

**World Investment Report 2013: “Global Value Chains: Investment and  
Trade for Development”**

*26 June 2013, Geneva*

**Statement**

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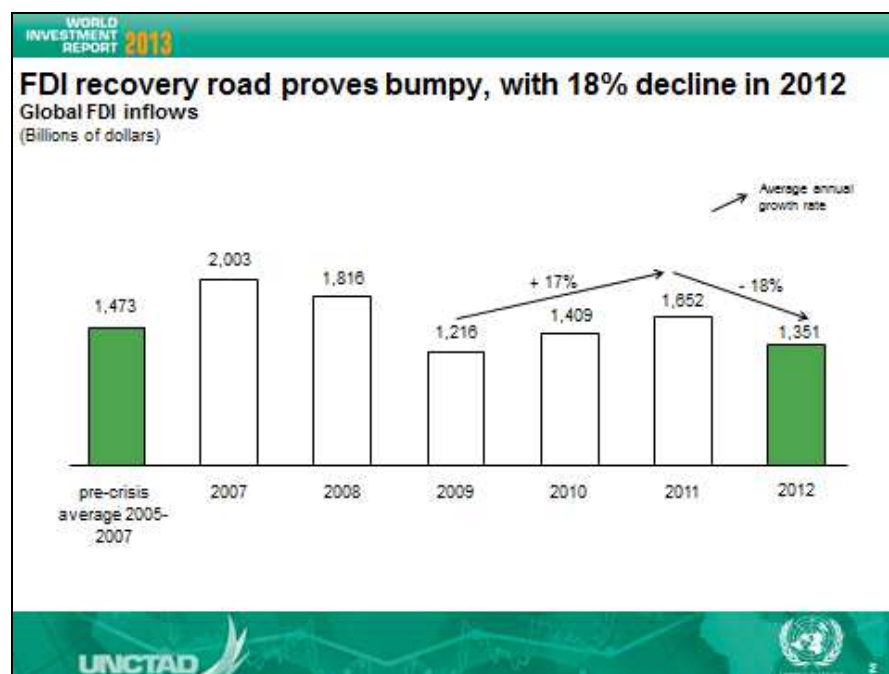
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Ladies and Gentlemen,

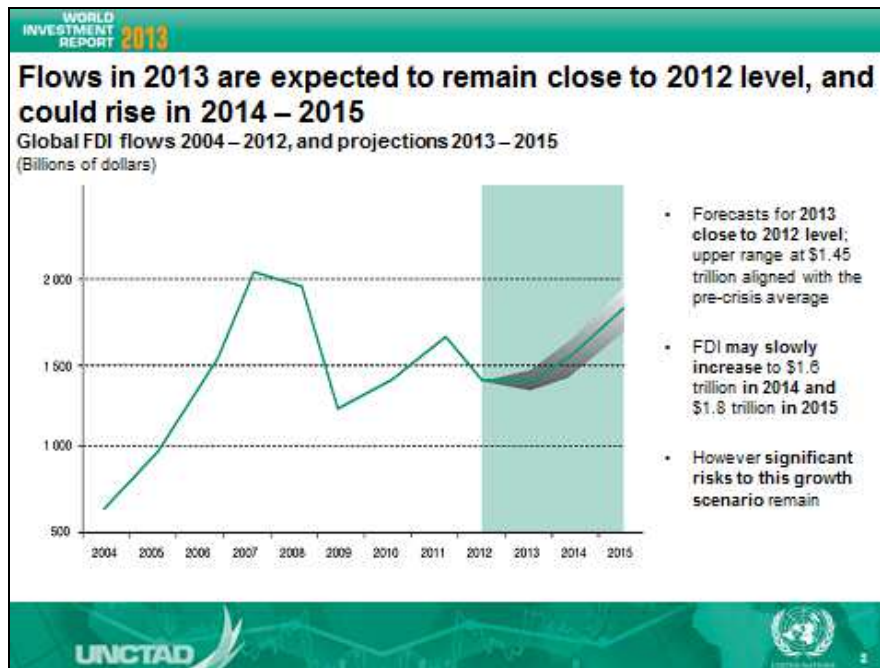
I welcome you to the launch of the 2013 edition of the World Investment Report. The Report, as always, examines recent trends in FDI flows and policies. This year's special topic is around Global Value Chains and Development. The Report provides an in-depth analysis, strategic development options and practical advice for policymakers and others on how to maximize the benefits and minimize the risks associated with global value chains. This is essential to ensure more inclusive growth and sustainable development. Hence the sub-title of the Report: *Global Value Chains: Investment and Trade for Development*

The presentation is structured around three main topics: global and regional FDI trends; recent policy developments related to FDI, both at national and international levels; and – this year's special topic – global value chains and development.

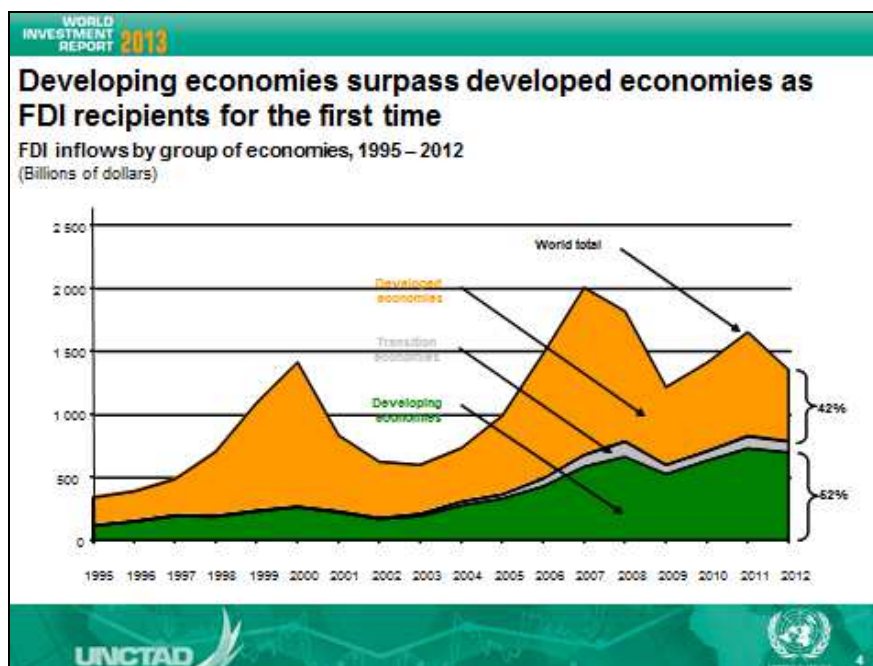
Let me start with FDI trends.



