4TH MULTI-YEAR EXPERT MEETING ON INVESTMENT FOR DEVELOPMENT

CURRENT POLICY CHALLENGES

5-6 December 2011

Opening Statement

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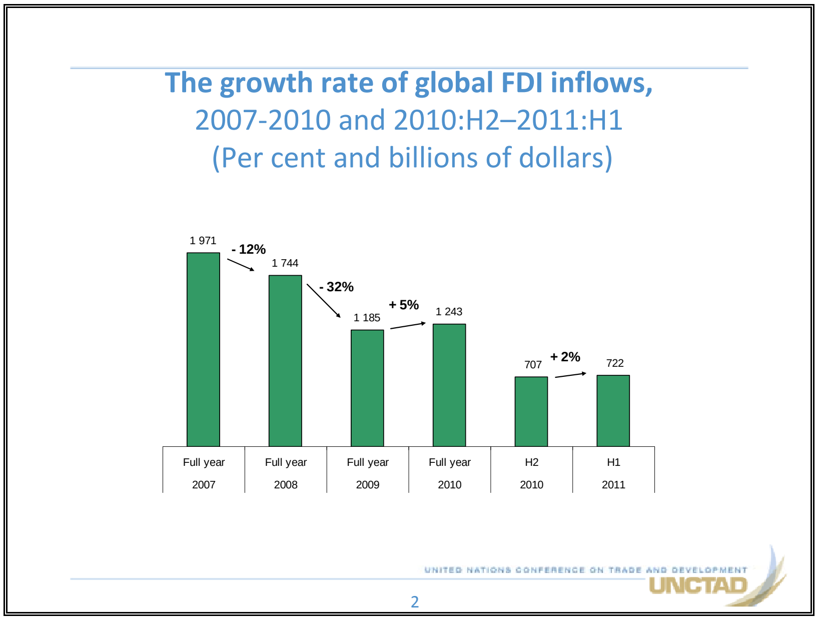
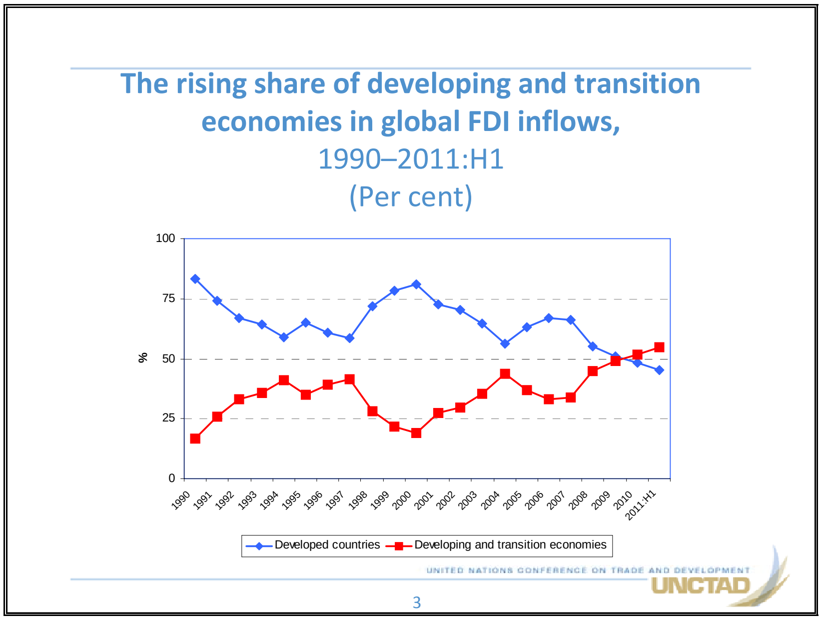
[*]The views expressed are those of the author and do not necessarily reflect the views of UNCTAD

