

Investment, Enterprise and Development Commission (5th session)

Latest Developments in FDI Trends and Policies

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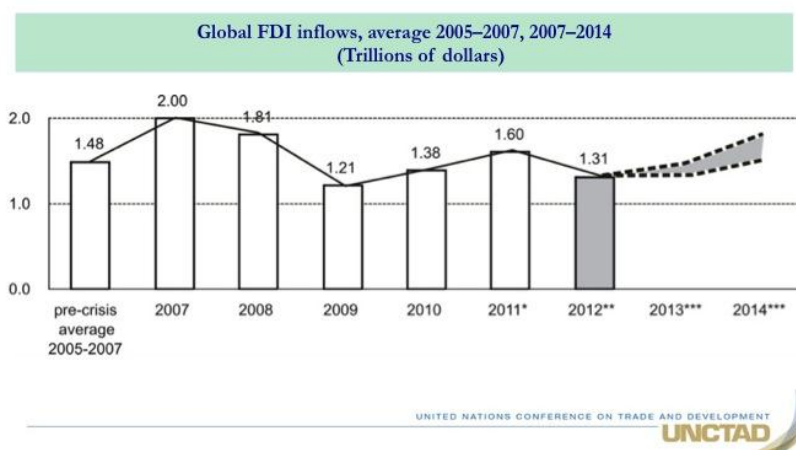
Excellences,
Distinguished delegates,
Ladies and Gentlemen,

My presentation this morning will follow the structure used previously in this Commission: firstly, I will outline recent global and regional trends in FDI, challenges in development finance, and then move to developments in the national and international policy environment. So let me begin with the latest developments in FDI trends.

1. Trends in FDI flows in 2012

FDI recovery will take longer than expected

The global FDI locomotive has become derailed:
FDI declined by 18 per cent in 2012.



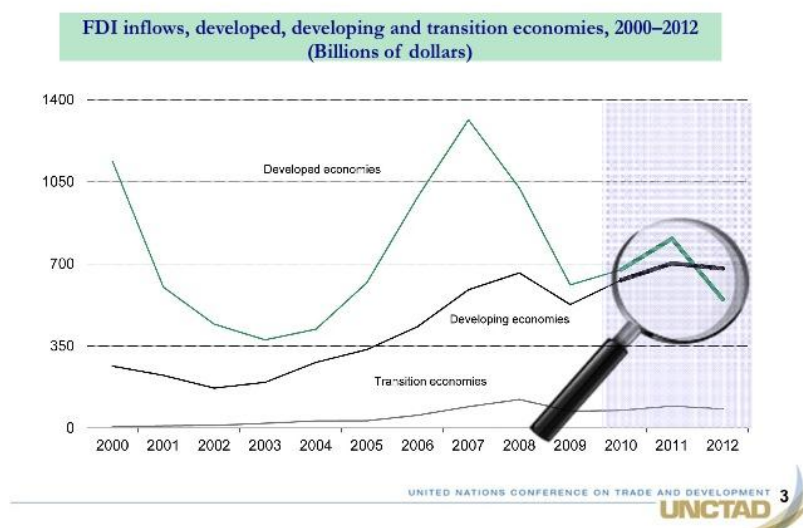
Global foreign direct investment (FDI) inflows declined by 18% in 2012, to an estimated \$1.3 trillion – a level close to the trough reached in 2009 – due mainly to macroeconomic fragility and policy uncertainty for investors. This uncertainty is driven by a weakening macroeconomic environment and by a number of perceived risk factors in the

policy environment, related to the Eurozone crisis, the United States "fiscal cliff", and various broad-based policy changes with implications for FDI.

This is in contrast to other economic indicators which have shown an opposite trajectory: global output rose 2.3 per cent last year, international trade 2.5 per cent, gross fixed capital formation by 4.6 per cent, and employment by 1.3 per cent.

The FDI recovery that had started in 2010 and 2011 will now take longer than expected. We estimate that FDI flows could rise moderately to \$1.4 trillion in 2013 and \$1.6 trillion in 2014, due to slight improvements in macroeconomic conditions and if transnational corporations (TNCs) start to re-profile their investment position and use some of the record levels of cash reserves they are currently sitting on. However, significant risks to this scenario persist, including structural weaknesses in major developed economies and in the global financial system, and significant policy uncertainty in areas crucial for investor confidence. We therefore add a caveat to our projections that should these risks be realised, FDI recovery could be further delayed.

