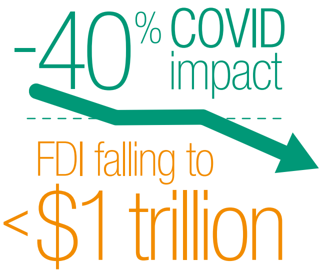
KEY MESSAGES

INVESTMENT TRENDS AND PROSPECTS



The COVID-19 crisis will cause a dramatic fall in FDI. Global FDI flows are forecast to decrease by up to 40 per cent in 2020, from their 2019 value of $1.54 trillion. This would bring FDI below $1 trillion for the first time since 2005. FDI is projected to decrease by a further 5 to 10 per cent in 2021 and to initiate a recovery in 2022. A rebound in 2022, with FDI reverting to the pre-pandemic underlying trend, is possible, but only at the upper bound of expectations.

The outlook is highly uncertain. Prospects depend on the duration of the health crisis and on the effectiveness of policy interventions to mitigate the economic effects of the pandemic. Geopolitical and financial risks and continuing trade tensions add to the uncertainty.

The pandemic is a supply, demand and policy shock for FDI. The lockdown measures are slowing down existing investment projects. The prospect of a deep recession will lead MNEs to re-assess new projects. Policy measures taken by governments during the crisis include new investment restrictions. Starting in 2022, investment flows will slowly recover, led by GVC restructuring for resilience, replenishment of capital stock and recovery of the global economy.

MNE profit alerts are an early warning sign. The top 5,000 MNEs worldwide, which account for most of global FDI, have seen expected earnings for the year revised down by 40 per cent on average, with some industries plunging into losses. Lower profits will hurt reinvested earnings, which on average account for more than 50 per cent of FDI.

Early indicators confirm the immediacy of the impact. Both new greenfield investment project announcements and cross-border mergers and acquisitions (M&As) dropped by more than 50 per cent in the first months of 2020 compared with last year. In global project finance, an important source of investment in infrastructure projects, new deals fell by more than 40 per cent.

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

- Among developed countries, FDI flows to *Europe* are expected to fall by 30 to 45 per cent, significantly more than those to *North America* and other developed economies (with falls of 20 to 35 per cent on average), because the region entered the crisis on a relatively more fragile footing. In 2019, flows to developed economies as a group increased by 5 per cent to $800 billion.
- FDI flows to *Africa* are forecast to fall by 25 to 40 per cent in 2020. The negative trend will be exacerbated by low commodity prices. In 2019, FDI flows to Africa already declined by 10 per cent to $45 billion.
- Flows to *developing Asia* will be severely affected due to their vulnerability to supply chain disruptions, the weight of GVC-intensive FDI in the region and global pressures

to diversify production locations. FDI is projected to fall by 30 to 45 per cent. In 2019, FDI flows to the region declined by 5 per cent, to $474 billion, despite gains in South-East Asia, China and India.

- FDI in *Latin America and the Caribbean* is expected to halve in 2020. Investment prospects are bleak because the pandemic compounds political turbulence and structural weaknesses in several economies. The industry profile of FDI in the region also makes it vulnerable. In 2019, FDI in Latin America and the Caribbean grew by 10 per cent to $164 billion.
- FDI flows to *economies in transition* are expected to fall by 30 to 45 per cent. The decline will largely undo a recovery of FDI to the region in 2019 (up 59 per cent to $55 billion) after several years of low inflows.
- *The outlook for FDI in structurally weak and vulnerable economies is extremely negative.* Many least developed countries (LDCs) are dependent on FDI in extractive industries, many small island developing States are dependent on investment in tourism, and landlocked developing countries are disproportionally affected by supply chain blockages. In 2019, FDI inflows to LDCs declined by 6 per cent to $21 billion, representing just 1.4 per cent of global FDI.

Despite the drastic decline in global FDI flows during the crisis, the international production system will continue to play an important role in economic growth and development. Global FDI flows will remain positive and continue to add to the existing FDI stock, which stood at $36 trillion at the end of 2019.

INVESTMENT POLICY DEVELOPMENTS

Investment policy is a significant component of the pandemic response. Several multilateral groupings, including the G20, have issued declarations in support of international investment. More than 70 countries have taken measures either to mitigate the negative effect on FDI or to shield domestic industries from foreign takeovers.