Ladies and Gentlemen,

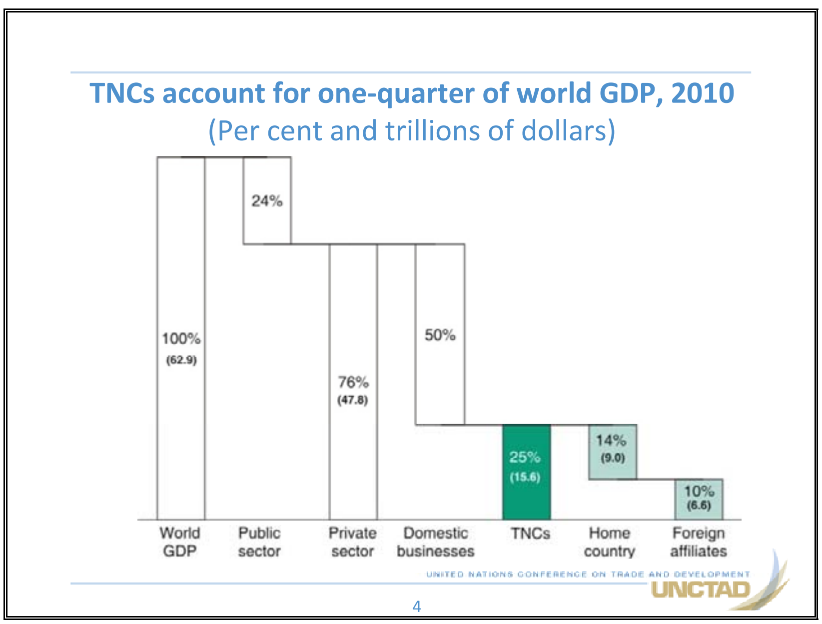
It is a real pleasure for me to discuss with you today the challenges in national and international policy making to enable investment work for development. As the Secretary-General just highlighted, these challenges are numerous and complex. However, let me first say a few more words on the recent trends in global foreign direct investment (FDI).



Global FDI has not yet recovered to its pre-crisis level. UNCTAD's latest *Global Investment Trends Monitor* shows that in the first half of 2011 global FDI flows rose by only 2% compared with the previous half in 2010, continuing the moderate recovery observed in 2010. FDI prospects were dampened in mid-2011, at the global and regional levels, on account of increased turmoil in the global economy. Already we see that FDI to developed countries experienced a 4% decline in the first half of 2011, after the decline in FDI flows to this region stabilized in 2010.

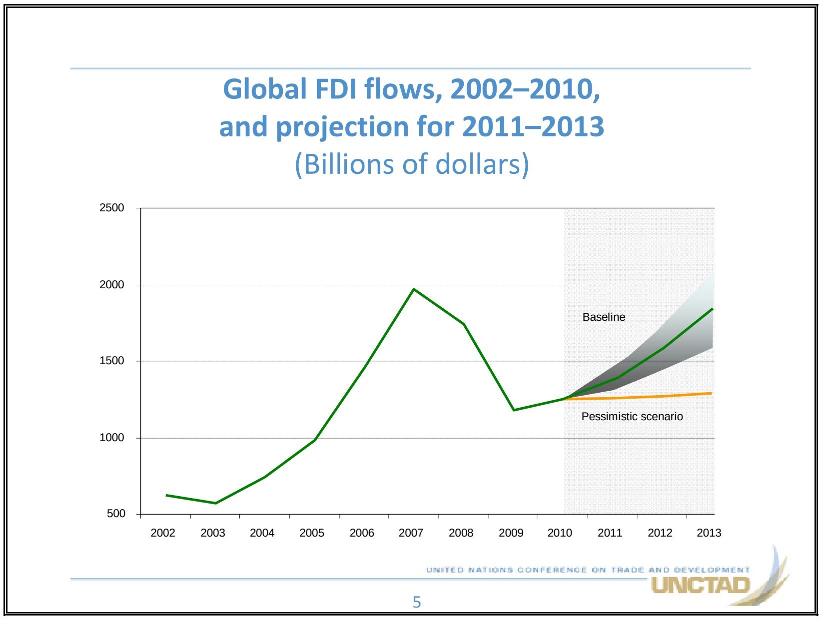


Against this background, it is remarkable that in 2010 developing and transition economies absorbed for the first time more than half of global FDI flows. Moreover, developing and transition economies generated nearly 30% of global outflows with much of the investment directed to other countries in the South. This trend continued in the first half of 2011. It reflects the growing confidence and dynamism of emerging-market TNCs and demonstrates the growing importance of these economies as sources of international investment.



Despite the current global economic crisis, international production is expanding, with foreign sales, employment and assets of TNCs all increasing. Our *World Investment Report*

2011 concludes that TNCs' production worldwide generated value added of approximately $16 trillion in 2010, about a quarter of global GDP. Foreign affiliates of TNCs accounted for one-third of world exports. International production and more recently international consumption increasingly shift to developing and transition economies, and TNCs are increasingly investing in both efficiency- and market-seeking projects in these countries.