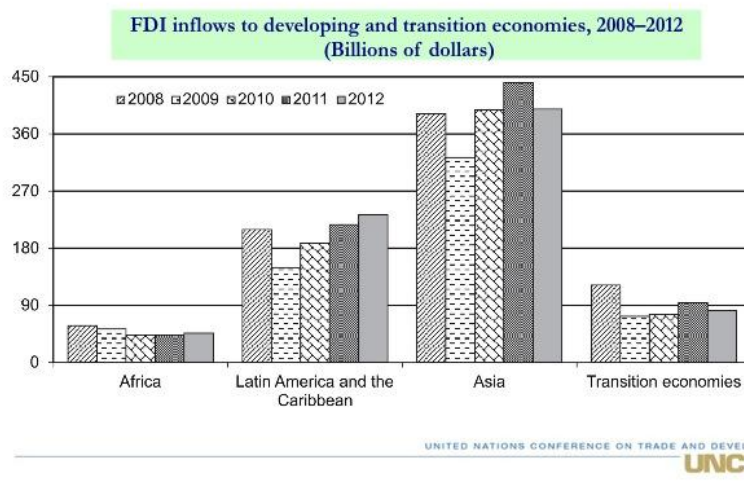
Developing countries surpassed developed countries in FDI inflows by some \$130 billion



FDI flows to developing economies in 2012, for the first time ever, exceeded those to developed countries, by some \$130 billion. FDI flows to developing economies remained resilient, declining only 3% while in developed countries FDI flows fell drastically to values last seen almost ten years ago. The changing pattern of FDI flows is confirmed also in the global ranking of the largest FDI recipients: in 2012 three of the top 4 host economies were

from developing economies. While the United States and China maintained their top position, Hong Kong (China) and Brazil each moved up one place from their 2011 ranking.

**Flows to Latin America and Africa rose.
FDI to developing Asia lost momentum in 2012, although
remained at the second highest level recorded**



Regional trends

Moving now from the global to the regional level, there is a diverging trend among developing countries. *Flows to developing Asia lost some momentum, although they remained at historically high levels. Latin America and Africa saw an increase.*

FDI inflows to developing Asia decreased by 9.5% as a result of declines across most sub-regions and major economies, including China, Hong Kong (China), India, the Republic of Korea, Singapore and Turkey. However, 2012 inflows to Asia were still at their second highest level, accounting for 59% of FDI flows to developing countries. FDI flows to China declined slightly but the country continues to be a major FDI recipient – the second largest in the world. FDI to India declined by 14%, although it remains at the high levels achieved in recent years. For ASEAN as a whole, FDI inflows declined by 7%. However, some member countries (such as Cambodia, Myanmar, the Philippines, Thailand and Viet Nam) registered increases in inflows. FDI flows to West Asia declined for the fourth consecutive year.

Latin America and the Caribbean registered significant growth in FDI in 2012. The rise was strongest in South America. The persistent strength of commodity prices continues to encourage investments in the extractive industries, particularly in Chile, Colombia and

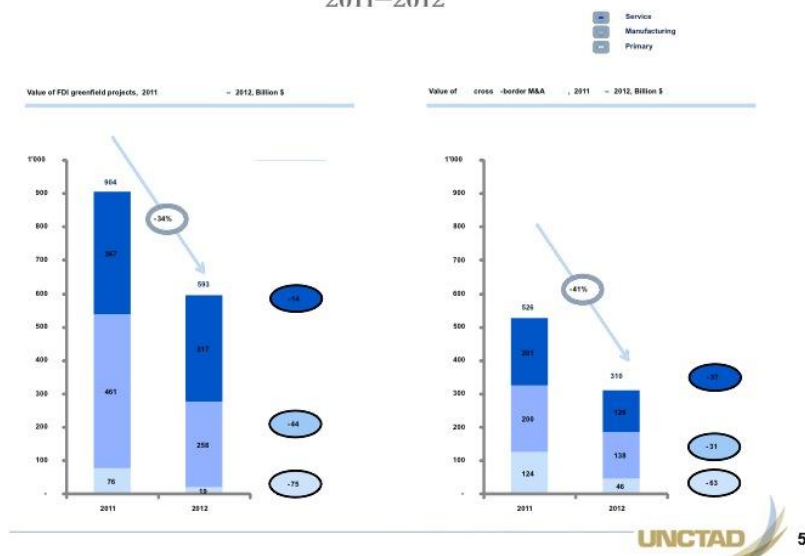
Peru. FDI to Brazil slowed but remained robust, and the country is still the top investment destination in the region.