Support measures include online investment facilitation, pandemic-related services of investment promotion agencies (IPAs) and new incentives for investment in health care. Several countries have tightened foreign investment screening mechanisms to protect health care and other strategic industries. Other interventions include mandatory production, export bans on medical equipment and a reduction of import duties for medical devices. The crisis has also slowed the pace of negotiating international investment agreements (IIAs).

The pandemic could have lasting effects on investment policymaking. On the one hand, it may solidify the shift towards more restrictive admission policies for foreign investment in strategic industries. On the other, it may trigger increased competition for investment as economies seek to recover from the crisis. At the international level, the pandemic will accentuate the need for IIA reform as government responses to the health crisis and its economic fallout could create friction with IIA obligations.

Already in 2019, continuing the trend of recent years, several countries – almost all developed – introduced more rigorous screening of investment in strategic industries on the basis of national security considerations. At least 11 large cross-border M&A deals were withdrawn or blocked for regulatory or political reasons.

+22
in 2019
Total IIAs
3 284

Attracting FDI remains an important policy objective. Overall, 54 economies introduced at least 107 measures affecting foreign investment in 2019; three-quarters were in the direction of liberalization, promotion and facilitation, with developing countries and emerging economies in Asia most active. Steps toward liberalization were made in mining, energy, finance, transportation and telecommunication. Several countries streamlined administrative procedures for investors or expanded investment incentive regimes.

Change in the IIA regime is underway. In 2019, the number of IIA terminations (34) exceeded the number of new IIAs (22) for the second time. This brought the total to 3,284 IIAs and 349 effective terminations. Several other developments will affect the international investment policy landscape, including the agreement by European Union (EU) member States to terminate intra-EU bilateral investment treaties, Brexit and the entry into force of the agreement establishing the African Continental Free Trade Area.

The number of treaty-based investor–State dispute settlement (ISDS) cases reached over 1,000. Most of the 55 publicly known ISDS cases initiated in 2019 were brought under IIAs signed in the 1990s or earlier. ISDS tribunals rendered at least 71 substantive decisions. In the decisions holding the State liable, the amounts awarded ranged from several millions to $8 billion.

Progress on the reform of the IIA regime is visible in treaties concluded in 2019. Nearly all new IIAs contain features in line with UNCTAD's Reform Package for the International Investment Regime, with the preservation of States' regulatory space being the most frequently seen area of reform. To support the IIA reform process, UNCTAD will launch its IIA Reform Accelerator later in 2020.

INTERNATIONAL PRODUCTION: A DECADE OF TRANSFORMATION AHEAD

WIR
@30

The World Investment Report *has monitored FDI and the activities of MNEs for 30 years*, during which international production saw two decades of rapid growth followed by one of stagnation. Flows of cross-border investment in physical productive assets stopped growing in the 2010s, the growth of trade slowed down and GVC trade declined.

The 2010s were only the quiet before the storm. The crisis caused by the COVID-19 pandemic arrives on top of existing challenges to the system of international production arising from the new industrial revolution (NIR), growing economic nationalism and the sustainability imperative. These challenges were already reaching an inflection point; the pandemic looks set to tip the scales. *The decade to 2030 is likely to prove a decade of transformation for international production.*

Trade and investment trends unfold in three key dimensions of international production: the degree of fragmentation and the length of value chains, the geographical spread of value added, and the governance choices of MNEs that determine the prevalence of arm's-length trade versus FDI. This report identifies several archetypical configurations covering industries that, together, account for the lion's share of global trade and investment.

Three key technology trends of the NIR will shape international production going forward: robotics-enabled automation, enhanced supply chain digitalization and additive manufacturing. Each will have distinct effects on the length, geographical distribution and governance of GVCs. Each technology, depending on industry-specific deployment, will flatten, stretch or bend the "smile curve" of international production in its own way.

The pace and extent of adoption of these technologies will depend in part on the policy environment for trade and investment, which is trending towards more interventionism, rising protectionism and a shift away from multilateral to regional and bilateral frameworks. *They will also depend on sustainability concerns,* including differences in approach between countries and regions on emission targets and environmental, social and governance (ESG) standards, market-driven changes in products and processes, and supply chain resilience measures.

The effects on international production of the technology, policy and sustainability trends are multifaceted. They are at times mutually reinforcing, they occasionally push in opposite directions and they will play out differently across industries and geographies. Depending on the starting point of individual industries – their archetypical international production configurations – they will tend to favour one of four trajectories.