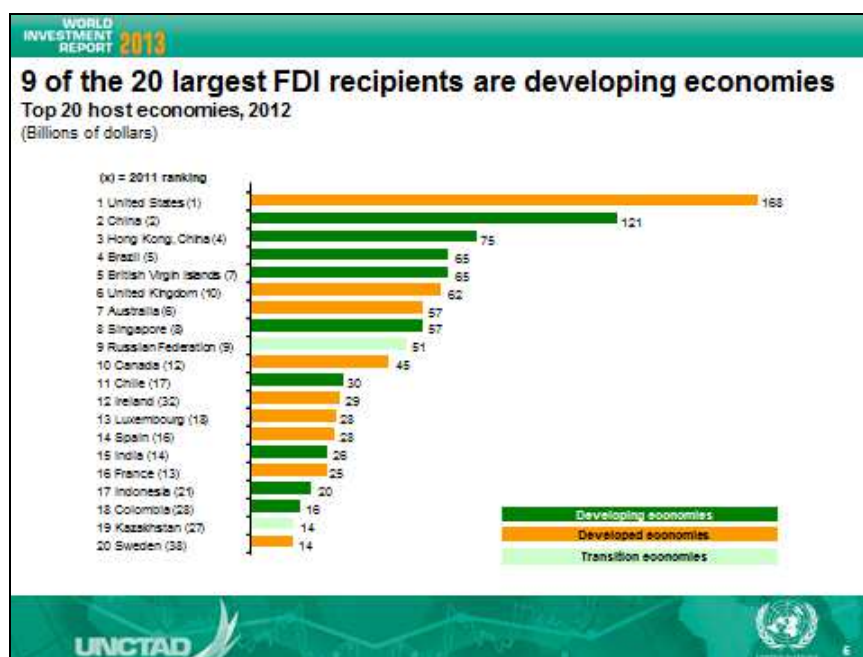
*Global foreign direct investment (FDI) fell by 18 per cent to \$1.35 trillion in 2012.* This sharp decline was in stark contrast to other key economic indicators such as GDP, international trade and employment, which all registered positive growth at the global level. Economic fragility and policy uncertainty in a number of major economies gave rise to caution among investors. Furthermore, many transnational corporations (TNCs) re-profiled their investments overseas, including through restructuring of assets, divestment and relocation. The road to FDI recovery is thus proving bumpy and may take longer than expected.



*FDI flows in 2013 are expected to remain close to the 2012 level, with an upper range of \$1.45 trillion – a level comparable to the pre-crisis average of 2005–2007. As macroeconomic conditions improve and investors regain confidence in the medium term, TNCs may convert their record levels of cash holdings into new investments. FDI flows may then reach the level of \$1.6 trillion in 2014 and \$1.8 trillion in 2015. However, significant risks to this growth scenario remain. Factors such as structural weaknesses in the global financial system, the possible deterioration of the macroeconomic environment, and significant policy uncertainty in areas crucial for investor confidence might lead to a further decline in FDI flows.*

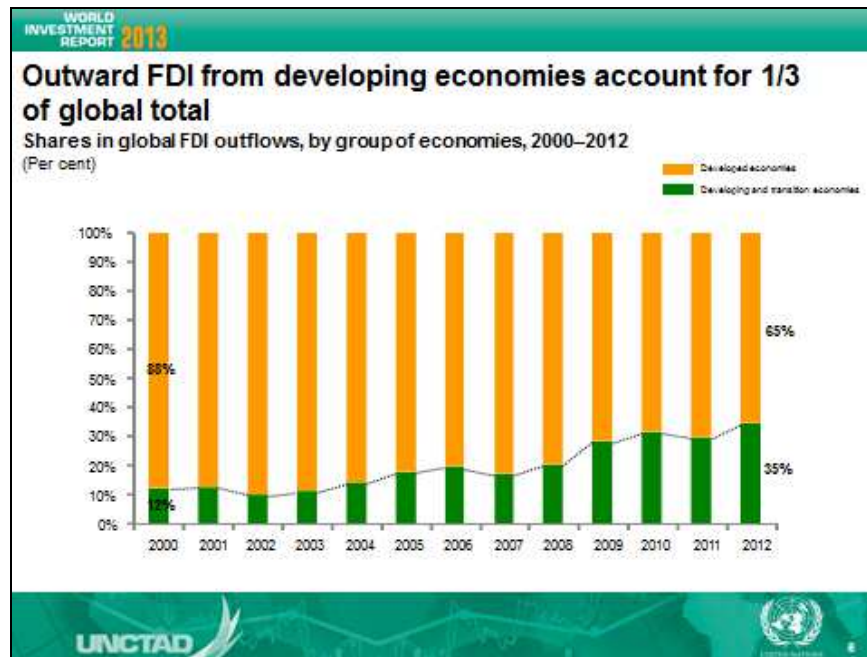


*Developing countries take the lead.* FDI flows to developing economies proved to be much more resilient than flows to developed countries, recording their second highest level – even though they declined slightly (by 4 per cent) to \$703 billion in 2012. They accounted for a record 52 per cent of global FDI inflows, exceeding flows to developed economies for the first time ever, by \$142 billion. The global rankings of the largest recipients of FDI also reflect changing patterns of investment flows: 9 of the 20 largest recipients were developing countries.

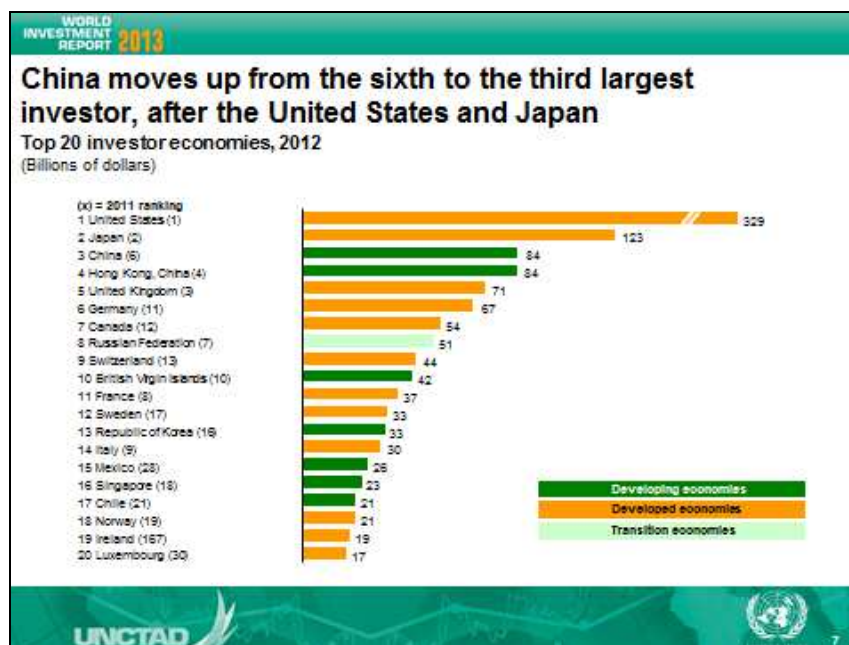


*The global rankings of the largest recipients of FDI also reflect changing patterns of investment flows.* Four developing economies now rank among the five largest recipients in the

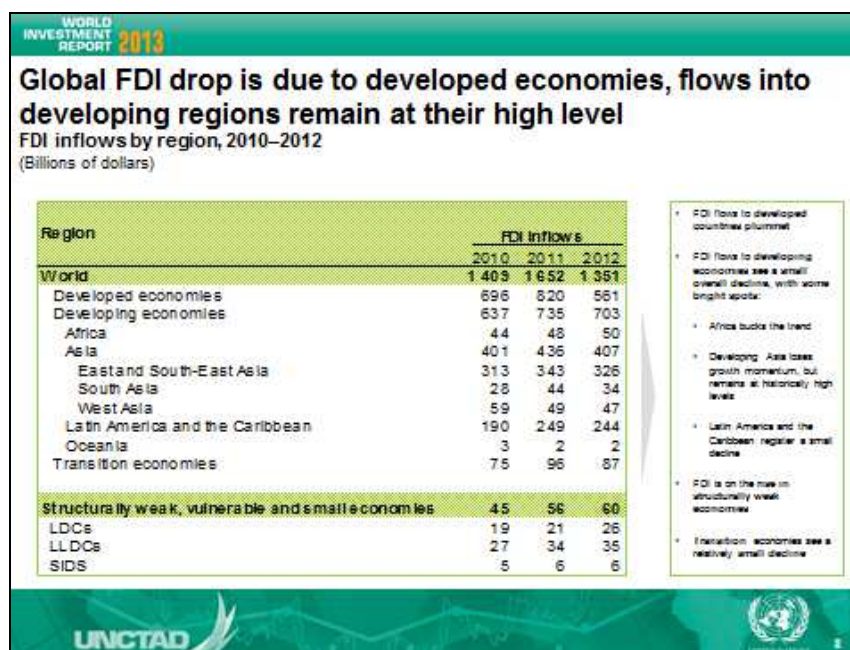
world; and among the top 20 recipients, the majority (12) are developing and transition economies.