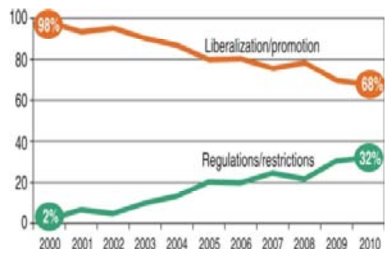


What are UNCTAD's forecasts for FDI this year? Amidst the crisis in financial markets, preliminary data for the third quarter of 2011 on cross-border merger and acquisitions and greenfield investment indicate an FDI growth deceleration. However, our full-year forecast remains cautiously optimistic, projecting FDI flows close to the pre-crisis annual average, though still remaining some 25 % below the 2007 peak. Downside risks, however, have intensified, reflecting turmoil in the sovereign debt markets, a fragile recovery of the global economy, spikes in investor risk aversion, turbulence in financial markets, and the rise of investment protectionism.

These risks need to be countered by appropriate policies that "unleash" the record amounts of cash reserves (in the order of four to five trillion dollars) accumulated by the world's transnational corporations. Indeed, "un-tapping" these funds to stimulate the global economy, create jobs and finance development may become an important policy priority for the months to come. However, at a time when the global economy urgently needs a boost from private investment, the attention of policymakers is diverted away from the necessities of long-term productive investment by the urgencies of short-term crisis management.

National regulatory changes, 2000–2010
(Per cent)

National regulatory changes in 2010, by industry
(Per cent)



	Liberalization/ promotion	Regulations/ restrictions
Total	67	33
No specific industry	84	16
Agribusiness	38	62
Extractive industries	7	93
Manufacturing	50	50
Electricity, gas and water	75	25
Financial services	59	41
Other services	61	39

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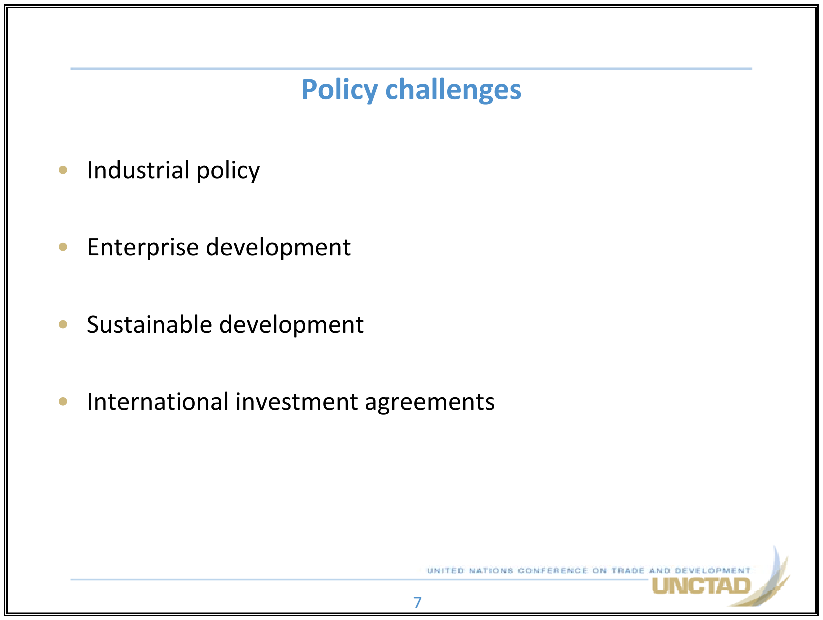
6

Let me turn to recent policy trends. Investment liberalization and promotion remained the dominant element in 2010, with 68% of measures in a direction more favourable to FDI. However, the risk of investment protectionism has also increased as investment-related restrictions and administrative procedures have accumulated over the past years. Almost one-third of measures in 2010 relate to regulation or restriction of FDI, compared to only 2% of measures at the start of the decade. Thus, the challenge for policymakers is to achieve the "right" balance between these two opposite policy directions. In the past, discussions primarily focused on how to create a stable, enabling and transparent legal framework for foreign investment. This remains a crucial task. However, lately and partly as a result of recent serious economic, financial and social crises around the globe, the pendulum has swung back and the issue of how to readjust the regulatory powers of the State in the economy has moved to the centre of debates. I will come back to this point again when I will talk about sustainability issues.

