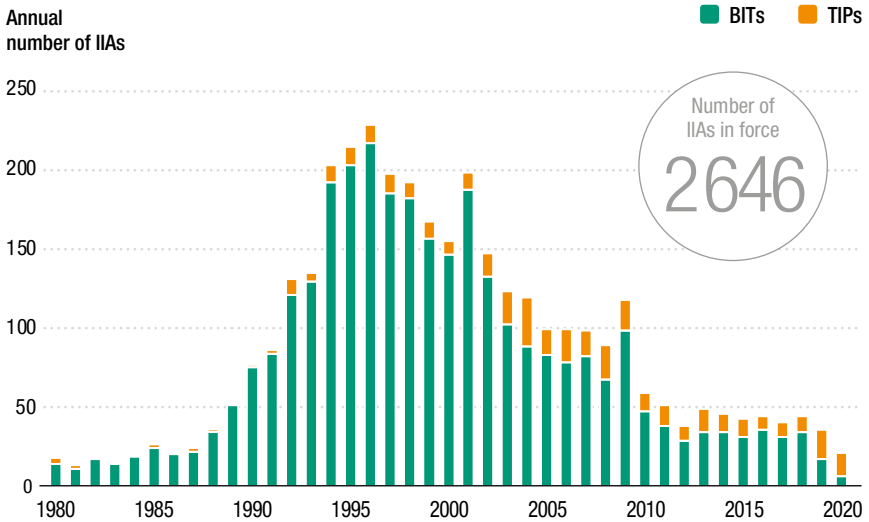
The heightened concerns for national security did not lead to a dramatic increase in the number of cross-border M&A deals formally blocked by the host countries for regulatory or political reasons; 15 large M&A deals (with values above \$50 million) were discontinued for regulatory or political reasons, two more than in 2019, with 3 of those formally rejected because of national security concerns. However, foreign investors may also have become more hesitant to engage in transactions that could cause national security concerns in host countries (a chilling effect). Also, many host-country authorities have started to engage more aggressively at the early stages of deal negotiations, effectively terminating some transactions before they reach the national security test.

Treaty networks are consolidating

At the international investment policy level, 21 new international investment agreements (IIAs) were signed in 2020. These new treaties included 6 bilateral investment treaties (BITs) and 15 treaties with investment provisions (TIPs). The most active economy was the United Kingdom, concluding 12 agreements to maintain trade and investment relationships with third countries after Brexit.

As in previous years, the number of terminations exceeded the number of newly concluded IIAs. In 2020, at least 42 IIAs were effectively terminated, of which 10 unilaterally, 7 by replacement, 24 by consent and 1 by expiry. Of these terminations, 20 were the consequence of the entry into force of the agreement to terminate all intra-EU BITs. As in 2019, India was particularly active in terminating treaties (six BITs), followed by Australia (3), and Italy and Poland (2 each). By the end of the year, the total number of effective IIA terminations reached at least 393, bringing the IIA universe to 3,360 (2,943 BITs and 417 TIPS), of which 2,646 were in force (figure 6).

Figure 6. | Number of new IIAs signed, 1980–2020



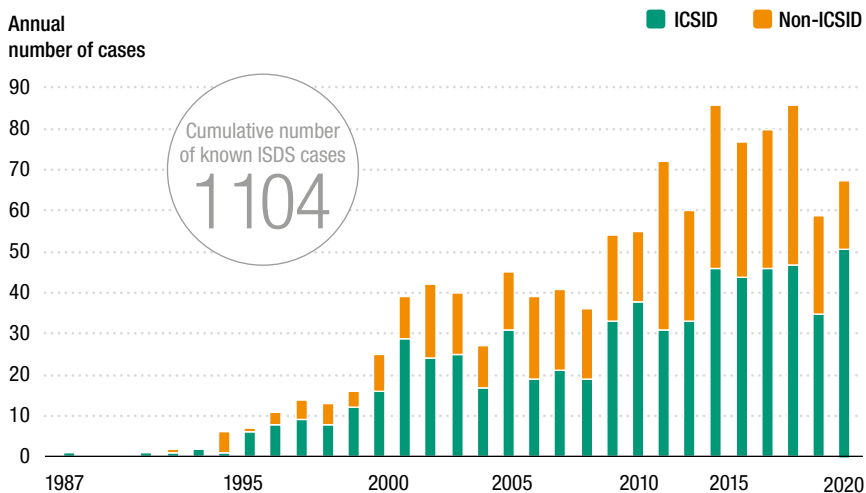
Source: UNCTAD, IIA Navigator.

Megaregional IIAs have been proliferating in recent years, significantly expanding the investment treaty network as each creates multiple bilateral IIA relationships. Megaregionals regulate investment protection and liberalization in different ways because of variations in how the parties approach investment provisions. Most importantly, recently concluded megaregional IIAs include many of the IIA reform approaches identified by UNCTAD.

There are now over 1,100 ISDS cases

In 2020, investors initiated 68 publicly known ISDS cases pursuant to IIAs (figure 7). As of 1 January 2021, the total number of publicly known ISDS claims reached 1,104. To date, 124 countries and one economic grouping are known to have been respondents to one or more ISDS claims. Most of the public decisions addressing jurisdictional issues upheld jurisdiction. More than half of the arbitral decisions rendered on the merits dismissed all investor claims. By the end of 2020, at least 740 ISDS proceedings had been concluded.

