Recent Trends in FDI and the Sustainable Development Challenge

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Recent trends in global FDI flows

Inflows: developing-country FDI inflows reached a record level

Global foreign direct investment (FDI) inflows fell by 16 percent in 2014 to 1.23 trillion US dollars, down from 1.47 trillion US dollars in 2013. This is mostly explained by fragility of the global economy, policy uncertainty for investors and elevated geopolitical risks. New investments were also offset by some large divestments. The decline in FDI flows contrasted to macroeconomic variables such as GDP, trade, gross fixed capital formation and employment, which all grew.

The global FDI decline masks regional variations. While developed countries and economies in transition saw a significant decrease, inflows to developing economies remained at historically high levels. FDI flows to the latter now account for 55 percent of the global total (Figure 1). Developing Asia drove the increase, while flows to Latin America declined and those to Africa remained flat.

FDI flows to developed countries dropped by 28 percent to 499 billion US dollars. Inflows to the United States fell to 92 billion US dollars (40 percent of their 2013 level), mainly due to Vodafone's divestment of Verizon, without which flows into the United States would have remained stable. FDI flows to Europe also fell by 11 percent to 289 billion US dollars. Among European economies, inflows decreased in Ireland, Belgium, France and Spain while they increased in the United Kingdom, Switzerland and Finland.

Inflows to transition economies declined by 52 percent to 48 billion US dollars, as regional conflict and sanctions deterred new foreign investors (Figure 2). FDI flows to the Russian Federation fell by 70 percent to 21 billion US dollars, partly as an adjustment from the level reached in 2013 as a result of the Rosneft-BP mega-transaction (see UNCTAD World Investment Report 2014).

FDI flows to developing economies increased by 2 percent to a historically high level in 2014, reaching 681 billion US dollars. Developments in Asia drove the increase, while flows to Latin America and the Caribbean declined and those to Africa remained flat. FDI flows to Asia grew by 9 percent to 465 billion US dollars in 2014. East Asia, South-East Asia and South Asia all saw increased inflows. FDI in China amounted to 129 billion US dollars, up by 4 percent from 2013, mainly because of an increase in FDI in the services sector. FDI inflows also rose in Hong Kong (China) and Singapore. India experienced a significant in-

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Figure 1

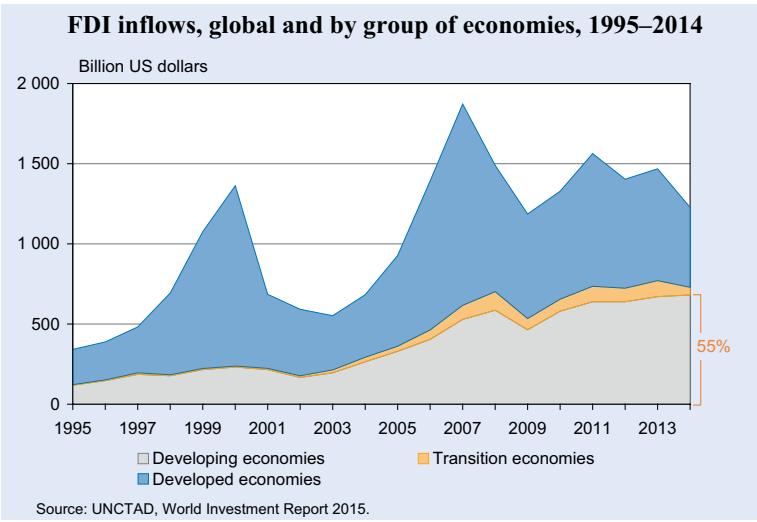
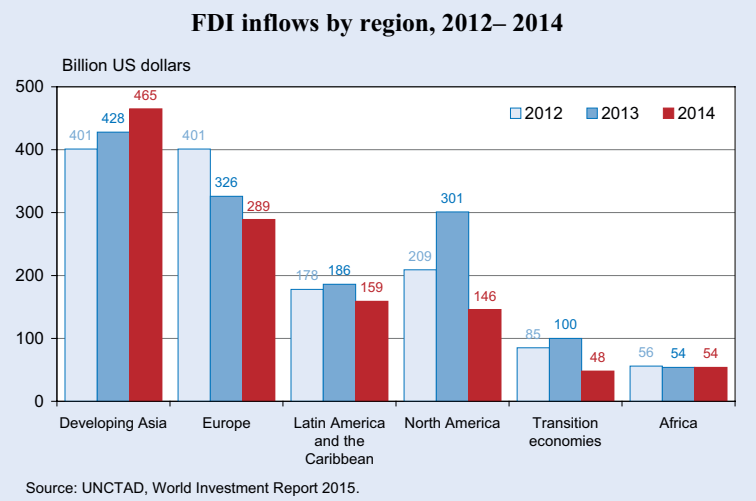