4 Replication Regionalization Diversification **trajectories** Reshoring

(1) Reshoring will lead to shorter, less fragmented value chains and a higher geographical concentration of value added. It will primarily affect higher-technology GVC-intensive industries. The implications of this trajectory include increased divestment and a shrinking pool of efficiency-seeking FDI. For some economies it implies the need to re-industrialize, for others to cope with premature de-industrialization. Access to and upgrading along the GVC development ladder becomes more difficult for developing countries.

(2) Diversification will lead to a wider distribution of economic activities. It will primarily affect services and GVC-intensive manufacturing industries. This trajectory will increase opportunities for new entrants (economies and firms) to participate in GVCs, but its reliance on supply chain digitalization will cause those GVCs to be more loosely governed, platform-based and asset-light, and value capture in host countries will become more difficult. GVC participation will require high-quality hard and soft digital infrastructure.

(3) Regionalization will reduce the physical length but not the fragmentation of supply chains. The geographical distribution of value added will increase. This trajectory will affect regional processing industries, some GVC-intensive industries and even the primary sector. It will imply a shift from global efficiency-seeking investment to regional market-seeking investment, and from investment in vertical GVC segments to investment in broader industrial bases and clusters. Regional economic cooperation, industrial policy and investment promotion will become indispensable to build regional value chains.

(4) Replication will lead to shorter value chains and a rebundling of production stages. It will lead to more geographically distributed activities, but more concentrated value added. It will be especially relevant for hub-and-spoke and regional processing industries. This trajectory implies a shift from investment in large-scale industrial activity to distributed manufacturing, which relies on lean physical infrastructure and high-quality digital infrastructure. A local manufacturing base and producer services become prerequisites to attract the final stages of GVCs, but value capture and technology dissemination will not be guaranteed.

Although the different trajectories show that the expected transformation of international production is not unidirectional, overall, the trends show a system under severe pressure with heightened risks of a dismantling and hollowing-out of GVCs and declining cross-border investment in productive assets. Given the importance of international production for post-pandemic recovery, for economic growth and job creation, and for the development prospects of lower-income countries, *policymakers need to maintain a trade and investment policy environment that favors a gradual – rather than shock – adjustment of international production networks*.

The transformation of international production will bring both challenges and opportunities for investment and development policymakers:

- *Challenges* include increased divestment, relocations and investment diversion, and a shrinking pool of efficiency-seeking investment, implying tougher competition for FDI. Value capture in GVCs and development based on vertical specialization will become more difficult. Infrastructure built for a world of GVCs will see diminishing returns. Changes in locational determinants of investment will often negatively affect the chances of developing countries to attract MNE operations.
- *Opportunities* arising from the transformation include attracting investors looking to diversify supply bases and building redundancy and resilience. The pool of regional market-seeking investment will increase. Shorter value chains will bring more investment in distributed manufacturing and final-goods production with broader industrial capacity-building and clustering. And digital infrastructure and platforms will enable new applications and services and improve bottom-up access to GVCs.

Confronting the challenges and capturing the opportunities requires a change in the investment-development paradigm: (i) From a focus on export-oriented efficiency-seeking investment in narrowly specialized GVC segments to an "export-plus-plus" focus – plus investment in production for regional markets, plus investment in a broader industrial base. (ii) From cost-based competition for single-location investors to competition for diversified investments based on flexibility and resilience. And (iii) from prioritizing large-scale industrial investors with "big infrastructure" to making room for small-scale manufacturing facilities and services with "lean infrastructure". This report proposes a new framework for investment-development policies to reflect this change.

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

INVESTING IN THE SDGs

SDG-investment trends in developing countries

UNCTAD first estimated investment requirements for the SDGs in *WIR14*, identifying 10 relevant sectors (encompassing all 17 SDGs) and estimating an annual investment gap of in developing countries of $2.5 trillion. Progress on investment in the SDGs – from all sources (domestic and international, public and private) – is now evident across six of the 10 SDG sectors: infrastructure, climate change mitigation, food and agriculture, health, telecommunication, and ecosystems and biodiversity. *However, overall growth is falling well short of requirements.*

SDG-financing trends in global capital markets

Sustainability funds have grown rapidly in number, variety and size. UNCTAD estimates that funds dedicated to investment in sustainable development have reached $1.2-1.3 trillion today. However, most of these funds are invested in developed countries (e.g. in renewable energy).

The global effort to fight the pandemic is boosting the growth of sustainability funds, particularly social bonds. In the first quarter of 2020, social bonds related to COVID-19 crisis relief raised $55 billion, exceeding the total value of social bonds issued in all of 2019. Stock exchanges actively support the fast-growing COVID-19 response bond market, for example by waiving listing fees.