*Developing economies' outflows reached \$426 billion, a record 31 per cent of the world total.* Despite the global downturn, TNCs from developing countries continued their expansion abroad. Conversely, FDI outflows from developed countries dropped to a level close to the trough of 2009. The uncertain economic outlook led TNCs in developed countries to maintain their wait-and-see approach towards new investments or to divest foreign assets, rather than undertake major international expansion. In 2012, 22 of the 38 developed countries experienced a decline in outward FDI, leading to a 23 per cent overall decline.



*The global ranking of the largest FDI investors shows the continuing rise of developing and transition economies. Two developing countries now rank among the five largest foreign investors in the world, and for the first time ever, China was the world's third largest investor, after the United States and Japan.*

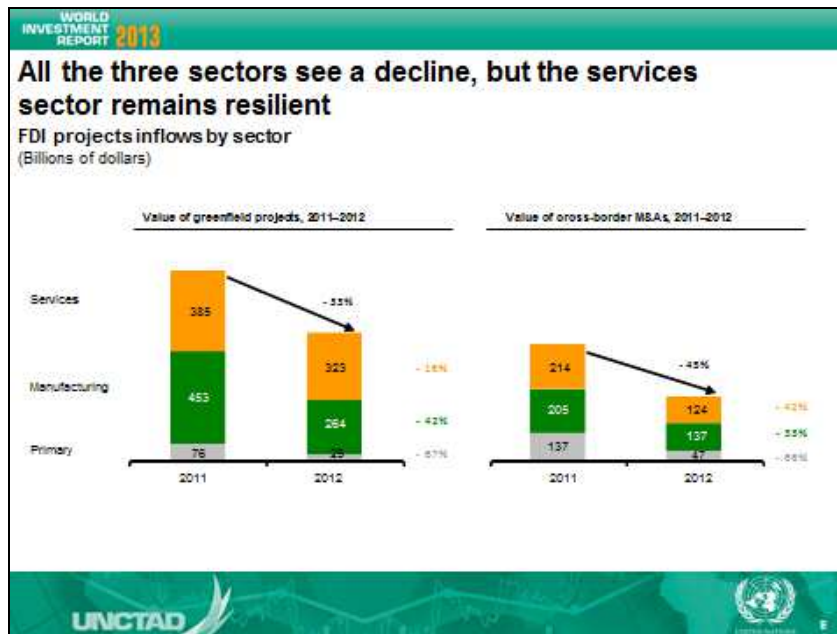


*Looking at regional patterns, FDI flows to developed economies plummeted. In developed countries, FDI inflows fell drastically, by 32 per cent, to \$561 billion – a level last seen almost 10 years ago. The majority of developed countries saw significant drops of FDI inflows, in particular the European Union, which alone accounted for two thirds of the global FDI decline.*

*FDI flows to developing regions remained at their high levels despite a small overall decline in 2012.* In particular:

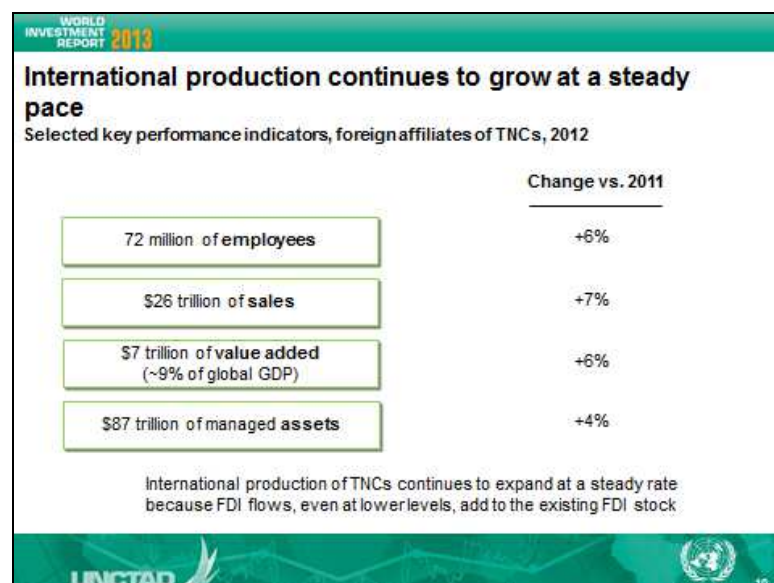
- *Africa bucked the trend* with a 5 per cent increase in FDI inflows to \$50 billion. This growth was driven partly by FDI in extractive industries, but investment in consumer-oriented manufacturing and service industries is also expanding.
- FDI flows to *developing Asia* fell 7 per cent, to \$407 billion, but remained at a high level. Driven by continued intraregional restructuring, lower-income countries such as Cambodia, Myanmar and Viet Nam are bright spots for labour-intensive FDI.
- In *Latin America and the Caribbean*, FDI inflows decreased 2 per cent to \$244 billion due to a decline in Central America and the Caribbean. This decline masked an increase of 12 per cent in South America, where FDI inflows were a mix of natural-resource-seeking and market-seeking activity.
- *Transition economies saw a relatively small decline.* A slump in cross-border mergers and acquisitions (M&As) sales caused inward FDI flows to *transition economies* to fall by 9 per cent to \$87 billion; \$51 billion of this went to the Russian Federation, but a large part of it was “round-tripping”.

*FDI is on the rise in structurally weak economies.* FDI inflows to *least developed countries* (LDCs) hit a record high, an increase led by developing-country TNCs, especially from India. A modest increase in FDI flows to *landlocked developing countries* (LLDCs) occurred, thanks to rising flows to African and Latin American LLDCs and several economies in Central Asia. FDI flows into *small island developing States* (SIDS) continued to recover for the second consecutive year, driven by investments in natural-resource-rich countries.



In 2012 FDI flows declined in all three sectors according to FDI project data (comprising cross-border M&As and greenfield investments), *although with different intensities*. In the Primary sector and in Manufacturing the number and the value of FDI projects fell heavily, with the value of greenfield projects reaching the lowest level in the last ten years, while the Services sector displayed relatively higher resilience. As a consequence the Services sector gained FDI share, replacing manufacturing as the largest recipient of FDI.

The worst performing industries were those related to extractive activities, accounting for almost half of the decrease in the value of greenfield projects. Also consumer discretionary industries, like motor vehicles or electronics were among the most affected by the downturn, while some less cyclical manufacturing activities, like food, beverages and tobacco or pharmaceuticals, and services industries managed to limit FDI losses.