Figure 2



Source: UNCTAD, World Investment Report 2015.

crease of 22 percent to 34 billion US dollars. However, FDI flows to West Asia continued their downward trend in 2014 for the sixth consecutive year, decreasing by 4 percent to 43 billion US dollars owing to the security situation in the region.

FDI flows to Latin America and the Caribbean – excluding the Caribbean offshore financial centers – decreased by 14 percent to 159 billion US dollars in 2014, after four years of consecutive increases. This decrease was mainly the result of a 72 percent decline in cross-border mergers and acquisitions (M&A) in Central America and the Caribbean, and of lower commodity prices, which reduced investment in extractive industries in South America. While FDI flows to Mexico, Venezuela, Argentina, Colombia and Peru declined, flows to Chile increased, owing to high levels of cross-border M&A sales. In Brazil, the sharp fall in FDI in the primary sector was offset by an increase in FDI in manufacturing and services, keeping total flows similar to 2013 levels.

Inflows to Africa remained stable at 54 billion US dollars in 2014. North Africa saw its FDI flows decline by 15 percent to 12 billion US dollars, while flows to Sub-Saharan Africa increased by 5 percent to 42 billion US dollars. In Sub-Saharan Africa, FDI flows to West Africa declined by 10 percent to 13 billion US dollars, as Ebola, regional conflicts and falling commodity prices negatively affected several countries. Flows to Southern Africa also fell by 2 percent to 11 billion US dollars. By contrast, Central Africa and East Africa saw their FDI flows increase by 33 percent and 11 percent, to 12 billion US dollars and 7 billion US dollars, respectively.

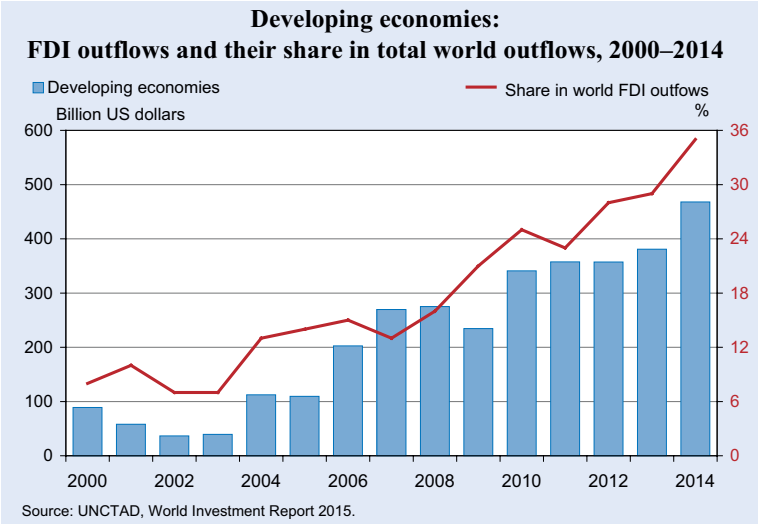
Outflows: investment by MNEs from developing and transition economies continued to grow

In 2014, MNEs from developing economies alone invested 468 billion US dollars abroad, a 23 percent increase from the previous year. Their share in global FDI reached a record 35 percent, up from 13 percent in 2007 (Figure 3).

