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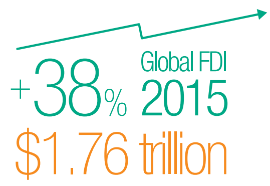
KEY MESSAGES

GLOBAL INVESTMENT TRENDS

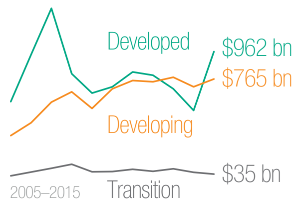
Recovery in FDI was strong in 2015. Global foreign direct investment (FDI) flows jumped by 38 per cent to $1.76 trillion, their highest level since the global economic and financial crisis of 2008–2009. A surge in cross-border mergers and acquisitions (M&As) to $721 billion, from $432 billion in 2014, was the principal factor behind the global rebound. The value of announced greenfield investment remained at a high level, at $766 billion.



Part of the growth in FDI was due to corporate reconfigurations. These transactions often involve large movements in the balance of payments but little change in actual operations. Discounting these large-scale corporate reconfigurations implies a more moderate increase of around 15 per cent in global FDI flows.

Inward FDI flows to developed economies almost doubled to $962 billion. As a result, developed economies tipped the balance back in their favour with 55 per cent of global FDI, up from 41 per cent in 2014. Strong growth in inflows was reported in Europe. In the United States FDI almost quadrupled, albeit from a historically low level in 2014.

Developed economies took largest share of global FDI



Developing economies saw their FDI inflows reach a new high of $765 billion, 9 per cent higher than in 2014. Developing Asia, with FDI inflows surpassing half a trillion dollars, remained the largest FDI recipient region in the world. Flows to Africa and Latin America and the Caribbean faltered. Developing economies continue to comprise half of the top 10 host economies for FDI flows.

Outward FDI flows from developed economies jumped by 33 per cent to $1.1 trillion. The increase notwithstanding, their outward FDI remained 40 per cent short of its 2007 peak. With flows of $576 billion, Europe became the world's largest investing region. FDI by MNEs from North America stayed close to their 2014 levels.

Primary sector FDI activity decreased, manufacturing increased. A flurry of deals raised the share of manufacturing in cross-border M&As above 50 per cent in 2015. FDI in the primary sector declined because of reductions in planned capital expenditures in response to declining commodity prices, as well as a sharp fall in reinvested earnings as profit margins shrank. Services continue to hold over 60 per cent of global FDI stock.

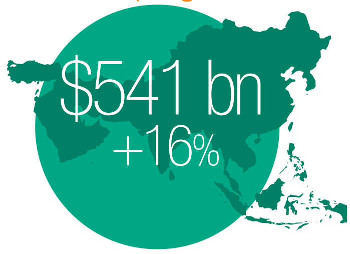
Looking ahead, FDI flows are expected to decline by 10-15 per cent in 2016, reflecting the fragility of the global economy, persistent weakness of aggregate demand, sluggish growth in some commodity exporting countries, effective policy measures to curb tax inversion deals and a slump in MNE profits. Over the medium term, global FDI flows are projected to resume growth in 2017 and to surpass $1.8 trillion in 2018, reflecting an expected pick up in global growth.

REGIONAL INVESTMENT TRENDS

FDI flows to Africa fell to $54 billion in 2015, a decrease of 7 per cent over the previous year. An upturn in FDI into North Africa was more than offset by decreasing flows into Sub-Saharan Africa, especially to West and Central Africa. Low commodity prices depressed FDI inflows in natural-resource-based economies. FDI inflows to Africa are expected to increase moderately in 2016 due to liberalization measures and planned privatizations of state-owned enterprises.

Developing Asia saw FDI inflows increase by 16 per cent to $541 billion – a new record. The significant growth was driven by the strong performance of East and South Asian economies. FDI inflows are expected to slow down in 2016 and revert to their 2014 level. Outflows from the region dropped by about 17 per cent to $332 billion – the first decline since 2012.

Record inflows to developing Asia



FDI flows to Latin America and the Caribbean – excluding offshore financial centres – remained flat in 2015 at $168 billion. Slowing domestic demand and worsening terms of trade caused by falling commodity prices hampered FDI mainly in South America. In contrast, flows to Central America made gains in 2015 due to FDI in manufacturing. FDI flows to the region may slow down in 2016 as challenging macroeconomic conditions persist.