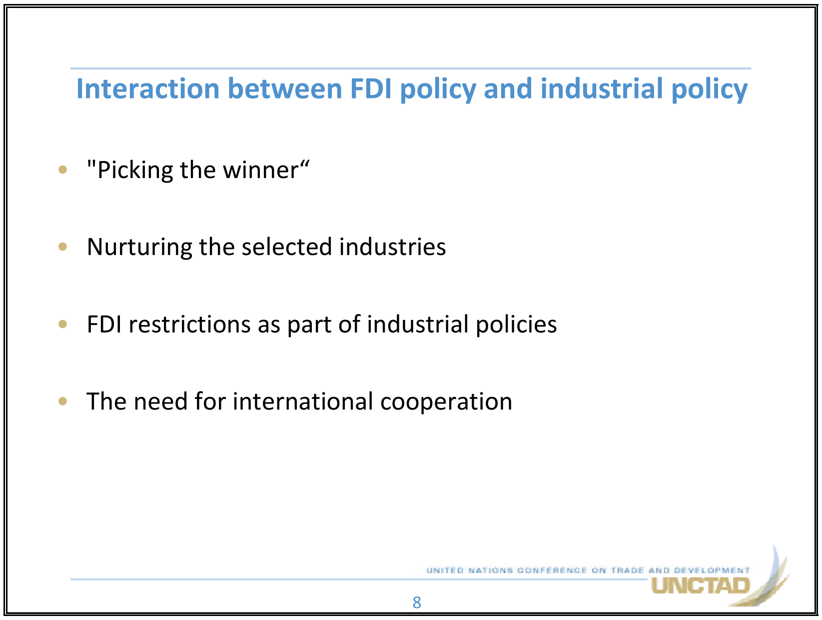
For the moment, let me just shed some light on the industries that are affected by these divergent investment policies. Liberalization measures were taken mainly in electricity, gas and water distribution, as well as in manufacturing. On the other hand, new restrictions or regulations were introduced particularly in the financial sector and there was more state intervention in extractive industries and agribusiness.

This underlines the importance of our meeting today and tomorrow. Tackling the policy challenges related to investment for development may soon become a top priority of highest policy levels.

As we all know, good policy requires good expert advice – which is why we meet and deliberate on this matter.



In his opening remarks, our SG has already summarized the key challenges that developing countries face in this respect. I will not repeat them all. Rather, I would like to focus on four particular issues that come to the forefront when countries seek to integrate foreign investment into their overall development strategies. These are (1) industrial policy, (2) enterprise development, (3) sustainable development and (4) the role of international investment agreements in this context.



To start with the first, we witness a strong recourse to industrial policies in many countries as governments seek to steer economic development and regulate markets more than in the past. This raises a number of important challenges for policymakers:

First, one of the strongest criticisms of industrial policy relates to the difficulty in identifying the “right” industries for promotion. This problem does not only relate to picking “winning industries”, but also to choosing “winning firms”. It includes the risk of wasting valuable and scarce resources if support is provided to “losers”, the risk of distorting market mechanisms to the long-term detriment of the economy, and the risk of succumbing to the pressure of lobbying. However, there are ways and means to reduce these risks. Above all, governments need to identify those industries or activities where they consider having comparative advantages. Based on this assessment and provided that it is correct, there is a case for nurturing these industries and activities. In addition, successful industrial policies also include the option to let “losers” go if necessary.