Over the next 10 years, the "decade of delivery" for the SDGs, capital markets can be expected to significantly expand their offering of sustainability-themed products. The challenge will be *how to combine growth with a greater focus on channeling funds to SDG-relevant investment projects in developing countries, and especially LDCs*.

ESG integration trends

Progress on investing in the SDGs is not just about mobilizing funds and channeling them to priority sectors. It is also about *integrating good environmental, social and governance (ESG) practices in business operations to ensure positive investment impact*. Global capital markets are again instrumental in this process. Stock exchanges provide a platform for sustainable finance and guidance for corporate governance. More than half of exchanges worldwide now provide guidance to listed companies on sustainability reporting. Security regulators and policymakers, as well as international organizations, such as the UN Sustainable Stock Exchanges initiative and IOSCO, also push for ESG integration.

Companies and institutional investors acknowledge the need to align investment and business decisions with positive SDG outcomes. *The SDGs are increasingly becoming a focus of investor interest and company reporting for impact.* A key challenge is the quality of disclosure and harmonization of reporting standards.

One SDG on which companies are increasingly expected to report is gender equality. *About 70 per cent of the world's 5,000 largest MNEs now report on progress in this area.* Overall, women's representation remains unequal. Regulation and investor pressure have led to better representation at the board level, but not at managerial levels. The implementation of gender equality policies related to flexible work and childcare remains weak.

70% of Top
5,000 MNEs
report
on gender

Mainstreaming the SDGs in investment policies

More than 150 countries have adopted national strategies on sustainable development or revised existing development plans to reflect the SDGs. An analysis by UNCTAD shows that although many of these strategies highlight the need for additional financial resources, *very few contain concrete road maps for the promotion of investment in the SDGs*.

Existing investment promotion instruments applicable to the SDGs are limited in number and follow a piecemeal approach. UNCTAD's global review of national investment policy regimes shows that less than half of UN member States maintain specific tools for promoting investment in the SDGs. Countries promote inward investment in the SDGs primarily through incentive schemes. Nevertheless, several key SDG sectors, such as health, water and sanitation, education and climate change adaptation, are rarely covered by specific investment promotion measures.

Since the adoption of the SDGs, some efforts have been made to enhance the promotion of investment in sustainable development. More than 150 investment measures have been put in place worldwide to specifically liberalize or promote investment, targeting mostly transportation and innovation, as well as food and agriculture. This is far from sufficient to re-orient the entire national investment regime towards SDGs investment.

Factoring the SDGs into the international investment treaty regime also presents a daunting task. The vast majority of the 3,300 existing treaties pre-date the SDGs and need to be modernized. Recent treaties increasingly incorporate them, and many countries are reformulating their treaty models in line with UNCTAD's Reform Package for the IIA regime.

A more systematic approach is needed for mainstreaming SDGs into national investment policy frameworks and the IIA regime, and to factor investment promotion into national SDG strategies.

A big push for investment in the SDGs – a new set of transformative actions

Action Plan for Investment in the SDGs

A new set of global actions to facilitate a "Big Push" in private sector investment in the SDGs is urgently needed. Building on the six transformative actions proposed in its Investment Policy Framework for Sustainable Development, UNCTAD's new Action Plan combines several policy instruments to provide an implementation framework for the UN Secretary-General's Strategy for Financing the 2030 Agenda for Sustainable Development.

The Action Plan presents a range of policy options to respond to the investment mobilization, channeling and impact challenges faced especially by developing countries. Its transformative actions include these six:

- Mainstreaming the SDGs in national investment policy frameworks and in the international investment treaty regime
- Re-orienting investment promotion and facilitation strategies toward SDG investment
- Establishing regional SDG Investment Compacts
- Fostering new forms of partnerships for SDG investment
- Deepening ESG integration in financial markets by establishing a global monitoring mechanism with a harmonized approach to disclosure
- Changing the global business mindset

The updated Action Plan is a response to the call in the United Nations General Assembly resolution on "Promoting investments for sustainable development" (A/RES/74/199), for "concrete recommendations for the advancement of investment for the implementation of the 2030 Agenda".

As requested by the General Assembly, UNCTAD will continue its regular monitoring of global SDG investment trends and policies through the *Global SDG Investment Trends Monitor*, the *Global SDG Investment Policy Monitor* and the *World Investment Report*. It will also continue to promote investment in the SDGs through global platforms, such as the World Investment Forum, in partnership with all key investment-development stakeholders.