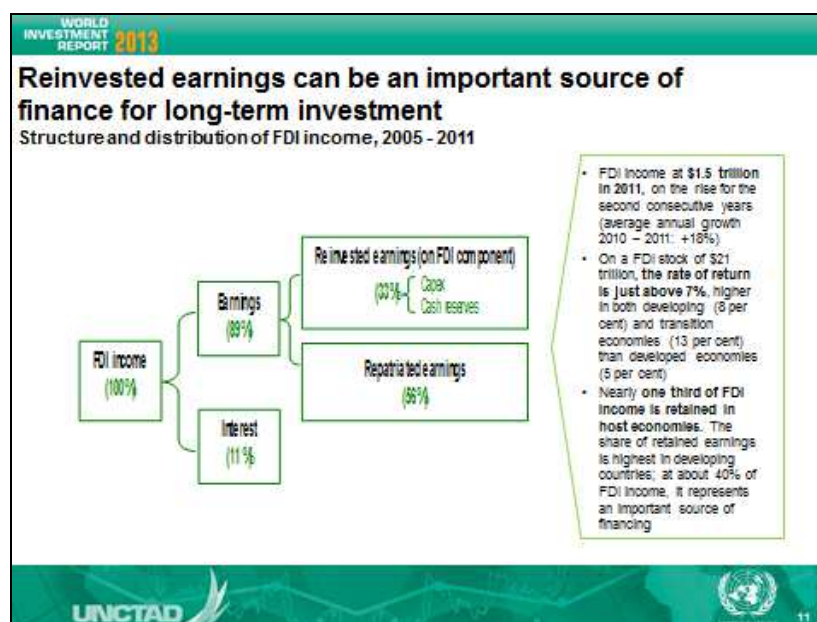




In 2012, international production by TNCs continued to expand at a steady rate because FDI flows, even at lower levels, add to the existing FDI stock. FDI stocks rose by 9 per cent in 2012, to \$23 trillion. Foreign affiliates of TNCs generated sales worth \$26 trillion (of which \$7.5 trillion through exports), increasing by 7.4 per cent from 2011. They contributed value added worth \$6.6 trillion, up 5.5 per cent, which compares well with global GDP growth of 2.3 per cent. Their employment numbered 72 million, up 5.7 per cent from 2011.

\* \* \*

In addition to the standard items around FDI stocks and flows included in the WIR every year, this year the Report takes a closer look at the *income generated by FDI*: how much is it, where is it generated, and what do TNCs do with it.



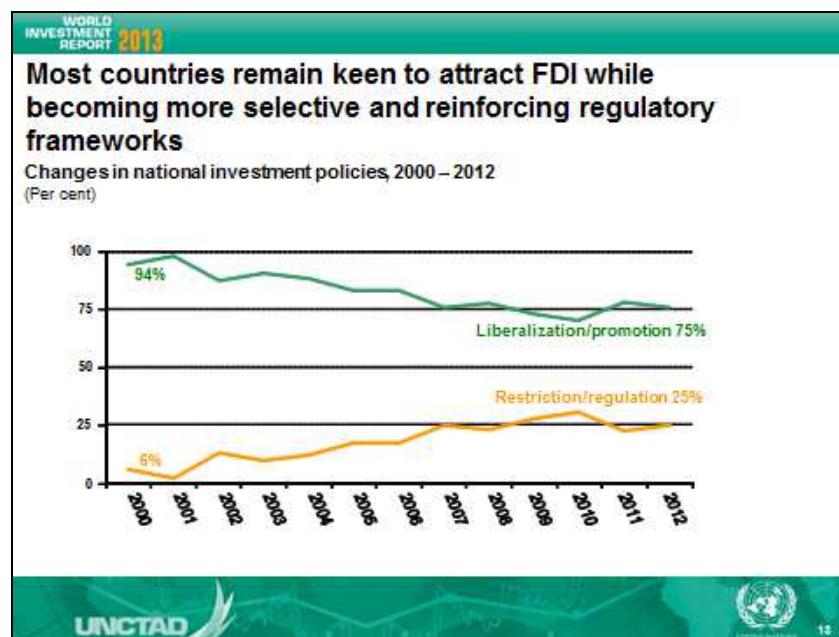
FDI income as registered on countries' Balance of Payments consists of earnings (profits) and interest. The earnings component is partly repatriated to home countries or other countries in the TNC network, and partly retained in the host country -- the technical term is "reinvested earnings", although not all of it is actually invested as it can be held as cash reserves or liquid assets.

Key findings from our research include:

- Global FDI income increased sharply in 2011, for the second consecutive year, to \$1.5 trillion, on a stock of \$21 trillion, after declining in both 2008 and 2009 during the depths of the global financial crisis.

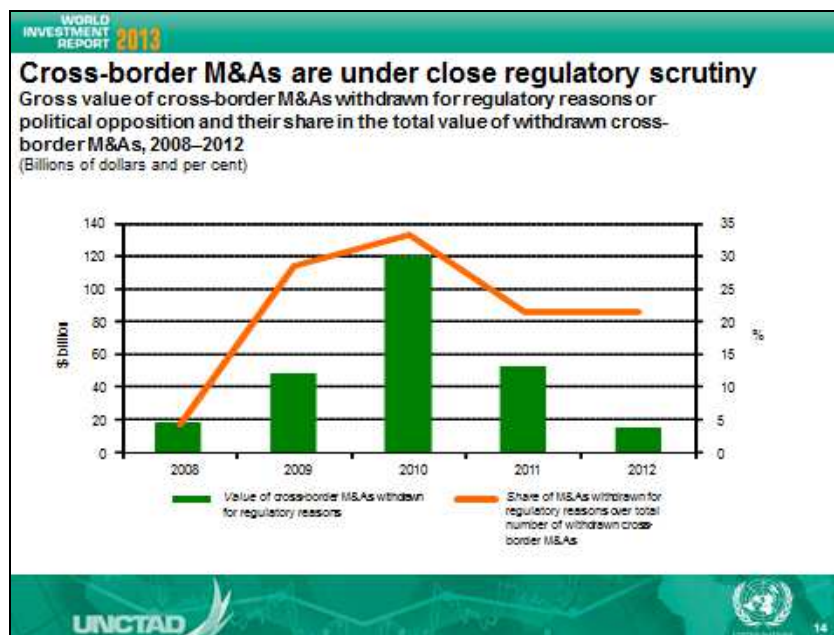
- The rates of return on FDI are 7 per cent globally, and higher in both developing (8 per cent) and transition economies (13 per cent) than in developed countries (5 per cent).
- Of total FDI income, about one-third or \$500 billion was retained in host countries, while \$1 trillion was repatriated. That figure represents on average 3.4 per cent of countries' total current account payments.
- The share of FDI income that is retained in host economies is highest in developing countries; at about 40 per cent it represents an important source of FDI financing.
- However, as said earlier, not all retained earnings are turned into actual capital expenditures; the challenge for host governments is how to channel retained earnings into productive investment.

I move now to the presentation of the recent policy developments related to FDI. I first present the developments in national investment policy making and then move to international investment policies.



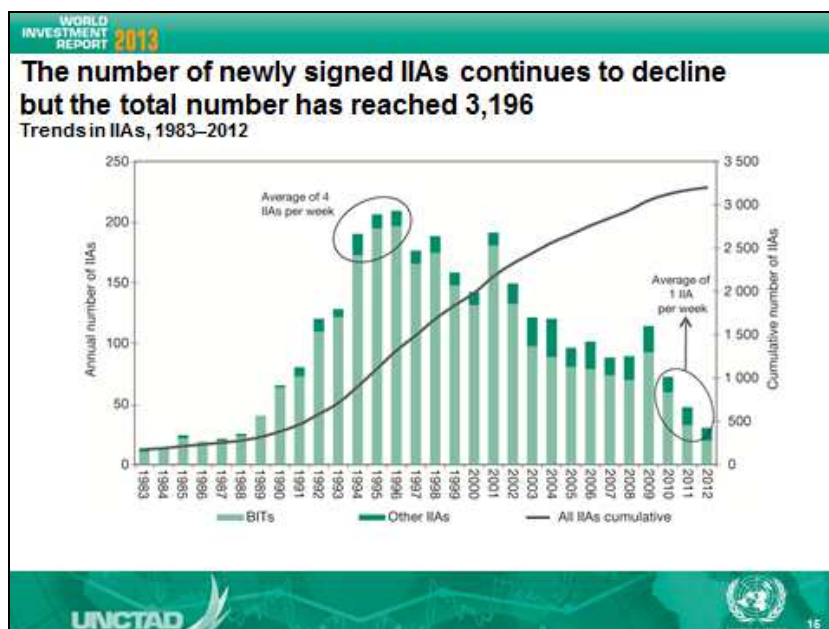
Looking at national investment policymaking, we see that *most governments remain keen to attract and facilitate foreign investment* and specifically target those investments that generate jobs, deliver concrete contributions to alleviate poverty, or help tackle environmental challenges. *At the same time, we see that numerous countries reinforce their regulatory environment for foreign investment, make more use of industrial policies in strategic sectors, tighten screening and monitoring procedures, and closely scrutinize cross-border M&As.*