Figure 7. | Trends in known treaty-based ISDS cases, 1987–2020



Source: UNCTAD, ISDS Navigator.

IIA reform continues

All new IIAs contain features in line with UNCTAD’s Reform Package for the International Investment Regime, highlighting the progress on the reform of the IIA regime. As in 2019, the preservation of States’ regulatory space was the most frequent area of reform. More than 75 countries and regional economic integration organizations benefited from UNCTAD’s support in their reform efforts. In November 2020, UNCTAD launched its IIA Reform Accelerator, a tool to assist States in the process of modernizing the existing stock of old-generation investment treaties. It focuses on the reform of the substantive provisions of IIAs in selected key areas.

Investing in the health sector

The COVID-19 pandemic has created enormous challenges for national health systems and policies. It has tested the resilience of global supply chains for medical goods, revealed the fragility of many national health systems and highlighted the urgent need to invest more in health. An UNCTAD survey

of 70 economies sheds light on key aspects of the policy framework for investment in health.

The survey found that entry restrictions on investment in health are rare. Only 18 developing countries impose FDI bans or ceilings in at least one of the three segments of the health sector analyzed, namely the manufacturing of medical equipment, pharmaceutical production and biotechnology, and healthcare facilities and medical services.

Most countries (58) have put in place policies to promote investment in the health sector. The range of tools employed varies significantly depending on the region and level of development. While developing countries in Africa rely primarily on investment incentives that are part of general investment promotion schemes, developed countries – and increasingly also developing countries in Latin America and Asia – deploy a wider set of promotional policies. These include incentives targeted at the sector, proactive investment promotion and enhanced facilitation, and dedicated special economic zones and clusters. The pandemic has led to a rise in the use of targeted investment incentives in the health sector, mainly to foster digital medical technologies, manufacturing of medical equipment and supplies, and medical and pharmaceutical research.

At the international level, policies relevant to the health sector can help promote cross-border investment through market access and national treatment commitments for providers of health-related services (e.g. under GATS). The protection of intellectual property rights and accompanying flexibilities, most prominently regulated in the TRIPS Agreement, exerts an impact on investment in health. These international policies are complemented by BITs and the investment chapters of free trade agreements, which pursue the promotion and protection of investments while increasingly recognizing the need to safeguard national policy space to pursue legitimate public health objectives.

Thus, the overall policy framework is generally conducive to investment in health in most countries, while many maintain safeguards to address legitimate concerns about public health and national security. However, investment policies alone will not suffice to attract the levels of investment required to achieve SDG 3, which aspires to ensure health and well-being for all by 2030, particularly in low and lower-middle-income countries (LLMICs), where a more holistic approach is needed.

In LLMICs, open investment policies and investment promotion schemes cannot make up for the challenges that limit their capacity to host medical industries with adequate portfolios of medicines or vaccines, health infrastructure or services. These include (1) lack of capital, technology and skills; (2) low regulatory capacity and weak health-care systems; (3) weak policy coherence and enabling frameworks; (4) small markets and unstable demand; and (5) poor infrastructure and related services. UNCTAD's action plan for building productive capacity in health proposes 10 main areas for establishing an adequate ecosystem at the national, regional and international levels and address these challenges, as follows:

- i. Invest in skills development and technological capacity
- ii. Share technologies to enable affordable mass production
- iii. Improve access to finance and tap into impact investment
- iv. Build partnerships to initiate “lighthouse” projects
- v. Provide investment incentives to improve local firms' sustainability
- vi. Upgrade and streamline regulations and administration
- vii. Invest in infrastructure
- viii. Emphasize a regional approach to reduce cost
- ix. Seek funding through official development assistance
- x. Ensure sustainability of efforts despite an unpredictable market

Given the magnitude of the challenge, concerted actions by all stakeholders are needed to effectively build and expand productive capacity in the health sector. Countries will also need to assess which segments to prioritize and how to build the tailored support ecosystem through coherent policy, efficient regulatory institutions and infrastructure, and relevant skills and technology.

INVESTMENT IN SUSTAINABLE RECOVERY

The recovery of international investment has started, but it could take some time to gather speed. Early indicators on greenfield investment and international project finance – and the experience from past FDI downturns – suggest that even if firms and financiers are now gearing up for “catch-up” capital expenditures, they will still be cautious with new overseas investments in productive assets and infrastructure.

Nevertheless, the attention of policymakers in most countries has shifted decisively to recovery. The focus of both governments and firms is on building back better. Resilience and sustainability will shape their investment priorities.

For firms, especially the largest MNEs engaged in complex international production networks, a key priority is making their supply chains more resilient. Many are expanding inventories of key components, diversifying supply sources or improving flexibility to allow the shifting of production between facilities in different locations. In some industries, especially those more exposed to policy pressures – such as pharmaceuticals or medical equipment, but also strategic growth industries – there is talk of the need to restructure international production networks, with capacity moving closer to home or spread across multiple locations, which would have important implications for cross-border investment flows in the coming years.