Among developing economies, MNEs from Asia increased their investment abroad, while outflows from Latin America and the Caribbean, and Africa fell. For the first time, MNEs from developing Asia became the world's largest investing group, accounting for almost one third of the total (Figure 4). Nine of the 20 largest home economies were developing or transition economies, namely Hong Kong (China), China, Russia, Singapore, South Korea, Malaysia, Kuwait, Chile and Taiwan.

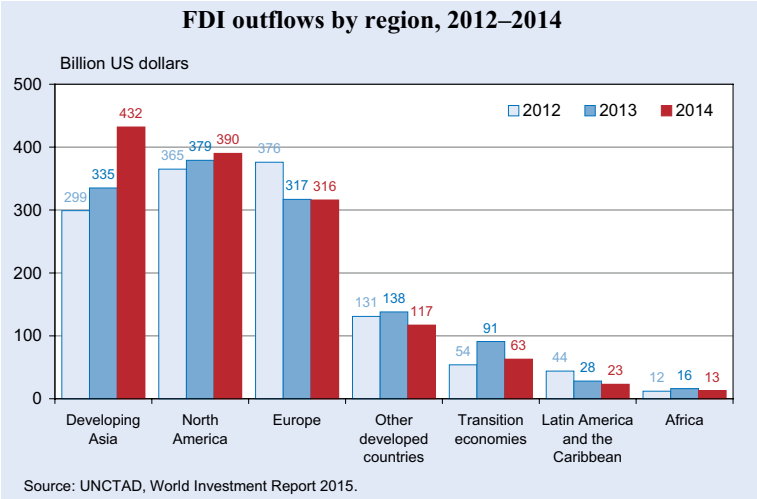
Outward investments by MNEs based in developing Asia increased by 29 percent to 432 billion US dollars in 2014. The growth was widespread, including all the major Asian economies and sub-regions. In East Asia,

Figure 3



Source: UNCTAD, World Investment Report 2015.

Figure 4



Source: UNCTAD, World Investment Report 2015.

investment by MNEs from Hong Kong (China) jumped to a historic high of 143 billion US dollars, making the economy the second largest investor after the United States. The remarkable growth was mainly due to booming cross-border M&A activity. Investment by Chinese MNEs grew faster than inflows into the country, reaching a new high of 116 billion US dollars. In South-East Asia, the increase was principally the result of growing outflows from Singapore, to 41 billion US dollars in 2014. In South Asia, FDI outflows from India reversed the slide of 2013, increasing fivefold to 10 billion US dollars in 2014, as large Indian MNEs resumed their international expansion. Investments by West Asian MNEs declined by 6 percent in 2014, owing to decreased flows from Kuwait, the region's largest overseas investor, with flows of 13 billion US dollars. Investments by Turkish MNEs almost doubled to 7 billion US dollars.

MNEs from Latin America and the Caribbean, excluding offshore financial centres, decreased their investment in 2014 by 18 percent to 23 billion US dollars. Outward flows from Mexican and Colombian MNEs fell by almost half to 5 billion US dollars and 4 billion US dollars, respectively. By contrast, investment by Chilean MNEs – the region's main direct investors abroad for the year – increased by 71 percent to 13 billion US dollars, boosted by a strong increase in intra-company loans. Brazilian MNEs continued to receive repayments of loans or to borrow from their foreign affiliates, resulting in negative FDI outflows from that country for the fourth consecutive year.

Outward investments made by MNEs in Africa decreased by 18 percent in 2014 to 13 billion US dollars. South African MNEs invested in telecommunications, mining and retail, while those from Nigeria focused largely on financial services. These two largest investors from Africa increased their investments abroad in 2014. Intra-African investments rose significantly during the year.