In 2012, at least 53 economies around the globe adopted 86 policy measures relating to foreign investment. The bulk of these measures, 75 per cent, referred to investment liberalization, facilitation and promotion. At the same time, the share of FDI-related regulations and restrictions rose to 25 percent, confirming a long-term trend after a temporary reverse in 2011.



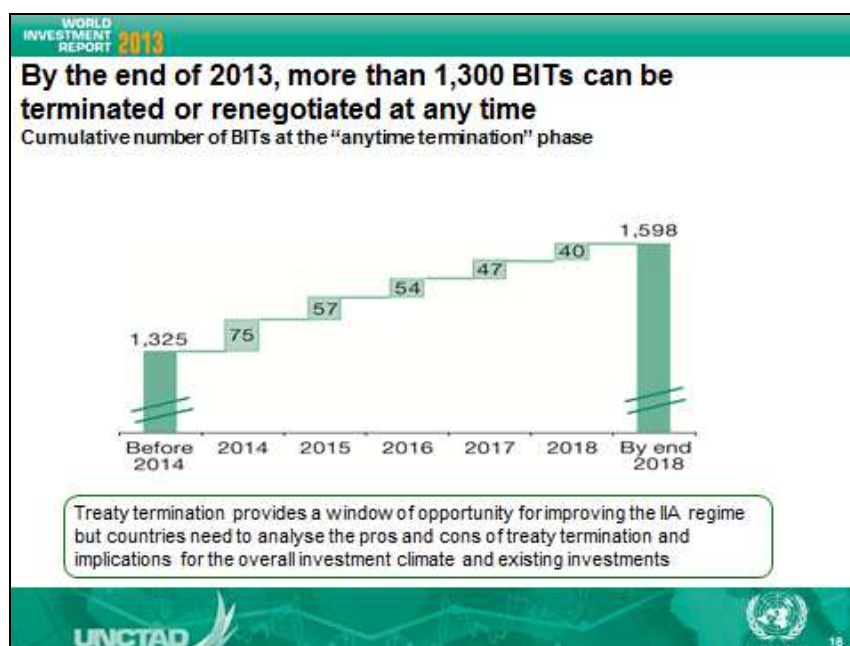
For this year’s Report, UNCTAD analyzed more than 200 planned cross-border M&A deals that were first announced but subsequently *withdrawn*, in the period between 2008 and 2012, with a transaction value of at least \$500 million. We found that while most of these deals were aborted for business reasons, a notable share – about 15 per cent – were withdrawn because of regulatory concerns, such as competition issues, economic benefit tests or national security screening, or political opposition. These deals had an approximate total gross value of \$265 billion and mostly related to the extractive industry.

As countries make more use of investment regulations and restrictions, the risk grows that some of these measures could be taken for protectionist purposes. UNCTAD suggests that efforts should be undertaken at the international level to establish criteria for identifying protectionist measures against foreign investment.

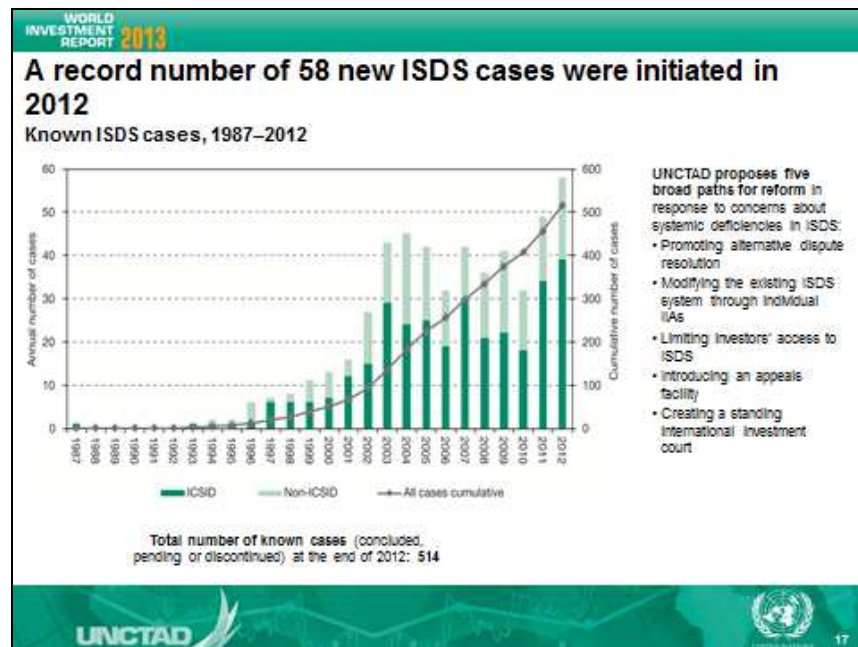


Looking at international investment policymaking – or international investment agreements (IIAs) – we can see that *the number of newly signed agreements continues to decline*. More specifically, 2012 saw the conclusion of 30 IIAs. This includes 20 bilateral investment treaties (BITs) and 10 "other IIAs", such as integration or cooperation agreements with an investment dimension. As a result, by the end of 2012, the IIA regime consisted of 3,196 agreements, which included 2,857 BITs and 339 "other IIAs".

The 20 BITs signed in 2012 represent the lowest annual number of concluded treaties in a quarter century. From 2010 to 2012, on average one IIA was signed per week. This was a quarter of the frequency rate during the peak period in the 1990s, when four treaties were concluded per week on average.



By the end of 2013, more than 1,300 BITs will be at the stage where – by the letter of these treaties themselves – they can be terminated or renegotiated at any time. This creates a window of opportunity to address inconsistencies and overlaps in the multi-faceted and multi-layered IIA regime, and to strengthen its development dimension. In taking such actions, countries need to weigh the pros and cons in the context of their investment climate and their overall development strategies.



International investment arbitration shows an increasing number of cases – a continuing trend. In 2012, 58 new known investor–State dispute settlement (ISDS) cases were initiated. This constitutes the highest number of known ISDS claims ever filed in one year and confirms foreign investors’ increased inclination to resort to investor–State arbitration. These 58 new cases bring the total number of known cases to 514 and the total number of countries that have responded to one or more ISDS cases to 95.

In light of the increasing number of ISDS cases and persistent concerns about the system’s deficiencies, the debate about the pros and cons of the ISDS mechanism has gained momentum. This is especially the case in those countries and regions where ISDS is on the agenda of IIA negotiations.