FDI flows to Africa rose in 2012. Flows to North Africa reversed their downward trend, as Egypt saw a rebound of investment from European investors. The positive growth of FDI flows to South Africa contributed to a rise in inward FDI flows to Southern Africa.

Transition economies experienced a decline in FDI flows of 13% as a result of sluggishness of investment from EU countries in South-East Europe, and the fall of FDI flows to the Russian Federation.

Sectoral trends

Sectoral distribution of greenfield and cross-border M&As, 2011–2012



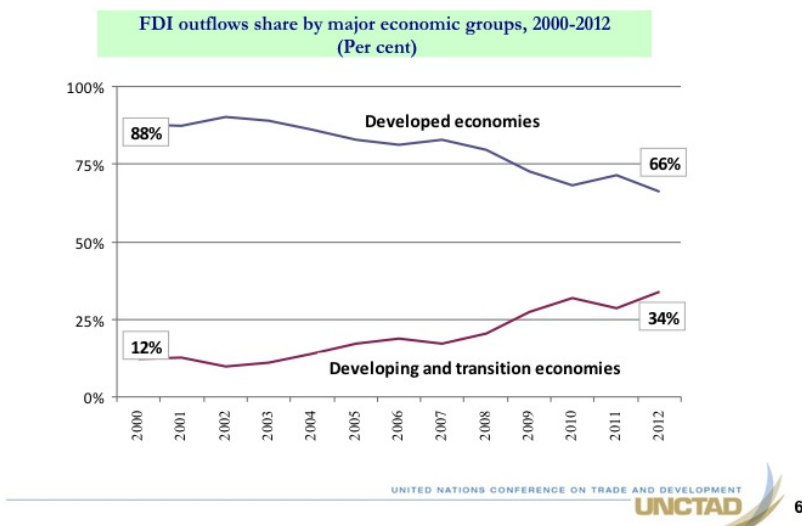
The next slide shows what happened to FDI at the sectoral level from 2011 to 2012. All the three industry sectors – primary, manufacturing and services – were hit by a downturn, although with different intensities. As a consequence, the sectoral decomposition of FDI changed, with the service sector replacing manufacturing as the largest recipient of FDI. I should make clear that, in the absence of FDI data by sector at this point in the year, the sectoral analysis relies on data for M&As and greenfield investments.

The primary sector was the most heavily hit in relative terms in 2012, both in greenfield projects and cross-border M&As. The fall was driven by a decline in the mining, quarrying and petroleum industry, representing the bulk of FDI activity in this sector. The main *manufacturing industries* displayed very poor FDI performance. Manufacturing

industries in the area of processing of extractive material (like metals and metal products, and coke, petroleum and nuclear fuel) were the main losers in this sector. Consumer industries such as motor vehicles or electrical and electronic equipment were among the most affected by the downturn, while less cyclical activities, like food, beverages, tobacco and pharmaceuticals, managed to resist the trend.

In contrast, *services* were the least affected sector. This may be due to the fact that some service industries are by nature less sensitive to business cycles (for example in the utilities) whilst others face more promising medium term growth prospect (for example business services).