Governments are already fully engaged in supporting their populations and business communities through the crisis, with those in rich countries having rolled out huge rescue packages over the past year. They are now gearing up to direct new investment to growth priorities, with developed countries able to direct public funds to sizeable recovery investment packages and poorer ones relying on alternative sources of finance, such as development banks, and on initiatives to attract foreign capital. The focus of spending is on infrastructure, on growth sectors – especially the digital economy – and on the energy transition, in many cases building on or accelerating existing plans. Again, the implications for international investment flows in the coming years are likely to be significant.

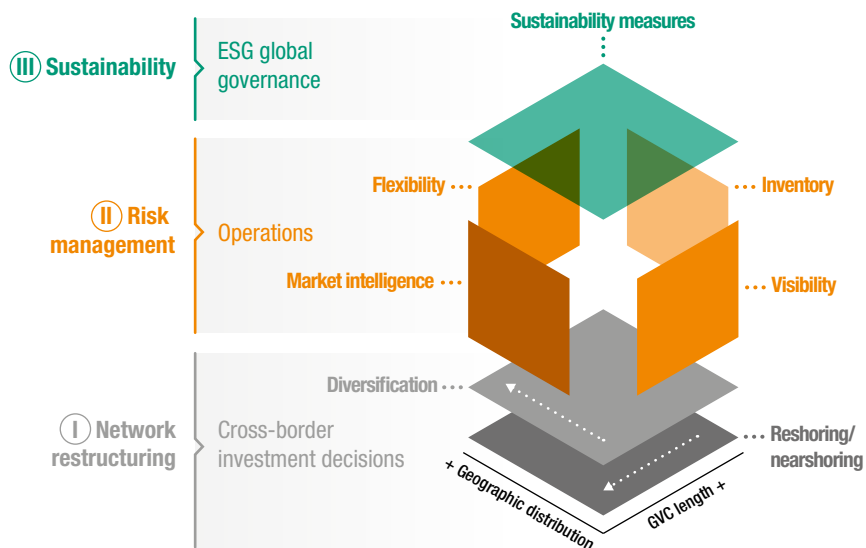
The theme chapter of *WIR21* looks at the possible impact of the post-pandemic priorities of both firms and governments on global investment patterns over the coming years. It identifies challenges and risks that could damage the prospects

for a big push of investment in sustainable development and suggests policy options to counter them. As such, the chapter serves to address General Assembly Resolution 75/207, which requests UNCTAD, through its *World Investment Report*, to inform the GA on the impact of the COVID-19 pandemic on investment in sustainable development, and to make recommendations for the promotion of SDG investment.

A firm-level perspective: supply chain resilience

MNEs have three sets of options to improve supply chain resilience (figure 8). They include (i) network restructuring; which involves production location decisions and, consequently, investment and divestment decisions; (ii) supply chain management solutions (planning and forecasting, buffers, and flexibility); and (iii) sustainability measures, which have the additional benefit of mitigating certain risks. Because of the cost of network restructuring, MNEs will first exhaust other supply-chain risk mitigation options.

Figure 8. | Supply chain resilience: a framework



Source: UNCTAD.

Network restructuring involves production location decisions and, consequently, investment and divestment decisions. It implies the redesigning of global supply chains in two directions: reshoring or nearshoring, and diversification. Both resilience-seeking options – centralization or decentralization – have major implications for international production and FDI. Reshoring is associated with disinvestment, with a negative impact not only on future FDI flows but also on existing stock. Diversification would bring changes to the nature of FDI, with a shift from efficiency-seeking to market-seeking investment.

Because of the cost of network restructuring, MNEs will first exhaust other supply-chain risk mitigation options. Therefore, in the short term, the impact of the resilience push on international investment patterns will be limited. In the absence of policy measures that either force or incentivize the relocation of productive assets, MNEs are unlikely to embark on a broad-based restructuring of their international production networks. Resilience is not expected to lead to a rush to reshore but to a gradual process of diversification and regionalization as it becomes part of MNE location decisions for new investments.

However, in some industries the process may be more abrupt. Policy pressures and concrete measures to push towards production relocation are already materializing in strategic and sensitive sectors. Recovery investment plans could provide further impetus: most investment packages, in both developed and developing countries, include domestic or regional industrial development objectives.

Recovery investment priorities

Recovery investment plans in most countries focus on infrastructure sectors – including physical, digital and green infrastructure. These are sound investment priorities that (i) are aligned with SDG investment needs; (ii) concern sectors in which public investment plays a bigger role, making it easier for governments to act; and (iii) have a high economic multiplier effect, important for demand-side stimulus.

A broader perspective on priorities for promoting investment in sustainable recovery includes not only infrastructure but also industries that are key to growth in productive capacity. The pandemic has brought the productive capacities agenda to the fore. It has disproportionately affected those working

in low-productivity sectors, which worsens inequality, reverses gains in poverty reduction and increases vulnerable employment.

An analysis of investment trends in sectors and industries associated with key productive capacity components (such as human and natural capital, infrastructure, private sector development and structural change) shows where FDI has the potential to contribute more to growth in productive capacities. It also shows which components of productive capacity are affected most by the current investment downturn.

Investment in industry, both manufacturing and services, was hit much harder by the pandemic than investment in infrastructure. A slow recovery of investment in industrial sectors – in which FDI often plays a more important role – will put a brake on productive capacity growth. For developing countries in particular, initiatives to promote and facilitate new investment in industry, especially in sectors that drive private sector development and structural change, will be important to complement recovery investments in infrastructure.