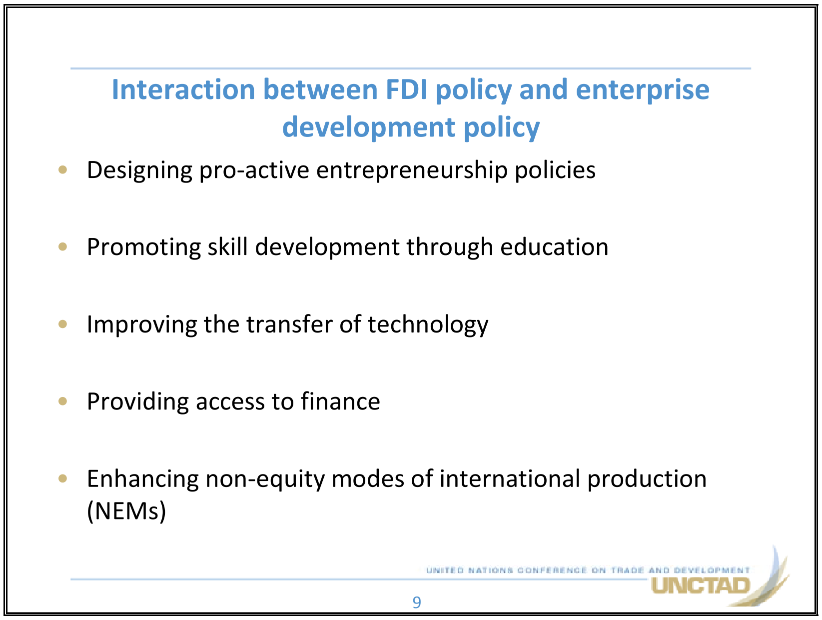
Second, as regards the nurturing of industries, horizontal policies are the basis, aiming at improving the hard and soft infrastructure of the host country. What is needed depends on the type of business activity to be developed, the technology and skills required for it, and the form of TNC involvement. This may include, for instance, fiscal or financial investment incentives for certain industries or regions or for the achievement of specific development goals, such as export promotion, job creation, technology transfer or industrial upgrading. Business facilitation policies, such as "one-stop shop" mechanisms, special economic zones and incubators, can also be very useful to attract and guide investments.

Third, industrial policy may also come along with FDI restrictions. The motivations for FDI restrictions are manifold and include, for instance, sovereignty or national security concerns, strategic considerations, socio-cultural reasons, prudential policies in financial industries, competition policy, infant industry protection or reciprocity policies. In each case, countries may have very different perceptions of whether and under what conditions such motivations are legitimate, and this may result in tensions or even disputes. In particular, there is a risk that countries resort to protectionist measures in the framework of their industrial policies, especially in times of economic and financial crisis. The number of investment restrictions that have accumulated over the recent years, including the tightening of administrative procedures, point in this direction. It is also for this reason that UNCTAD regularly monitors FDI policy developments – in the context of the G-20 countries together with the OECD and the WTO.

Fourth, managing the interaction between international investment policy and industrial policy also implies preserving space for the dynamics of industrial policy. Yet it is well-known that the policy space can be reduced by the conclusion of IIAs. The challenge here is threefold:

- It consists in identifying those industries and existing or potential future domestic policies for which such policy flexibility is the most needed.
- It requires the identification of IIA provisions that are particularly likely to impact on industrial policy.
- At the same time it needs to be taken into account that industrial policy is likely to change over time - even though such changes are difficult to anticipate.

Fifth, as more and more countries adopt industrial policies, competition and conflict are bound to intensify and become more complex. To avoid a global race to the bottom in regulatory standards, or a race to the top in incentives, better international coordination of industrial policies is warranted. More international coordination in particular at the regional level can also contribute to achieving synergies and to realizing industrial projects that would be too complex and expensive for one country alone.