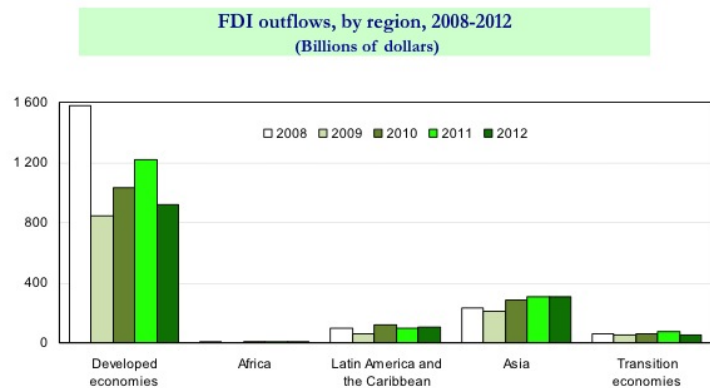
Developing and transition economies share reached record level



FDI outflows

Turning now to FDI outflows, developed economies experienced lower FDI outflows than during their crisis levels of 2009 – and in particular, the EU, due to uncertainty surrounding the euro. In contrast, investors from developing countries continued their expansion and together with transition economies, their share reached 34% of total outflows in 2012. TNCs continue to hold large cash reserves in their foreign affiliates in the form of retained earnings, which today accounts for a record 60% of global FDI outflows.

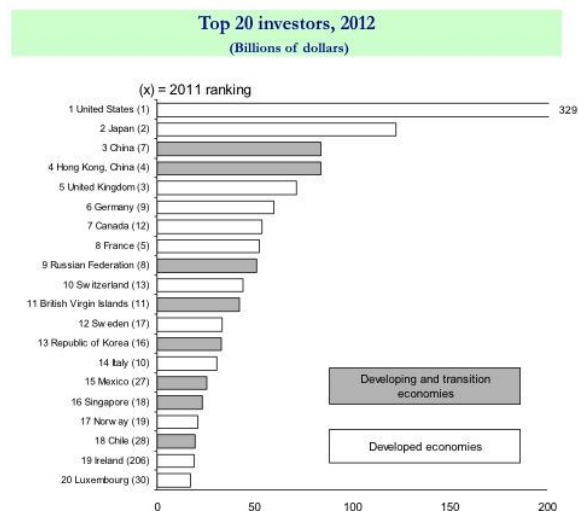
FDI outflows by region



Regional trends in FDI outflows

Looking more closely at the regional level, outward FDI from *developed economies* declined by over \$300 billion in 2012 – which accounts almost entirely for the fall in global outward FDI. Among the 38 developed economies, outward FDI declined in 21 economies, including most of the major home countries of FDI. The largest declines were observed in Belgium, the United States and the Netherlands. The continuing Eurozone crisis appears to have put off United States investment in Europe, their main target region. Japan kept the momentum of the previous year and became the second largest source of FDI in the world.

Developing economies are higher in the rank of top investors



In contrast to the sharp decline of FDI flows from developed countries, FDI flows from *developing economies* alone reached \$418 billion in 2012. As a result, their share in global outflows reached a record 30%. The 2012 increase in FDI outflows from this group was driven by Latin America and the Caribbean and by Africa. However, Asian countries remained the largest source of FDI accounting for three quarters of the group's total.

Outward FDI from Latin America increased by 5% in 2012 to more than \$100 billion, due to strong increases in flows from Mexico and Chile. In contrast, outflows from Brazil continued their decline of the previous year.

Flows from Africa almost doubled in 2012, mainly due to a surge of flows from South Africa in mining, wholesale and healthcare products.

FDI outflows from developing Asia (excluding West Asia) remained at a high level, registering \$280 billion in 2012. China has been one of the main drivers of outflows from Asia, and became the third largest investor in the world after the United States and Japan, for the first time ever. Similarly flows from the Republic of Korea, Malaysia and Thailand rose in 2012. In contrast, Hong Kong (China), India and Singapore saw their FDI flows fall compared to 2011.

West Asia saw its outward FDI flows increase slightly in 2012, consolidating the previous year's recovery, but remaining below the peak reached in 2008. While GCC countries continued to account for most of the region's outward FDI flows, Turkey has emerged as a significant new investor: its outward investment grew by 74% to a record \$4.1 billion.

Outward FDI flows from transition economies declined in 2012, due to the fall of FDI outflows by Russian investors - the main investors from the region. Besides the Russian Federation, outflows from Azerbaijan, Ukraine and Kazakhstan exceeded \$1 billion in 2012. Although TNCs from natural-resource-based economies, supported by high commodity prices, continued their expansion abroad, the largest acquisitions in 2012 took place in the financial industry.