MNEs from transition economies decreased their investments abroad by 31 percent to 63 billion US dollars. Natural-resource-based MNEs, mainly from Russia, reduced investments in response to constraints in international financial markets, low commodity prices and the depreciation of the *rouble*.

Investments from MNEs based in developed economies were almost steady at 823 billion US dollars at the aggregate level, but this figure hides a large number of new investments and divestments that cancelled each other out.

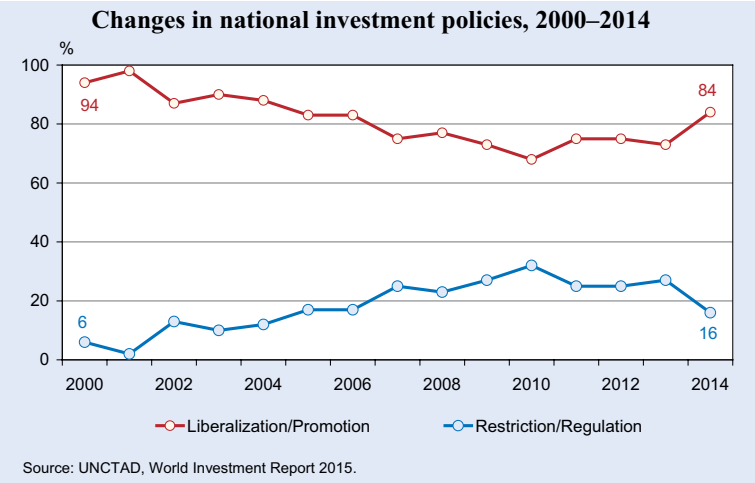
Outflows from European MNEs remained flat in 2014. A robust rise in investments by German and French MNEs was offset by the negative flows from MNEs in Britain and Luxembourg. Germany became the largest investing country in Europe. Vodafone's divestment of its stake in Verizon Wireless heavily dented outflows from Britain (down 45 billion US dollars to – 60 billion US dollars). Outflows from Luxembourg fell sharply (down from 35 billion US dollars to – 4 billion US dollars), primarily due to changes in intra-company loans.

In North America, active acquisitions of assets by Canadian MNEs increased Canada's outflows by 4 percent to 53 billion US dollars. FDI from the United States rose by 3 percent to 337 billion US dollars. Investment in and divestment from equity, and the withdrawal of intra-company loans cancelled each other out, so that US outward investment in 2014 effectively consisted only of reinvested earnings. FDI from Japan declined by 16 percent, ending a three-year phase of expansion. Although Japanese MNEs' investments into North America remained stable, they declined sharply in major recipient economies in Asia and Europe.

FDI policy developments

Countries' investment policy measures continue to be predominantly directed towards investment liberaliza-

Figure 5



tion, promotion and facilitation. Measures geared towards investment in sectors important for sustainable development are still relatively rare. In 2014, according to UNCTAD's count, 37 countries and economies adopted 63 policy measures affecting foreign investment. Of these measures, 47 related to the liberalization, promotion and facilitation of investment, while 9 introduced new restrictions or regulations on investment. The share of liberalization and promotion increased significantly, from 73 percent in 2013 to 84 percent in 2014 (Figure 5).

With the addition of 31 international investment agreements (IIAs), the IIA regime had grown to 3,271 treaties (2,926 BITs and 345 'other IIAs') by the end of 2014 (Figure 6). Most active in concluding IIAs in 2014 were Canada (seven), Colombia, Côte d'Ivoire, and the EU (three each). Overall, while the annual number of BITs continues to decline, a growing number of countries are engaged in IIA negotiations at regional and subregional levels. For example, the five ongoing efforts in the TPP, TTIP, RCEP, Tripartite and PACER Plus negotiations involve close to 100 countries.