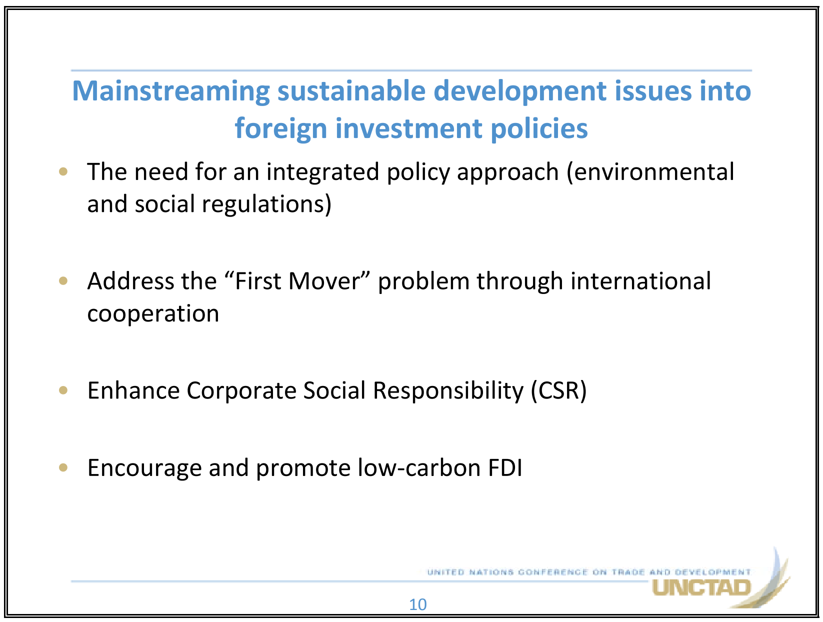


Let me now turn to my second point: the interaction between investment policies and enterprise development. This interaction is crucial in two aspects: Without already existing local capacities in the host countries to work with, foreign investors will be reluctant to invest. At the same time, foreign investment - through business linkages and spillover effects – can make an important contribution to improving and upgrading these domestic capacities. These effects mainly occur through the transfer of capital, technology and know-how, as well as the integration of local firms into international production chains.

Governments play a crucial role in this context. One example is proactive entrepreneurship policies to develop a class of local entrepreneurs who know the business and learn to cope with risks. Education policy plays a fundamental role in developing entrepreneurial attitudes, technological and managerial skills and behaviours. Governments can also facilitate the transfer of technology and know how. Examples are policies geared towards developing technology clusters and incubation centres, the protection of intellectual property as well as improving local absorptive capacities. Finally, improving access to finance is crucial. In this respect, Government policies need to particularly aim at promoting credit for SMEs, for instance through tax breaks, subsidies and government loan guarantees, or through the formation of venture capital funds to assist start-ups.

Each of these policy areas has its own dynamics, but the overall challenge for policymakers is to seek technological and entrepreneurial upgrading over time so that domestic firms are able to gain access to global value chains or retain a higher share within these and to remain competitive once they lose their "low labour cost" advantage.

As we have highlighted in our latest *World Investment Report*, this is a policy challenge not only with regard to FDI. In addition, non-equity modes of international production, such as contract manufacturing, service outsourcing, franchising, licensing and contract farming are becoming increasingly important for economic cooperation. They offer new significant sources of economic growth for many developing countries. It is important that developing countries identify, enhance and exploit their entrepreneurial potential in this area.



Now, I come to my third point: the issue of sustainable development and the role of FDI in this context. Clearly, sustainability has become THE core topic on the economic policy agenda, as all countries share a common vital interest that economic development does not come at the price of serious social and environmental degradation. The UN Millennium Goals document this common objective.

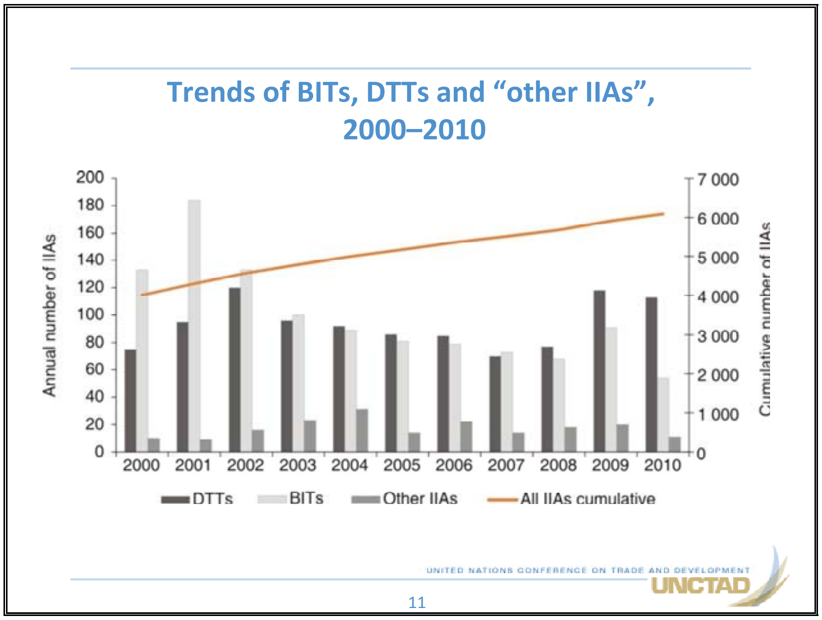
The goal of sustainable development has significant implications for FDI policies. We need an integrated policy approach that gives sufficient weight to environmental and social issues in relation to FDI. This has both a regulatory and a promotional aspect. Adequate regulation is necessary so that FDI does not have undesired social or environmental consequences. Sector-specific policies are a crucial element, for instance in respect of recent concerns about investment in agricultural production and the associated risk of land grabs and crowding out of local farmers. And existing regulations need to be enforced vigorously. This is a major problem in many countries. The necessary laws exist on paper, but there is no effective implementation, and corruption allows to circumventing existing laws.