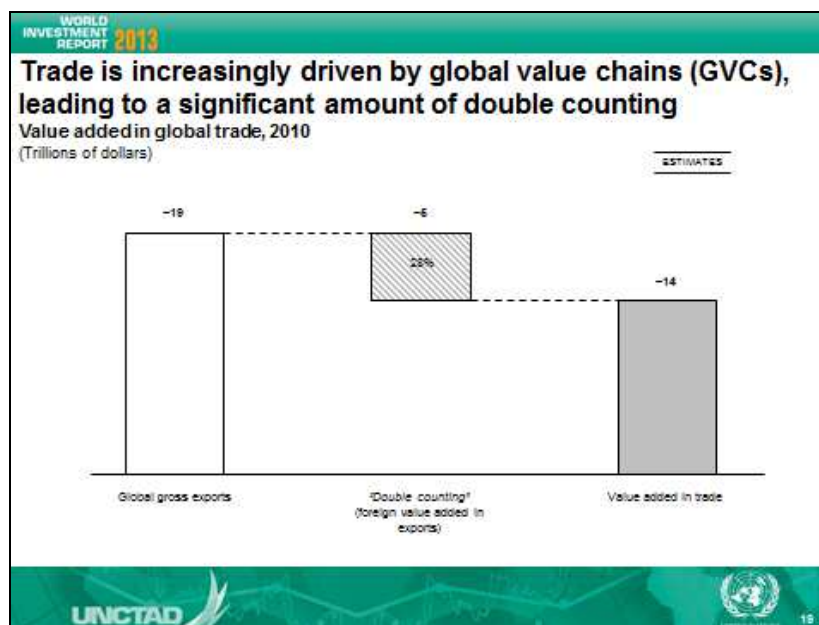
In response, UNCTAD has identified five broad paths for reform, ranging from:

1. promoting alternative dispute resolution,
2. modifying the existing ISDS system through the drafting of individual IIAs,
3. limiting investors’ access to ISDS,
4. introducing an appeals facility, and

5. creating a standing international investment court.

Collective efforts at the multilateral level can help develop a consensus about the preferred course of reform and ways to put it into action.

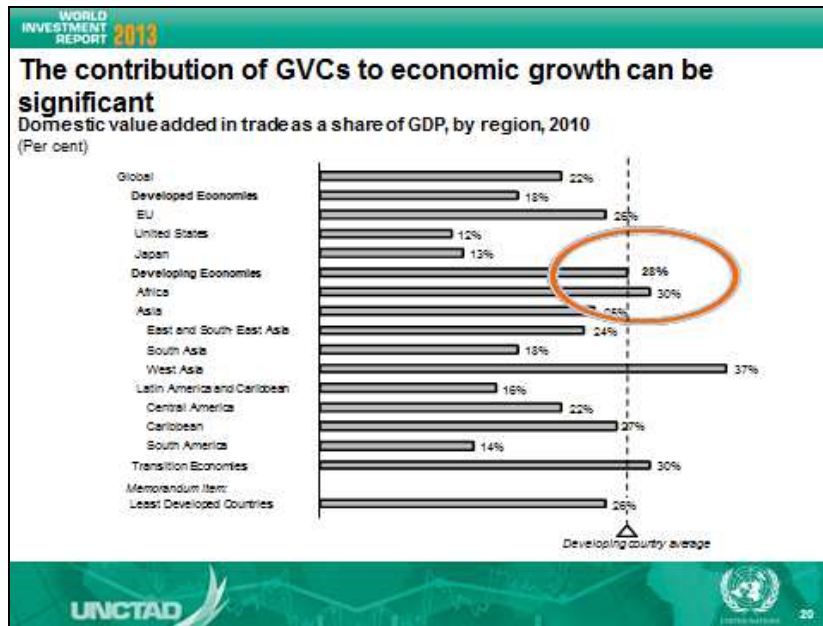
I will dedicate the remaining time to illustrating this year's special topic: Global Value Chains: Investment and Trade for Development.



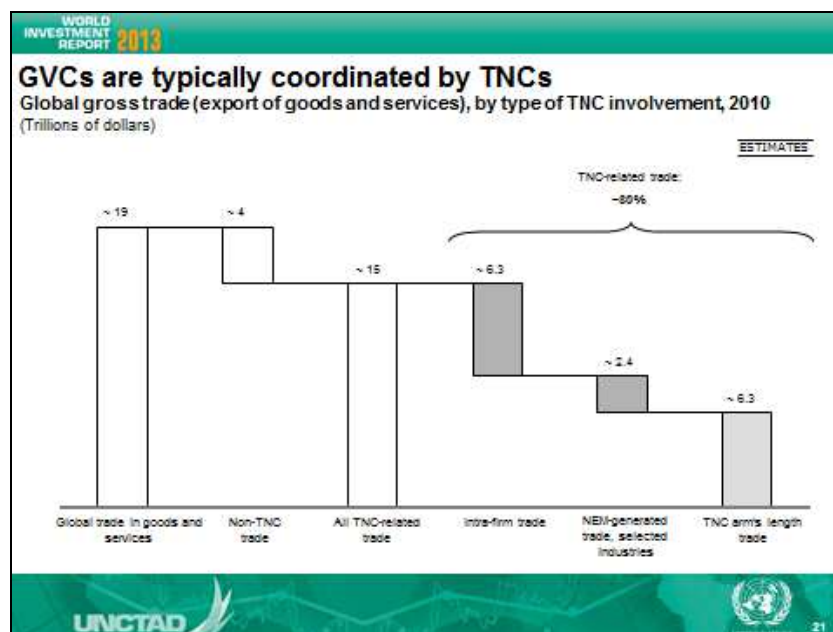
Today's global economy is characterized by global value chains (GVCs), in which intermediate goods and services are traded in fragmented and internationally dispersed production processes.

GVCs lead to a significant amount of double counting in trade, because intermediate goods and services may cross borders several times before final consumption. Raw material extracted in one country may be exported first to an affiliate in a second country for processing, then exported again to a manufacturing plant in a third country, which may then export the manufactured product to a fourth for final consumption. The value of the raw material counts only once as a GDP contribution in the original country but is counted several times in world exports.

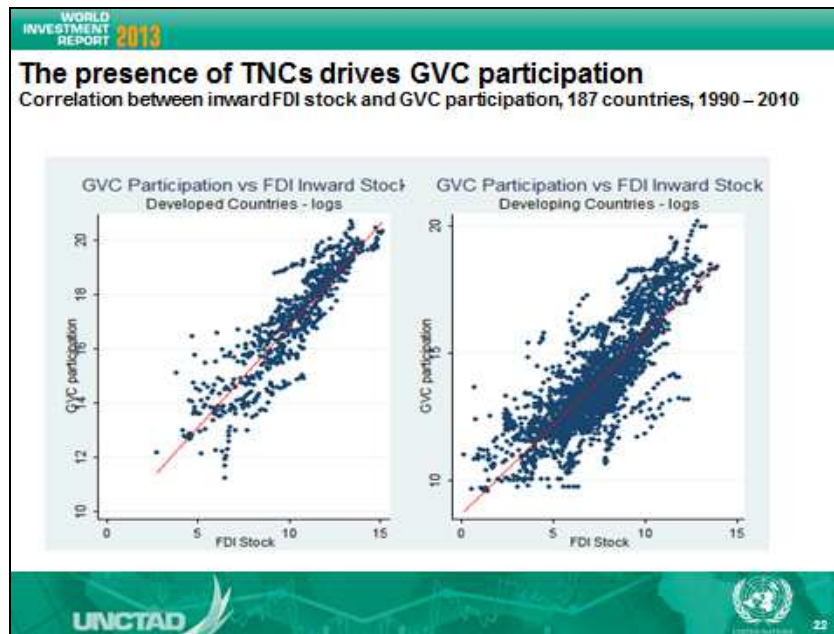
Today, some 28 per cent of gross exports consist of value added that is first imported by countries only to be incorporated in products or services that are then exported again. Some \$5 trillion of the \$19 trillion in global gross exports (in 2010 figures) is double counted.