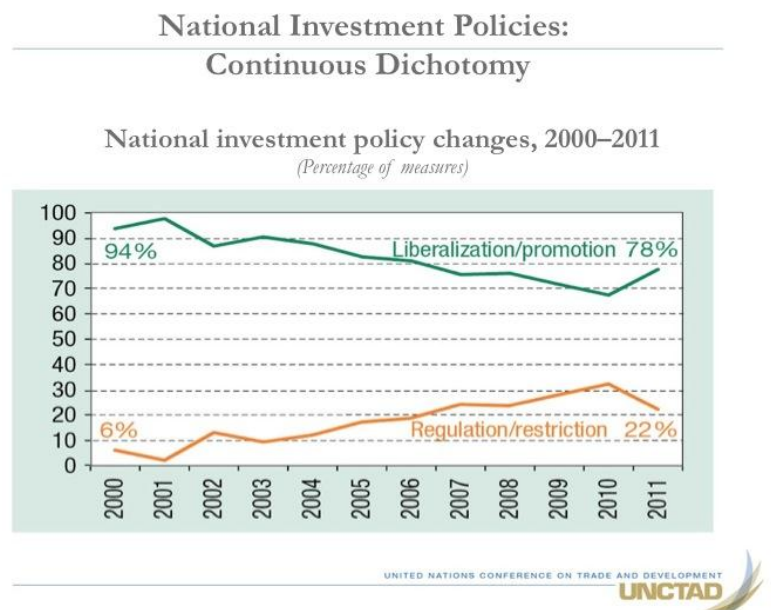
To conclude this section, let me highlight a striking paradox for development finance, including international investment. On the one hand there remains a yawning gap in development finance to fund, for example, the growing demand for infrastructure, as well as

long-term adaptation to climate change and efforts to meet poverty reduction targets. Added to this, last year's decline in FDI and the first ever fall in Official Development Assistance and the challenges loom even larger. On the other hand, and somewhat paradoxically, the world is sitting on record cash reserves: TNCs are estimated to be holding \$6 trillion, and sovereign wealth and pension funds, \$10 trillion. This cash could be used for productive investment. The question is how to mobilise it, and here national and international policy matters. I therefore now turn to recent trends in investment policymaking at both the national and international levels.

2. Trends in investment policymaking

National policy developments

The evolving global investment landscape has implications for investment policymaking. Together with the on-going fallout from the economic and financial crisis and the growing desire of countries to mainstream sustainable development into investment policy, this has led many economies to revisit their stance on investment policy, both nationally and internationally. Indeed, investment policymaking is in a transition from an era of liberalization to one of more regulation. This has manifested itself in the continuing review and revision of existing national and international investment regimes.



Source: UNCTAD, World Investment Report 2012.

We are witnessing an ongoing dichotomy between investment liberalization and promotion, on the one hand, and investment restrictions and regulations, on the other hand. Many countries continue to liberalize and promote foreign investment, but we also observe the move towards more regulatory or restrictive policy measures. Two decades ago, on average, more than 95 percent of investment policy changes were related to improving the entry conditions and treatment for foreign investors – i.e. more liberalization, promotion and facilitation of FDI. However, in the time since then, the share of national policy measures directed at more investment regulations and restrictions has increased significantly and is now heading towards 30 percent. This trend is characterized by more FDI entry restrictions, more State influence in "sensitive" industries – such as extractive industries, financial services and agriculture – and a more critical approach towards outward FDI. The trend reflects an increasing recognition that proper regulatory and institutional frameworks must balance liberalization policies in order to ensure more sustainable outcomes.

Although the graph is taken from last years *World Investment Report* this dichotomy in investment policy making continues today. Our latest Investment Policy Monitor (covering the period November 2012 – February 2013) reports a surge in new investment restrictions and regulations, bringing the share of such measures to a new height. Individual measures included new land ownership restrictions, nationalizations and stricter screening procedures for FDI. Despite the fact that many of these policies reflect the legitimate concerns of national governments and may be supportive of sustainable development objectives, there is a risk that investment restrictions are misused for protectionist purposes. More international cooperation is needed to clarify the distinction between legitimate investment restrictions and protectionism.