There is also a first-mover problem. Countries that strengthen environmental and social protection, thereby making business more expensive, risking to lose attractiveness for foreign investment compared to other countries with laxer regulations. We therefore need more international cooperation in this field. And policymakers need to ensure that at the very least, human rights, including core labour rights, are always respected.

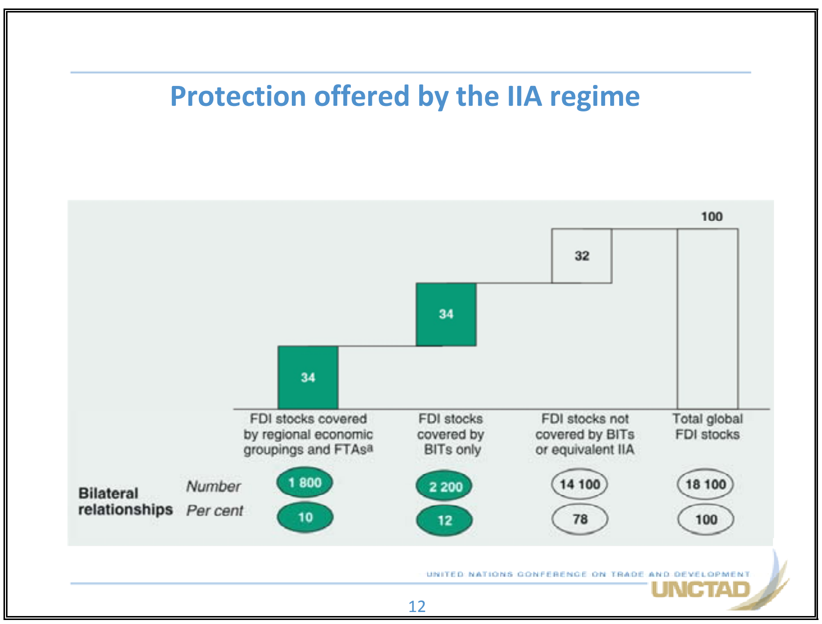
More attention should also be given to the issue of corporate social responsibility. These codes are rapidly proliferating at the company and industry levels, and there are also multi-stakeholder initiatives and government-led instruments, such as the UN Global Compact and the OECD Guidelines for Multinational Enterprises. These are encouraging developments, but more needs to be done. We need, for example, a better monitoring of respect for these codes and we should seek to harmonize their substantive scope. And governments should also explore whether there are possibilities to make these standards at least partially legally binding.

Sustainable investment is, however, not only about regulations and prohibitions. Equally important are policies to promote sustainable investment. One case in point is low carbon investment on which we have focused in our WIR 2010. It is a common task of host and home countries of investors. Most developing countries do neither have the financial means, nor the technological know how to shoulder promotion efforts alone. And we need to be careful that promotion of sustainable investment does not become a pretext for protectionist policies.

My fourth and last point relates to current challenges concerning international investment agreements.