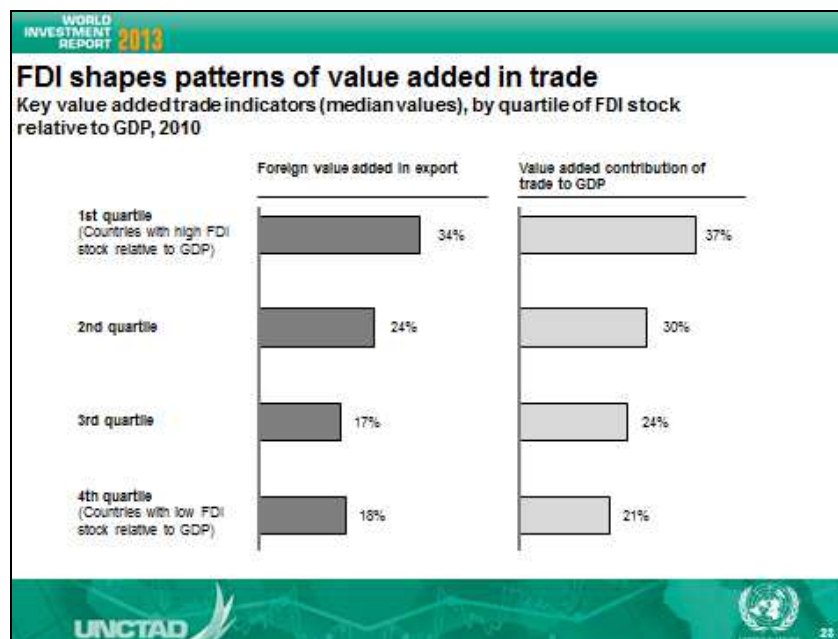
*The contribution of GVCs to economic growth can be significant.* In developing countries, value added trade contributes nearly 30 per cent to countries' GDP on average, as compared with 18 per cent in developed countries. And there is a positive correlation between participation in GVCs and growth rates of GDP per capita. GVCs have a direct economic impact on value added, jobs and income.



*GVCs are typically coordinated by TNCs*, with cross-border trade of inputs and outputs taking place within their networks of affiliates, contractual partners and arm's-length suppliers. TNC-coordinated GVCs account for some 80 per cent of global trade.



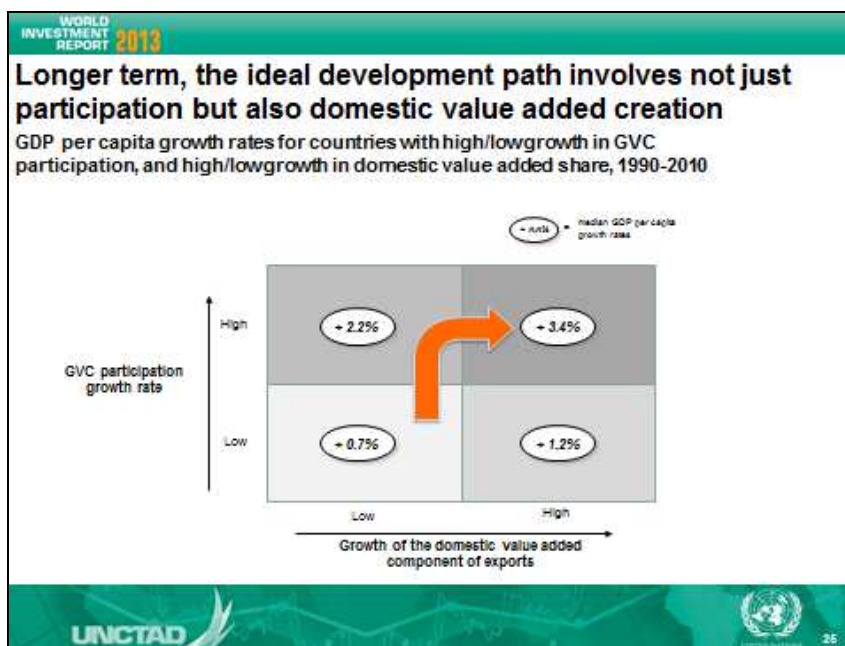
As a result of the role of TNCs in global trade, foreign direct investment, or FDI, is closely linked with countries' GVC participation. The correlation between FDI stock in countries and their GVC participation rates is strongly positive, and increasingly so over time, especially in the poorest countries, indicating that FDI may be an important avenue for developing countries to gain access to GVCs and grow their participation.



Patterns of value added trade in GVCs are shaped to a significant extent by the investment decisions of TNCs. Ranking countries by the ratio of FDI stock over GDP and grouping them in quartiles shows that the group of countries with most FDI relative to the size of their economies tend to have:

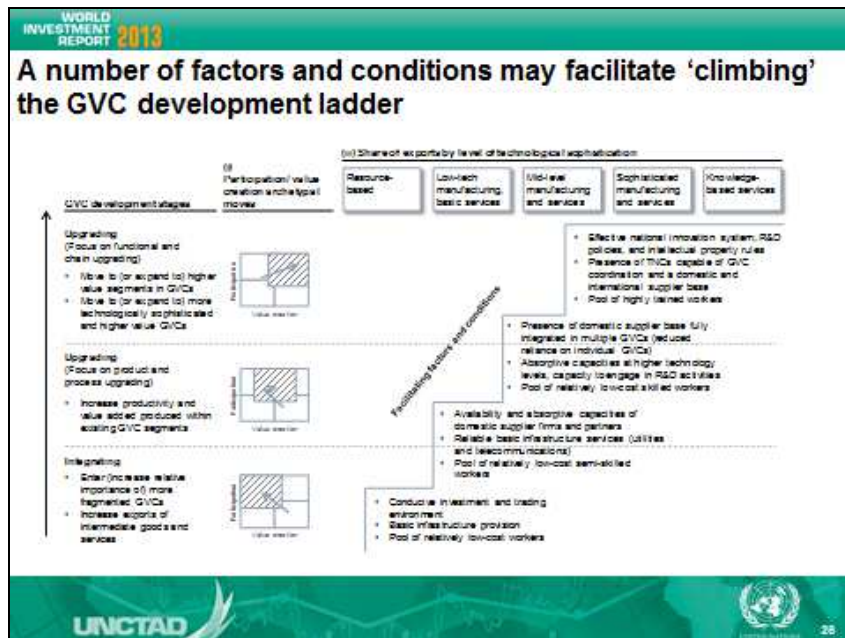


1. higher foreign value added in their exports (foreign affiliates of TNCs producing for exports tend to use value added produced by other parts of the TNC production network); and
2. a higher relative share in global value trade compared their share in global exports.



Most developing countries have seen increasing participation in GVCs over the past 20 years (moving from the lower to the higher end of the matrix shown here), almost invariably at the cost of a higher share of foreign value added in exports, at least initially.

As is clear from the matrix, which shows the highest rate of per capita GDP growth in the top right quadrant, *the optimal policy outcome is higher GVC participation combined with or followed by higher domestic value added creation* (i.e. moving not just upwards but also towards the right).



Climbing the GVC development ladder implies not only increasing GVC participation and increasing domestic value added in exports. It also means moving into activities that can provide more development value added and increasing participation in more sophisticated GVCs, from resource-based activities, to low-, medium- and high tech activities, to knowledge-based activities such as design, innovation, R&D, marketing and branding. In other words, climbing the ladder means moving up and to the right of the chart presented here.

At each step along the GVC development ladder – defined by opportunities to *increase participation* and to *upgrade* along GVCs – there are a number of facilitating factors and conditions that countries need to put in place, which are discussed in-depth in the Report.