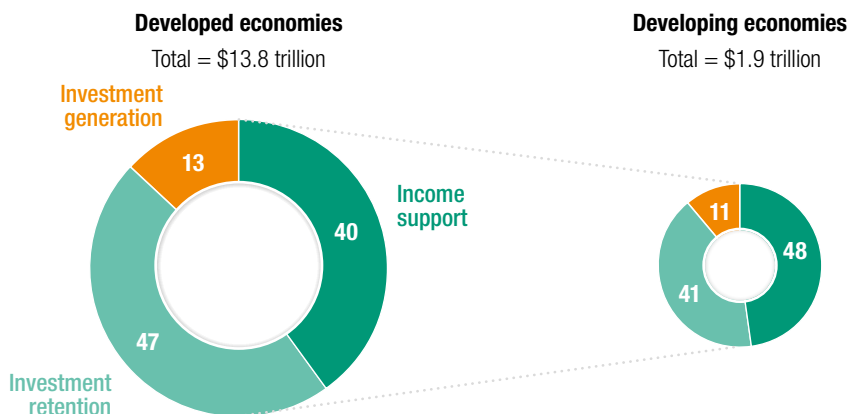
Recovery investment challenges

Recovery investment packages are likely to affect global investment patterns in the coming years owing to their sheer size. The cumulative value of recovery funds intended for long-term investment worldwide is already approaching \$3.5 trillion, and sizeable initiatives are still in the pipeline. Considering the potential to use these funds to draw in additional private funds, the total “investment firepower” of recovery plans could exceed \$10 trillion. For comparison, that is close to one third of the total SDG investment gap as estimated at the time of their adoption.

The bulk of recovery finance has been set aside by and for developed economies and a few large emerging markets (figure 9). Developing countries account for only about 10 per cent of total recovery spending plans to date. However, the magnitude of plans is such that there are likely to be spillover effects – positive and negative – to most economies. And international project finance, one of the principal mechanisms through which public funds will aim to generate additional private financing, will channel the effects of domestic public spending packages to international investment flows.

The use of international project finance as an instrument for the deployment of recovery funds can help maximize the investment potential of public efforts,

Figure 9. Recovery investment packages in developed and developing countries



Source: UNCTAD and IMF Fiscal Monitor April 2021 edition.

but also raises new challenges. Addressing the challenges and maximizing the impact of investment packages on sustainable and inclusive recovery will require several efforts:

- Swift intervention to safeguard existing projects that have run into difficulty during the crisis, in order to avoid cost overruns and negative effects on investor risk perceptions.
- Increased support for and lending to high-impact projects in developing countries, as the deployment of recovery funds in developed economies will draw international project finance to lower-risk and lower-impact projects.
- Efforts by bilateral and multilateral lenders and guarantee agencies to counter upward pressure on project financing costs in lower-income developing countries.
- Vastly improved implementation and absorptive capacity, because recovery investment plans imply an increase in global infrastructure spending of, at a minimum, three times the biggest annual increment of the last decade for several years running.

- Strong governance mechanisms and contracts that anticipate risks to social and environmental standards on aggressively priced projects.

A policy framework for investment in sustainable recovery

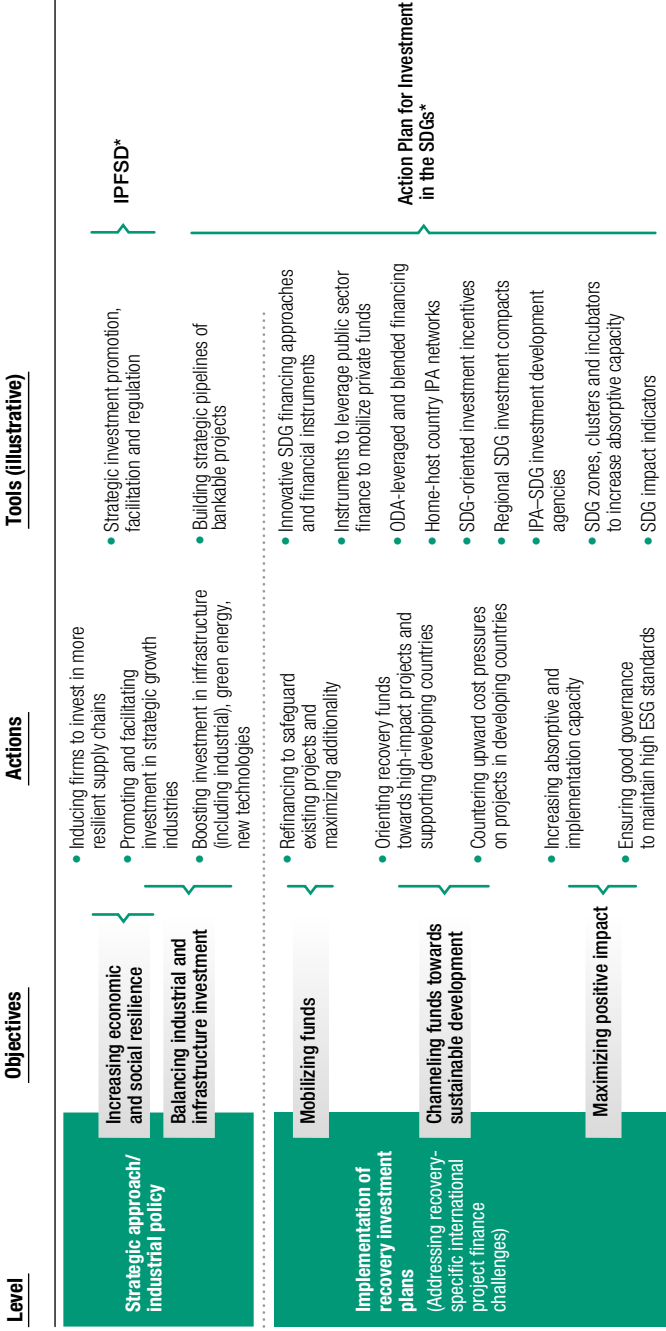
Promoting investment in resilience, balancing stimulus between infrastructure and industry, and addressing the implementation challenges of recovery plans requires a coherent policy approach. At the strategic level, development plans or industrial policies should guide the extent to which firms in different industries should be induced to rebalance international production networks for greater supply chain resilience (from a firm perspective) and greater economic and social resilience (from a country perspective). They should also drive the promotion and facilitation of investment in industry, needed for complementarity with infrastructure spending.