FDI flows to transition economies declined further, to levels last seen almost 10 years ago owing to a combination of low commodity prices, weakening domestic markets and the impact of restrictive measures/geopolitical tensions. Outward FDI from the region also slowed down, hindered by the reduced access to international capital markets. After the slump of 2015, FDI flows to transition economies are expected to increase modestly.

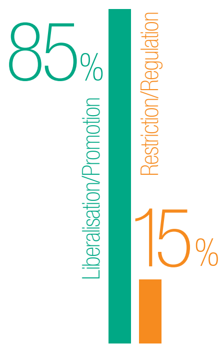
After three successive years of contraction, FDI inflows to developed countries bounced back sharply to the highest level since 2007. Exceptionally high cross-border M&A values among developed economies were the principal factor. Announced greenfield investment also remained high. Outward FDI from the group jumped. Barring another wave of cross-border M&A deals and corporate reconfigurations, the recovery of FDI activity is unlikely to be sustained in 2016 as the growth momentum in some large developed economies weakened towards the end of 2015.

Europe
largest investor region in 2015

FDI flows to structurally weak and vulnerable economies as a group increased moderately by 2 per cent to $56 billion. Developing economies are now major sources of investments in all of these groupings. Flows to least developed countries (LDCs) jumped by one third to $35 billion; landlocked developing countries (LLDCs) and small island developing States (SIDS) saw a decrease in their FDI inflows of 18 per cent and 32 per cent respectively. Divergent trends are also reflected in their FDI prospects for 2016. While LLDCs are expected to see increased inflows, overall FDI prospects for LDCs and SIDS are subdued.

INVESTMENT POLICY TRENDS

Most new investment policy measures continue to be geared towards investment liberalization and promotion. In 2015, 85 per cent of measures were favourable to investors. Emerging economies in Asia were most active in investment liberalization, across a broad range of industries. Where new investment restrictions or regulations were introduced, these mainly reflected concerns about foreign ownership in strategic industries. A noteworthy feature in new measures was also the adoption or revision of investment laws, mainly in some African countries.



National investment policy measures

National security considerations are an increasingly important factor in investment policies. Countries use different concepts of national security, allowing them to take into account key economic interests in the investment screening process. Governments' space for applying national security regulations needs to be balanced with investors' need for transparent and predictable procedures.

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The universe of international investment agreements (IIAs) continues to grow. In 2015, 31 new IIAs were concluded, bringing the universe to 3,304 treaties by year-end. Although the annual number of new IIAs continues to decrease, some IIAs involve a large number of parties and carry significant economic and political weight. Recent IIAs follow different treaty models and regional agreements often leave existing bilateral treaties between the parties in force, increasing complexity. By the end of May 2016, close to 150 economies were engaged in negotiating at least 57 new IIAs.

+31
in 2015
Total IIAs
3,304

With 70 cases initiated in 2015, the number of new treaty-based investor-State arbitrations set a new annual high. Following the recent trend, a high share of cases (40 per cent) was brought against developed countries. Publicly available arbitral decisions in 2015 had a variety of outcomes, with States often prevailing at the jurisdictional stage of proceedings, and investors winning more of the cases that reached the merits stage.

IIA reform is intensifying and yielding the first concrete results. A new generation of investment treaties is emerging. UNCTAD's Investment Policy Framework and its Road Map for IIA Reform are shaping key reform activities at all levels of policymaking. About 100 countries have used these policy instruments to review their IIA networks and about 60 have used them to design treaty clauses. During this first phase of IIA reform, countries have built consensus on the need for reform, identified reform areas and approaches, reviewed their IIA networks, developed new model treaties and started to negotiate new, more modern IIAs.

70 New
ISDS cases
annual record

Despite significant progress, much remains to be done. Phase two of IIA reform will require countries to focus more on the existing stock of treaties. Unlike the first phase of IIA reform, where most activities took place at the national level, phase two of IIA reform will require enhanced collaboration and coordination between treaty partners to address the systemic risks and incoherence of the large body of old treaties. The 2016 World Investment Forum offers the opportunity to discuss how to carry IIA reform to the next phase.