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## The contribution of GVCs to development can be significant, however participation in GVCs also involves risks

<ul style="list-style-type: none"> <li>Value added trade contributes nearly 30 per cent to developing countries' GDP on average</li> <li>There is a positive correlation between participation in GVCs and growth rates of GDP per capita</li> <li>GVCs have a direct economic impact on value added, jobs and income</li> <li>Participation in GVCs can help countries' acquisition and dissemination of technologies and skills, and spread international best practices, including on social and environmental issues, e.g. through the use of CSR standards</li> <li>GVCs can also be an important avenue for developing countries to build productive capacity, opening up opportunities for longer-term industrial upgrading</li> </ul>	<ul style="list-style-type: none"> <li>GDP contribution of GVCs can be limited if countries capture only a small share of the value added created in the chain</li> <li>Also, a large part of GVC value added in developing economies is generated by foreign affiliates of TNCs, which can lead to relatively low "value capture", e.g. as a result of transfer pricing or income repatriation</li> <li>Technology dissemination, skill building and upgrading are not automatic. Developing countries face the risk of remaining locked into relatively low value added activities</li> <li>Environmental impacts and social effects, including on working conditions, occupational safety and health, and job security, can be negative</li> <li>The potential "footlooseness" of GVC activities and increased vulnerability to external shocks pose further risks</li> </ul>
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*So far I have discussed the contribution of GVCs to development, which can be significant.* GVCs have a direct economic impact on value added, jobs and income. They can also be an important avenue for developing countries to build productive capacity, including through technology dissemination and skill building, thus opening up opportunities for longer-term industrial upgrading.

*However participation in GVCs also involves a number of risks:*

- The GDP contribution of GVCs can be limited if countries capture only a small share of the value added created in the chain.
- A large part of GVC value added in developing economies is generated by affiliates of TNCs, which can lead to relatively low "value capture", e.g. as a result of transfer pricing or income repatriation.
- Technology dissemination, skill building and upgrading are not automatic. Developing countries face the risk of remaining locked into relatively low value added activities.
- Environmental impacts and social effects, including on working conditions, occupational safety and health, and job security, can be negative.
- And the potential "footlooseness" of GVC activities and increased vulnerability to external shocks pose further risks.

*Thus, sound policies are needed to maximize the benefits and minimize the risks associated with GVCs.*

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## Countries need to make a strategic choice whether or not to promote GVCs

- Countries need to carefully weigh the pros and cons of GVC participation, and the costs and benefits of proactive policies to promote GVCs or GVC-led development strategies, in line with their specific situation and factor endowments
- Some countries may decide not to promote GVC participation. Others may not have a choice: for the majority of smaller developing economies with limited resource endowments there is often little alternative to development strategies that incorporate a degree of participation in GVCs. The question for those countries is not so much *whether* to participate in GVCs, but *how*. In reality, most countries are already involved in GVCs one way or another
- Promoting GVC participation requires targeting specific GVC segments, i.e. GVC promotion can be selective. Moreover, GVC participation is only one aspect of a country's overall development strategy

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First of all, countries need to make a strategic choice on whether or not to promote GVCs. They need to carefully weigh the pros and cons of GVC participation, and the costs and benefits of proactive policies to promote GVCs or GVC-led development strategies, in line with their specific situation and factor endowments. Some countries may decide not to promote GVC participation. Others may not have a choice: for the majority of smaller developing economies with limited resource endowments there is often little alternative to development strategies that incorporate a degree of participation in GVCs. The question for those countries is not so much *whether* to participate in GVCs, but *how*. In reality, most are already involved in GVCs one way or another. Promoting GVC participation requires targeting specific GVC segments, i.e. GVC promotion can be selective. Moreover, GVC participation is one aspect of a country's overall development strategy.

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## Policies matter to make GVCs work for development

A policy framework for GVCs and development

<b>Embedding GVCs in development strategy</b>	<ul style="list-style-type: none"> <li>• Incorporating GVCs in industrial development policies</li> <li>• Setting policy objectives along GVC development paths</li> </ul>
<b>Enabling participation in GVCs</b>	<ul style="list-style-type: none"> <li>• Creating and maintaining a conducive environment for trade and investment</li> <li>• Putting in place infrastructural prerequisites for GVC participation</li> </ul>
<b>Building domestic productive capacity</b>	<ul style="list-style-type: none"> <li>• Supporting enterprise development and enhancing the bargaining power of local firms</li> <li>• Strengthening skills of the workforce</li> </ul>
<b>Providing a strong environmental, social and governance framework</b>	<ul style="list-style-type: none"> <li>• Minimizing negative effects and risks associated with GVC participation through regulation, public and private standards</li> <li>• Supporting local firms in complying with international standards</li> </ul>
<b>Synergizing trade and investment policies and institutions</b>	<ul style="list-style-type: none"> <li>• Ensuring coherence between trade and investment policies</li> <li>• Synergizing trade and investment promotion and facilitation</li> <li>• Creating 'Regional Industrial Development Compacts'</li> </ul>

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*Second, policies are needed to make GVCs work for development.* If countries decide to actively promote GVC participation, policymakers should first determine where their countries' trade profiles and industrial capabilities stand and then evaluate realistic GVC development paths.

Gaining access to GVCs and realizing upgrading opportunities requires a structured approach that includes

- embedding GVCs in industrial development policies (e.g. targeting GVC tasks and activities);
- enabling GVC growth by creating a conducive environment for trade and investment and by putting in place infrastructural prerequisites; and
- building productive capacities in local firms and skills in the local workforce.

To mitigate the risks involved in GVC participation, these efforts should take place within a strong environmental, social and governance framework, with strengthened regulation and enforcement and capacity-building support to local firms for compliance.

Finally, UNCTAD proposes three specific initiatives:

1. *Synergistic trade and development policies and institutions.* Trade and investment policies often work in silos. In the context of GVCs they can have unintended and counterproductive reciprocal effects. To avoid this, policymakers – where necessary, with the help of international organizations – should carefully review those policy instruments that simultaneously affect investment and trade in GVCs; i.e. trade measures affecting investment and investment measures affecting trade. Furthermore, at the institutional level, the trade and investment links in GVCs call for closer coordination and collaboration between trade and investment promotion agencies.
2. *Sustainable export processing zones (EPZs).* Sustainability is becoming an important factor for attracting GVC activities. EPZs have become significant GVC hubs by offering benefits to TNCs and suppliers in GVCs. They could also offer – in addition to or in lieu of some existing benefits – expanded support services for corporate social responsibility (CSR) efforts to become catalysts for CSR implementation. Policymakers could consider setting up relevant services, including technical assistance for certification and reporting, support on occupational safety and health issues, and recycling or alternative energy facilities, transforming EPZs into centres of excellence for sustainable business. International

organizations can help through the establishment of benchmarks, exchanges of best practices and capacity-building programmes.

3. “Regional industrial development compacts” [SEE NEXT SLIDE]



*The relevance of regional value chains shows the potential impact of evolving regional trade and investment agreements towards “Regional Industrial Development Compacts”.* Such Compacts could focus on liberalization and facilitation of trade and investment and establish joint investment promotion mechanisms and institutions. They could extend to other policy areas important for enabling GVC development, such as the harmonization of regulatory standards and consolidation of private standards on environmental, social and governance issues. And they could aim to create cross-border industrial clusters through joint investments in GVC-enabling infrastructure and productive capacity building. Establishing such compacts implies working in partnership – between governments in the region to harmonize trade and investment regulations and jointly promotion trade and investment, between governments and international organizations for technical assistance and capacity-building, and between the public and private sectors for investment in regional value chain infrastructure and productive capacity.

## Thank You!

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