For developing countries, industrial development strategies should generate a viable pipeline of bankable projects. The lack of shovel-ready projects in many countries remains a key barrier to attracting more international project finance. The risk now is that, in the absence of projects that have gone through the phases of design, feasibility assessment and regulatory preparation, the roll-out of recovery investment funds will incur long delays.

At the level of execution, addressing recovery investment challenges can draw on initiatives included in UNCTAD's Action Plan for Investment in the SDGs – first proposed in *WIR14* and subsequently updated in the Investment Policy Framework for Sustainable Development (IPFSD) and in *WIR20*. The action plan – aimed at mobilizing finance, channeling it towards sustainable development and maximizing its positive impact – focuses on many of the same sectors (e.g. infrastructure, green, health) that are now central in sustainable recovery plans (figure 10).

UNCTAD believes that the drive on the part of all governments worldwide to build back better, and the substantial recovery programmes that are being adopted by many, can boost investment in sustainable growth. The goal should be to ensure that recovery is sustainable and that its benefits extend to all countries and all people.

Figure 10. A policy framework for investment in sustainable recovery



Source: UNCTAD.

* The list of tools includes selected elements of UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD) and its Action Plan for Investment in the SDGs.

CAPITAL MARKETS AND SUSTAINABLE FINANCE

Despite extreme market volatility last year, the sustainable investment market has been expanding steadily, as demonstrated by the number of new sustainability-themed products, the amount of new capital flows and the number of new initiatives developed by exchanges, security market regulators, assets owners and managers, and other market actors.

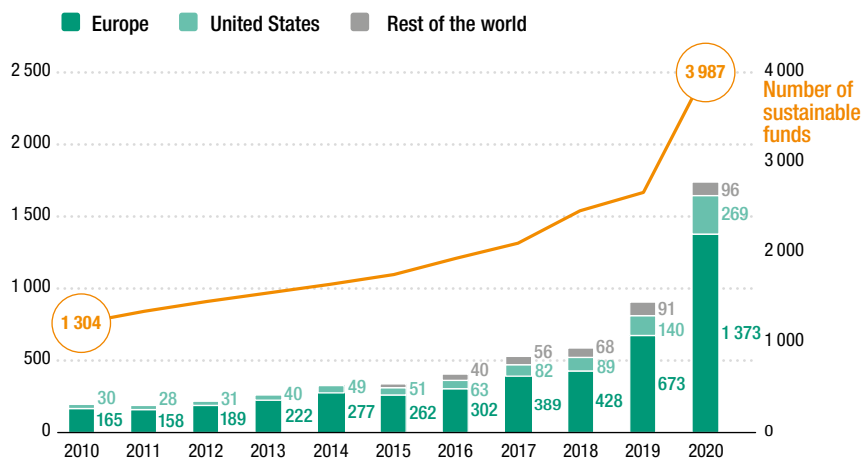
The pursuit of sustainability has led to a rapid growth in sustainability-themed financial products. The global efforts to fight the pandemic and climate change are accelerating this momentum. UNCTAD estimates that the value of sustainability-themed investment products in global capital markets amounted to \$3.2 trillion in 2020, up more than 80 per cent from 2019. These products include sustainable funds (over \$1.7 trillion), green bonds (over \$1 trillion), social bonds (\$212 billion) and mixed-sustainability bonds (\$218 billion). Most are domiciled in developed countries and targeted at assets in developed markets. This continued growth reaffirms the potential for capital markets to contribute to filling the financing gap for the SDGs.

Sustainability-themed capital market products

Over the past five years, the fund industry has been rapidly embracing sustainability through the multiplication of funds and indexes dedicated to sustainability themes. Sustainable funds include mutual funds and exchange-traded funds (ETFs) that describe themselves in their prospectus or other filings as selecting assets that integrate sustainability, impact or environment, social and governance (ESG) factors. Their number and assets under management (AUM) surged in 2020.

The total number of sustainability-themed funds had reached 3,987 by June 2020, up 30 per cent from 2019, with about half of all sustainable funds launched in the last five years. The AUM of sustainable funds quadrupled over the last five years; last year alone they nearly doubled, from roughly \$900 billion in 2019 to over \$1.7 trillion (figure 11). The growth held for both sustainable mutual funds and ESG ETFs. Nevertheless, together such funds represent only 3.3 per cent of all open-ended fund assets worldwide. That shows both the great potential and the long way to go.