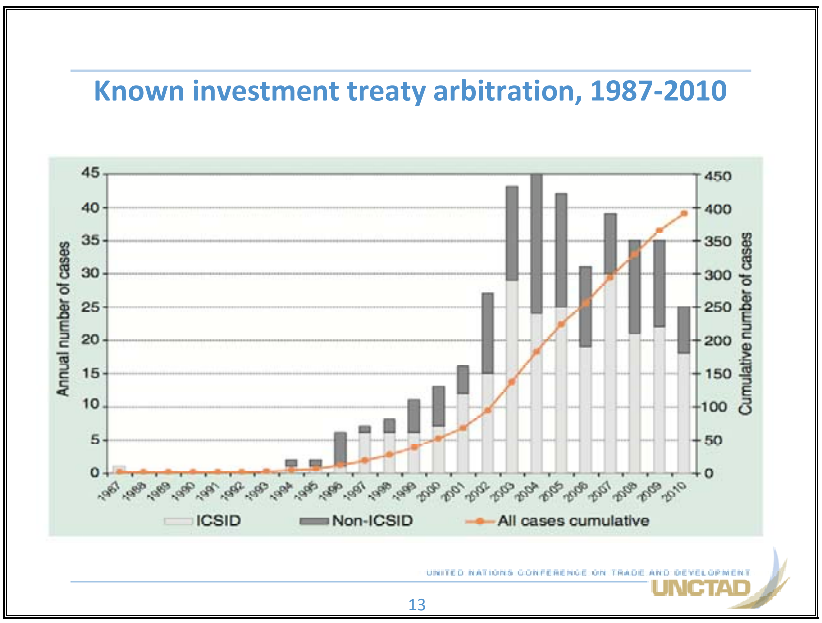


It is evident from the number of IIAs concluded over the past decades that the IIA regime is growing ever more complex. On average, three investment treaties were signed per week over the past few years. During 2010 alone, a total of 178 new IIAs were concluded. 2011 saw the trend continue, with close to 80 treaties concluded until end of November (23 BITs, 47 DTTs and 8 "other IIAs"). This brings the IIA universe to a total of more than 6,150 agreements. Unfortunately, this also means that 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. Despite its continuous growth, the coverage of the IIA regime significantly lags behind. In fact *full coverage* would require a further 14,100 bilateral treaties.

These numbers illustrate that policy-makers and investors are faced with a broader challenge of systemic nature that requires a more coordinated approach from the investment community. Moreover, we need to be aware that the conclusion of more IIAs does not automatically render all expected benefits. While IIAs can indeed contribute to ensuring an open, transparent and predictable investment climate in signatory countries, more IIAs can also mean more in-transparency and fragmentation of the IIA regime – we just need to remember the growing "spaghetti bowl" effect.



Also, a growing number of countries experience that IIAs have started to “bite” and hence they need to manage complex, lengthy and costly investor–State dispute settlement procedures (ISDS). With respect to ISDS, at least 25 new treaty-based cases were initiated in 2010 which makes a total of 390 known cases filed by the end of the year. The overwhelming majority of the claims were initiated by investors from developed countries against developing countries.[1] Even though the overall balance of awards has further tilted in favour

[1] . In 2010, the total number of countries involved in investment treaty arbitrations grew to 83. Fifty-one developing countries, 17 developed countries and 15 economies in transition have been on the responding side of ISDS cases

of the State (with 78 won cases against 59 lost), ISDS involve severe financial and reputational burdens for the responding States.

As the Secretary-General has pointed out, policy-makers are faced with numerous challenges: First, today's challenge is to better equip the IIA regime to promote investment for sustainable development. Second, the rights and obligations of investors vis-à-vis States require a re-balancing. In response to this, governments now pay greater attention to formulate agreements so as to reaffirm and strengthen the States' right to regulate in the public interest, including for the protection of human health or the environment. It seems that the issue of including investor obligations in IIAs is even more challenging and subject to controversy. Third, it is the point that we need to go beyond countries' individual initiatives in addressing some of today's IIA related challenges. Multilateral engagement and joint initiatives can offer important contributions in this regard. It allows countries to share experiences and discuss best practices in addressing the before-mentioned challenges. Our meeting can help us move along in this spirit and encourage a more coordinated effort to increase the sustainable development dimension of investment policies.

In this respect it is noteworthy, that the emerging policy discourse at the national – and partly regional – level encompasses a broad set of stakeholders. We are very pleased that also our meeting here today convenes a broad set of investment for development stakeholders, ranging from government representatives (both developed and developing), to academia, practitioners, civil society and other inter-governmental organisations.

Conclusion

The developments that I have described show how complex, diversified and inter-connected the policy agenda for foreign investment has become – both at the national and international level. This is why UNCTAD believes that there would be merit in developing a comprehensive investment framework for sustainable development. As the Secretary-General already mentioned, we will focus on this issue in our next *World Investment Report*. While it is impossible to forge a single investment framework that fits all, we think that one can provide some guidance on what works under what circumstances, building on best practices, and highlighting where serious concerns remain, and what solutions could be thought of. Also with this in mind, I look forward to having fruitful discussions with you over the next two days.

Thank you.