Nevertheless, the Monitor also showed that investment liberalisation and promotion remained the dominant feature of national investment policies. Recent investment liberalization and privatization measures benefitted investors in various industries, including media, energy, retail business and transportation. Also worth mentioning are several business facilitation and promotion measures, including those involved in promoting the Green Economy.

Among measures affecting the general business climate, changes in corporate taxation rates have been gaining in importance more recently. In particular, tax reductions as a form of investment incentive have been increasing over the past few years.

International policy developments

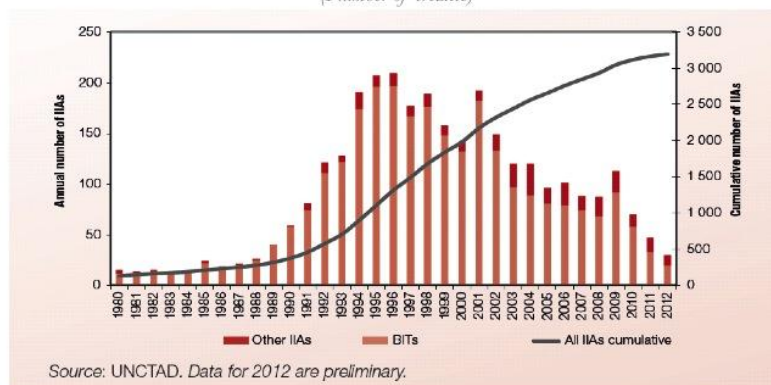
Turning now from policy trends at the national level to developments at the international level, we can see five salient developments. The first concerns the area of investment agreements. In 2012, 30 international investment agreements (IIAs) were signed, including 20 bilateral investment treaties (BITs) and 10 “other IIAs”. This is the lowest annual number of newly concluded treaties for 20 years and is also considerably lower than last year's number of 47 IIAs.

By the end of 2012, the total number of IIAs approached 3,200 agreements, including close to 2,850 BITs and some 350 “other IIAs”. Today, almost every country is party to one or more IIAs, but not everybody is satisfied with the existing regime. Many stakeholders, in particular civil society organizations, are increasingly voicing their views and concerns about these agreements.

International Investment Policies: Shifting from the Bilateral to the Regional Level

Trends of BITs and “other IIAs”, 1980–2012

(Number of treaties)



The second important development is the rise of regional approaches to policymaking. In today's spaghetti bowl of IIAs, bilateral agreements constitute the overwhelming majority. However, the gradual shift towards regionalism is potentially more significant economically, in terms of the global output covered by these agreements. This is particularly the case with respect to current negotiations.

In 2012, IIA negotiations at the regional level continued to intensify, involving at least 110 countries and 22 agreements. Two of the most prominent developments are the ongoing negotiation of the Trans-Pacific Partnership Agreement (TPP), in which the combined economic weight of the participating States accounts for 35 per cent of global GDP; and the European Union's new investment treaty-making powers, in which any agreement concluded by the EU as a bloc will bring together at least 27+1 countries. Other regional groupings, such as ASEAN and Central American States, have also emerged as regional investment actors. In most cases, regional treaties are at the same time FTAs and hence have the potential to more comprehensively address trade and investment inter-linkages.

The shift to regionalism can bring about the consolidation and harmonization of investment rules and represents a step towards multilateralism. However, where new regional treaties do not entail the phase-out of old bilateral ones, the result can be the opposite: instead of simplification and growing consistency, regionalization may lead to a multiplication of treaty layers, making the IIA network even more complex and prone to overlaps and inconsistencies.

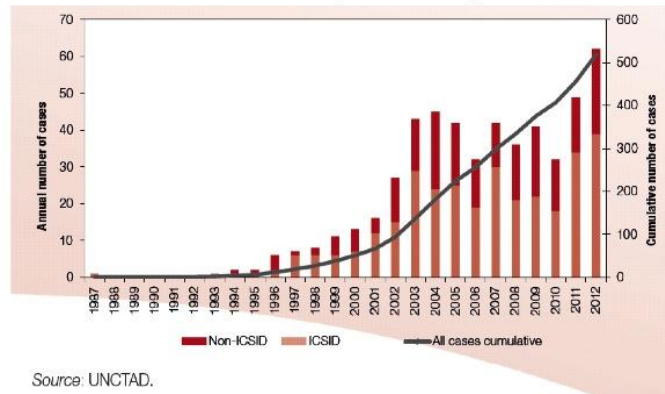
The third observable trend concerns the growing emphasis on sustainability considerations in the negotiation of IIAs. Although many of the recently concluded IIAs follow the traditional BIT model that focuses solely on investment protection, others deviate from this. Several new innovations are meant to ensure that treaties do not interfere with, but instead contribute to, countries' sustainable development strategies. Our Investment Policy Framework for Sustainable Development (IPFSD), which we launched as part of the 2012 World Investment Report (WIR), last July, is an attempt to further promote this re-orientation that focuses on inclusive economic growth, provides support for industrial development, and seeks to address the environmental and social impacts of investment.