Figure 11. Number and AUM of sustainability-themed funds, 2010-2020 (Billions of dollars)



Source: UNCTAD, based on Morningstar and TrackInsight data.

Note: Numbers of funds do not include funds that were liquidated; the numbers for 2020 are as of 30 June.

The vast majority of sustainability-themed funds is domiciled in Europe (73 per cent), followed by North America (18 per cent), with other regions, including developing countries, representing less than 10 per cent of funds. This reflects the maturity of the market and the relatively advanced regulatory environment for sustainable investment in Europe.

UNCTAD's analysis of 800 sustainable equity funds for which relevant data are available shows that about 27 per cent of their total assets (\$145 billion of a total AUM of \$540 billion) are deployed in eight key SDG sectors: transport infrastructure, telecommunication infrastructure, water and sanitation, food and agriculture, renewable energy, health, education and ecosystem diversity. The health sector, which covers medical services, pharmaceuticals and medical devices, is the most common and single largest SDG sector for these funds, followed by renewable energy, food and agriculture, and water and sanitation. The analysis also suggests that these funds do not systematically suffer a financial disadvantage because of their investment strategy. Over a period of three years, 48 per cent of sustainable funds outperformed their respective benchmarks, while 52 per cent underperformed them.

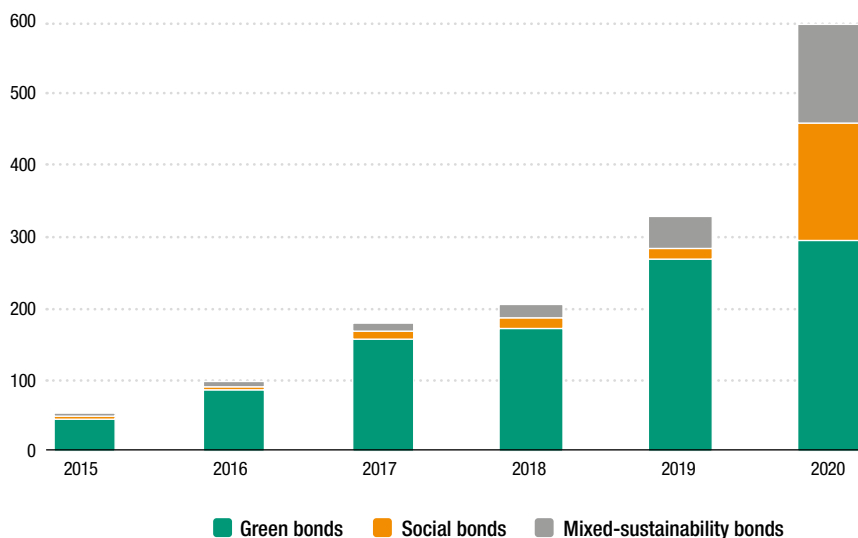
Developing and transition economies so far remain largely absent from the sustainable fund market. They host about 5 per cent of the world's sustainable funds by number and less than 3 per cent by assets, even though stock markets in developing and transition economies account for roughly 23 per cent of global market capitalization. This suggests that developing economies have the potential to significantly grow their sustainable fund markets.

There are persistent concerns about greenwashing and the real impact of sustainability-themed investment products. The fund market needs to enhance credibility by improving transparency. Funds should report not only on ESG issues but also on climate impact and SDG alignment. Importantly, to maximize impact on sustainable development, more funds should invest in developing and transition economies. Nonetheless, the rapid growth of the sustainable investment market confirms its potential to contribute to filling the SDG financing gap.

The sustainable bonds market (green, social and mixed) grew in every quarter of 2020, from less than \$70 billion in Q1 to close to \$180 billion in Q4, pushed by the issuance of social and mixed-sustainability bonds as national and supranational organizations and corporations financed relief efforts during the pandemic (figure 12). The largest increase was seen in the social bond market, with a tenfold rise to \$164 billion in 2020 — or one third of the total sustainable bond market, up from just 5 per cent in 2019. Mixed-sustainability bonds were valued at \$128 billion, surpassing their 2019 total by a factor of three. Social and mixed-sustainability bonds are thus rapidly catching up with the green bond segment and becoming increasingly popular tools for financing SDG-related activities. Cumulatively, the total amount of outstanding sustainable bonds is estimated at \$1.5 trillion.

Despite an average annual growth rate of 67 per cent and significant size in absolute terms, the sustainable bond market is still very much in its early growth stage, representing only about 1.3 per cent of the total global bond market of approximately \$119 trillion. This suggests enormous growth potential for this segment going forward. In the next five years, the sustainable bond market can expect to see further acceleration of growth as investors and issuers become more confident with this investment vehicle. By 2025, the sustainable bond market could reach 5 per cent of the total global market, which would bring over \$6 trillion of new resources to SDG sectors.

Figure 12. Growth in the sustainable bond market, 2015–2020
(Billions of dollars)



Source: UNCTAD based on Bloomberg data.