Investment facilitation: a policy gap that needs to be closed. Promoting and facilitating investment is crucial for the post-2015 development agenda. At the national level, many countries have set up schemes to promote and facilitate investment, but most efforts relate to promotion (marketing a location and providing incentives) rather than facilitation (making it easier to invest). In IIAs, concrete facilitation measures are rare.

UNCTAD's Global Action Menu for Investment Facilitation provides policy options to improve transparency and information available to investors, ensure efficient and effective administrative procedures, and enhance predictability of the policy environment, among others. The Action Menu consists of 10 action lines and over 40 policy options. It includes measures that countries can implement unilaterally, and options that can guide international collaboration or that can be incorporated in IIAs.

INVESTOR NATIONALITY: POLICY CHALLENGES

More than 40 per cent of foreign affiliates worldwide have multiple "passports". These affiliates are part of complex ownership chains with multiple cross-border links involving on average three jurisdictions. The nationality of investors in and owners of foreign affiliates is becoming increasingly blurred.

"Multiple passport affiliates" are the result of indirect foreign ownership, transit investment through third countries, and round-tripping. About 30 per cent of foreign affiliates are indirectly foreign owned through a domestic entity; more than 10 per cent are owned through an intermediate entity in a third country; about 1 per cent are ultimately owned by a domestic entity. These types of affiliates are much more common in the largest MNEs: 60 per cent of their foreign affiliates have multiple cross-border ownership links to the parent company.

The larger the MNEs, the greater is the complexity of their internal ownership structures. The top 100 MNEs in UNCTAD's Transnationality Index have on average more than 500 affiliates each, across more than 50 countries. They have 7 hierarchical levels in their ownership structure (i.e. ownership links to affiliates could potentially cross 6 borders), they have about 20 holding companies owning affiliates across multiple jurisdictions, and they have almost 70 entities in offshore investment hubs.

Rules on foreign ownership are ubiquitous: 80 per cent of countries restrict majority foreign ownership in at least one industry. The trend in ownership-related measures is towards liberalization, through the lifting of restrictions, increases in allowed foreign shareholdings, or easing of approvals and admission procedures for foreign investors. However, many ownership restrictions remain in place in both developing and developed countries.

The blurring of investor nationality has made the application of rules and regulations on foreign ownership more challenging. Policymakers in some countries have developed a range of mechanisms to safeguard the effectiveness of foreign ownership rules, including anti-dummy laws, general anti-abuse rules to prevent foreign control, and disclosure requirements.

Indirect ownership structures and mailbox companies have the potential to significantly expand the reach of IIAs. About one third of ISDS claims are filed by claimant entities that are ultimately owned by a parent in a third country (not party to the treaty on which the claim is based). Some recent IIAs try to address the challenges posed by complex ownership structures through more restrictive definitions, denial of benefits clauses and substantial business activity requirements, but the vast majority of existing treaties does not have such devices.

Policymakers should be aware of the de facto multilateralizing effect of complex ownership on IIAs. For example, up to a third of apparently intra-regional foreign affiliates in major (prospective) megaregional treaty areas, such as the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP), and the Regional Comprehensive Economic Partnership (RCEP), are ultimately owned by parents outside the region, raising questions about the ultimate beneficiaries of these treaties and negotiations. Policymakers should aim to avoid uncertainty for both States and investors about the coverage of the international investment regime.

Rethinking ownership-based investment policies means safeguarding the effectiveness of ownership rules and considering alternatives. On the one hand, policymakers should test the "fit-for-purpose" of ownership rules compared to mechanisms in investment-related policy areas such as competition, tax, and industrial development. On the other, policymakers can strengthen the assessment of ownership chains and ultimate ownership and improve disclosure requirements. However, they should be aware of the administrative burden this can impose on public institutions and on investors. Overall, it is important to find a balance between liberalization and regulation in pursuing the ultimate objective of promoting investment for sustainable development.

Mukhisa Kituyi
Secretary-General of the UNCTAD

40%
of foreign affiliates:
direct &
ultimate owners
have different passports

Complex ownership:
100 MNEs
500 affiliates
50 countries

80%
of countries restrict
majority foreign
ownership in at
least one industry