The fourth notable trend that I would like to highlight relates to the ongoing reassessment of IIAs by a number of countries. Governments have approached this in a different manner, including (i) revising their model BITs, (ii) renegotiating "old" BITs to replace them with "modern" ones, (iii) putting on hold the conclusion of any new agreements, and (iv) even terminating existing BITs and denouncing the ICSID Convention (WIR 2010).

These actions have been taken largely in response to an increasing number of international investor-State claims, which brings me to my fifth point. In 2012, investment disputes reached a new record, with at least 62 new investment arbitration cases being initiated against host countries. This is the highest number of known treaty-based disputes ever filed in one year.

**ISDS Mechanism:
Investors Continue Using It, Some States Express Discontent**

Known investor-State treaty-based disputes, 1987–2012



Source: UNCTAD.

Over the years, there has been a steady growth of investment arbitration cases against host countries: by the end of 2012, the total number of known treaty-based disputes reached 518 and the total number of countries that have responded to one or more investment treaty claim increased to 95.

These cases often touch upon sensitive public policy issues, and may lead to unexpected interpretation of IIA provisions and/or entail a heavy financial toll on State budgets. This has given rise to a number of concerns which we discussed in last year's World Investment Report, but which I will not go into here today.

Let me now sum up, and look towards a way forward.

At the national level, three challenges can be defined. The first challenge concerns integrating investment policy into the development strategies of countries, which implies channeling investment to areas that are key for the build-up of productive capacity and international competitiveness; and ensuring coherence with a host of policy areas geared towards overall development objectives. The second challenge is to incorporate sustainable

development objectives into investment policy, which implies maximizing positive and minimizing the negative impacts of investment; and fostering responsible investor behaviour. The third challenge is to ensure investment policy relevance and effectiveness, which implies building stronger institutions to implement investment policy; and measuring the sustainable development impact of investment.

These challenges do not exist in abstract, but arise from specific investment activities. To give you an example, one area - which will be the topic of this year's World Investment Report – concerns the growing importance of global value chains for sustainable development and inclusive growth. Integrating into GVCs and finding ways to move up into higher value added activities have become a key priority for developing countries. This poses a number of critical challenges for these countries in terms of domestic capacity building and creating attractive conditions for engaging TNCs, while addressing any social and environmental implications of GVCs.

At the international level, policy-making faces multiple challenges. The most pertinent of these are how to strengthen the sustainability dimension of international investment agreements (IIAs); how to preserve appropriate regulatory space for host countries; how to deal with the complexity of a fragmented treaty regime characterized by overlaps and incoherence; and how to address serious deficiencies in investor-State dispute settlement (ISDS).

UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD) offers a two-pronged approach for addressing these challenges:

- IPFSD offers expert guidance for the future formulation of investment policies. Through its eleven core principles, its guidelines on national policymaking and its options for IIA clauses, IPFSD provides direction for every level of investment policymaking.
- UNCTAD complements this expert-led guidance with a universal, inclusive and transparent policy dialogue, including the example of today's debate, as well as our series of expert meetings, such as our Multi-year Expert Meeting on Investment for Productive Capacity-Building and Sustainable Development: The Regional Context, which earlier this year focused on the rise of regionalism in investment policymaking.

You will have the chance this week to see how UNCTAD is further operationalizing the IPFSD in its own practice, when we hear the presentations of the investment policy reviews of Djibouti and Mozambique. Both reviews were undertaken through the lens of the IPFSD, which strongly informed the review process.

This brings me to the end of my remarks this morning and I thank you for your attention.