Institutional investors and financial service providers

Institutional investors are in a strong position to effect change towards sustainability. They can do so primarily through two routes: (i) asset allocation – where they choose to invest the capital at their disposal, which can have a determinative impact on companies and markets; and (ii) active ownership – how they influence the policies of the companies they invest in through corporate governance mechanisms.

In particular, four groups of upstream institutional investors have an important role to play in driving sustainable investment and have a strong institutional interest in doing so: the first two, pension funds and sovereign wealth funds (SWFs) managed reported global assets of \$52 trillion and \$9.2 trillion, respectively, in 2021. The second two, insurance companies and banks, manage assets but primarily provide financial services for their clients in the form of risk management products and loans. The investable assets of insurance companies reached \$32.9 trillion in 2018, and those of banks reached \$155 trillion in 2019.

The potential influence on corporate sustainability of pension funds and sovereign wealth funds (SWFs) is enormous. More than 40 per cent of their assets (over \$60 trillion in total) are invested in publicly listed equities, making them “universal owners” with large shareholdings in companies across a wide range of sectors and markets. Given their long-term obligations, pension funds are in a better position to assess long-term risks to their portfolios, and the intergenerational nature of their business model tends to make them more responsive to ESG- and SDG-related issues. Consequently, there has been a realization on the part of these large institutional investors that ESG factors constitute material risks.

However, public pension funds could do more to promote sustainability. According to an UNCTAD report, among the world’s 50 largest public pension funds and 30 largest SWFs, only 16 public pension funds and 4 SWFs published a sustainable or responsible investment report in 2019. More fundamentally, public pension fund portfolios largely bypass developing-country markets, limiting their contribution to sustainable development.

Meanwhile, SWFs should uphold responsible investment principles and standards, such as the Principles for Responsible Investment in Agriculture, which protect the rights of minority shareholders and local stakeholders. Home-country governments need to review the mandate of funds to allow them necessary space for investment abroad in productive assets and activities.

Developing host countries need to consider reducing entry barriers for institutional investors while safeguarding public interests. They can use risk-sharing tools, such as public-private partnership, investment insurance and blended financing, to help improve the risk-return profile of SDG investment projects and make bankable projects readily available for institutional investors, while taking measures to maximize development benefits. Insurance companies can contribute to sustainable development in their role as risk solution providers, as well as their role as investors (with AUM of more than \$30 trillion in 2018). Climate change is a systemic risk for the world. Total economic losses from disasters globally were an estimated \$202 billion in 2020, up from \$150 billion in 2019, with about \$190 billion resulting from natural catastrophes.

The banking sector can foster sustainable development through enhanced corporate lending. The volume of sustainable financial products has grown in recent years, driven by increased demand and by campaigns to promote

financial sector sustainability. The sustainable loan market was valued at about \$200 billion in 2020, consisting mainly of green loans (which are used to finance green assets and projects) and sustainability-linked loans (which are tied to the borrower's ESG rating and not the use of proceeds). The frameworks underpinning these instruments are the Green Loan Principles established in 2018 and the Sustainability Linked Loan Principles established in 2019 by the Loan Market Association, a banking industry group.

European markets played a leading role in the upward trend of the sustainable loan market, consistently representing about half or more of the market over the past five years. Most loans raised under the Green Loan Principles are raised to invest in renewable energy, while the sustainability-linked loans are going to a more diversified set of industries.

Stock exchanges and derivatives exchanges

Stock exchanges and derivatives exchanges affect sustainability in their markets through their influence on corporate ESG behaviour and through the promotion of sustainable finance products. Derivatives exchanges can contribute through sustainability-aligned derivatives products, ESG data products and enhanced transparency. Stock exchanges contribute through a wider set of mechanisms. The number of stock exchanges with written guidance for issuers on ESG disclosure rules (SDG 12.6) has grown rapidly, from 13 in 2015 to 56 in 2020. The number of exchanges that provide training on ESG topics to issuers and investors also continues to rise, with over half offering at least one training course.

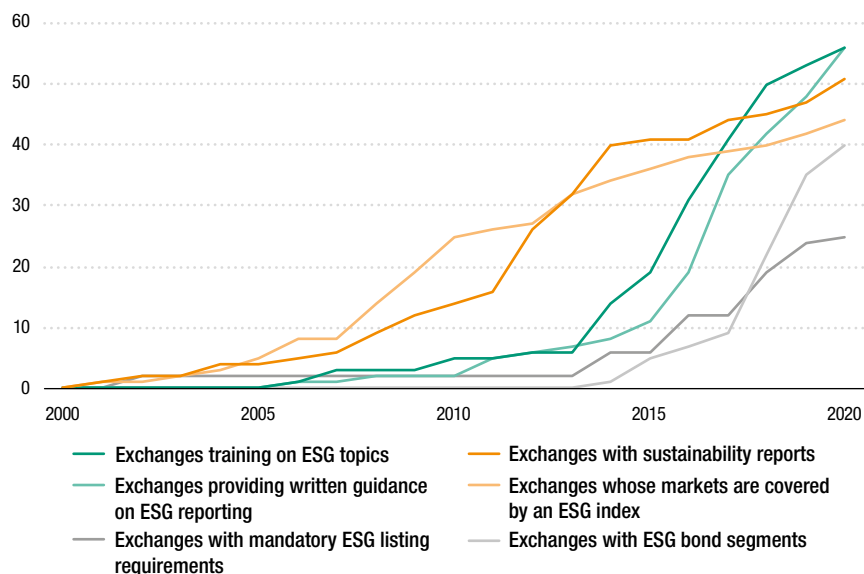
Mandatory ESG reporting is on the rise, supported by both exchanges and security market regulators. The number of exchanges covered by mandatory ESG disclosure rules more than doubled in the past five years, to 25 today. The number of stock exchanges with dedicated sustainability bond segments (including green bond segments, SDG 13) increased by 14 between 2019 and 2020, for a total of 38.

The United Nations Sustainable Stock Exchanges database contains data on 106 stock exchanges worldwide, listing over 53,000 companies and representing a market capitalization of more than \$88 trillion. The database specifically tracks various activities related to ESG factors, all of which have seen rapid growth over the last decade (figure 13).

This upward trend is expected to continue as investor interest in ESG-themed products is strong and growing, public policies to promote sustainable development are strengthened in several jurisdictions and more stock exchanges recognize the important role that they can play in promoting investment in sustainable development.

Whereas the role of stock exchanges in sustainable development has been well explored over the past decade, the potential role of derivatives exchanges – where nearly 35 billion futures and options contracts were traded globally in 2019 – is less understood. In 2020, both the United States Commodity Futures Trading Commission – an industry regulatory body – and the Futures Industry Association – an international industry association – acknowledged the potential role of derivatives markets in addressing climate change and associated risks. In early 2021, the United Nations Sustainable Stock Exchanges and the World Federation of Exchanges provided an Action Menu for derivatives exchanges to contribute to sustainable development.

Figure 13. | **Stock exchange trends, 2000–2021** (Number of exchanges)



Source: UNCTAD, SSE database.

The future of sustainable finance

To continue growing and ensure concrete impact over the long term and to fully unleash its potential to finance sustainable development, the sustainable investment market needs to address “a triple challenge”: (i) the niche market risk, (ii) the geographical imbalance of investments and (iii) greenwashing concerns. Addressing these challenges requires three fundamental transitions in the sustainable investment market:

- Growing sustainable investment from “market niche” to “market norm”, by making sustainability integration universal rather than a strategy of a subset of the larger market.
- Transforming the sustainable investment market from a developed-country phenomenon to a global market, which benefits all countries, in particular developing economies.
- Strengthening the credibility of sustainability ratings and reporting with more robust and regulated standards and taxonomies.

This transformation, from the market of today to the market of the future, entails concerted efforts by all stakeholders, including fund and index providers, institutional investors, stock exchanges and regulators. More work can be done to encourage the integration of ESG factors into mainstream products and indexes. Rules and guidelines to establish industry standards and governance requirements with an aim to bring transparency, predictability and credibility to the market are moving beyond voluntary measures. Slowly, regulation is helping to shape the future contours of the sustainable investment market.

To help address the challenges, UNCTAD, together with partners, will launch a new initiative, the UN Global Sustainable Finance Observatory. This initiative is built on the vision of a future global financial ecosystem in which sustainable development (as defined by the SDGs) is fully embedded into the business model of financial markets and in investment culture.

The Observatory will promote and facilitate the transition of sustainable investment from market niche to market norm, leading up to 2030 and beyond. It will address the challenges of fragmentation in standards, proliferation in benchmarking, complexity in disclosure and self-declaration of sustainability. It will integrate the relevant instruments and outputs on its virtual platform to facilitate the assessment, transparency and integrity of sustainable finance

products and services. The Observatory will work in tandem with the standards-setting processes of the financial industry and regulatory bodies to promote the full and effective integration of sustainable development (as defined by the SDGs) into all aspects of global financial ecosystem.

Specifically, the UN Global Sustainable Finance Observatory will

- i. Promote the integration of the SDGs into the sustainability assessment ecosystem in a coherent and synergistic manner, including through the established UN Core Indicators for SDGs reporting by enterprises (UN ISAR).
- ii. Build a global database of sustainable investment funds and other products to improve the open-source availability of sustainability data for key stakeholders and the public.
- iii. Conduct sustainability assessments and rankings of “self-declared” sustainable products on the global capital market, and award best performers while also disclosing greenwashing cases.
- iv. Establish a pool of various sustainability ratings on the capital market for transparency as well as public scrutiny for better reporting methodologies in different industries.
- v. Compile a global inventory of good regulatory and policy practices for sustainability integration into capital markets and facilitate peer learning.
- vi. Provide a capacity-building platform to assist developing countries with policies, regulatory measures, product development, industry standards, reporting and other related issues to ensure their maximum benefit from sustainable finance.

The UN Global Sustainable Finance Observatory will be launched officially in October 2021 at UNCTAD’s World Investment Forum, which brings together the global investment-for-development community, including all capital market stakeholders along the global investment chain. The Observatory will seek the endorsement of the UN General Assembly as part of its efforts to accelerate progress on the achievement of the SDGs, and to meet commitments on climate change, and financing for development, especially in the context of the pandemic recovery response.

NOTE

The Overview is prepared based on the in-depth analysis contained in *World Investment Report 2021: Investing in Sustainable Recovery* (United Nations publication, Sales No. E.21.II.D.13).

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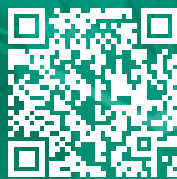
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