2014 also saw the conclusion of 84 double taxation treaties (DTTs). These treaties govern the fiscal treatment of cross-border investment operations between host and home states. The network of DTTs and BITs grew together, and there are now over 3,000 DTTs in force worldwide. BIT and DTT networks largely overlap; with two thirds of BIT relationships also covered by a DTT.

An increasing number of countries and regions are reviewing their model IIAs in line with recent developments in international investment law. This trend is not limited to a specific group of countries or region, but involves countries in Africa (where 12 countries are reviewing their models), Europe and North America (10), Latin America (8), and Asia (7), and 6 economies in transition, as well as at least 4 regional organizations. South Africa and Indonesia continued their treaty terminations, while formulating new IIA strategies. Brazil, India and Indonesia revealed their novel approaches at the UNCTAD Expert Meeting on the Transformation of the IIA Regime, held in February 2015. This was followed by the EU (with a concept paper) and Norway (with a new model BIT) in May 2015. These new approaches converge in their attempt to modernize IIAs and further improve their sustainable development dimension. UNCTAD's Investment Policy Framework, which represents a new generation of investment policies, has been widely used as a main reference in the above processes.

In 2014, investors initiated 42 known ISDS cases pursuant to IIAs. Last year's developments brought the overall number of known ISDS claims to 608, lodged against

Figure 6

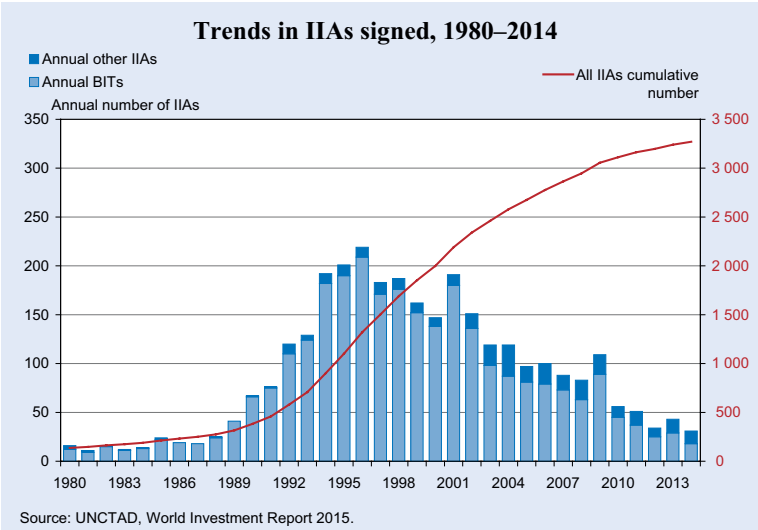


Table 1

Projections of FDI flows, by group of economies, billion US dollars and %

	Averages				Projections		
	2005–2007	**2009–2011**	**2013**	**2014**	**2015**	**2016**	**2017**
Global FDI flows	**1 397**	**1 359**	**1 467**	**1 228**	**1 368**	**1 484**	**1 724**
Developed economies	917	718	697	499	634	722	843
Developing economies	421	561	671	681	707	734	850
Transition economies	60	81	100	48	45	47	53
	Average growth rates		***Growth rates***		***Growth rate projections***		
Memorandum	***2005–2007***	***2009–2011***	***2013***	***2014***	***2015***	***2016***	***2017***
Global FDI flows	***40.1***	***3.1***	***4.6***	***– 16.3***	***11.4***	***8.4***	***16.2***
Developed economies	*48.2*	*3.0*	*2.7*	*– 28.4*	*23.8*	*13.9*	*16.7*
Developing economies	*26.1*	*4.8*	*5.0*	*1.6*	*3.3*	*3.9*	*15.8*
Transition economies	*48.0*	*– 1.1*	*17.0*	*– 51.7*	*– 2.3*	*5.3*	*12.3*

Note: Excludes Caribbean offshore financial centers.

Source: UNCTAD, World Investment Report 2015.

99 governments worldwide. 40 percent of new cases were lodged against developed countries. In 2014, the number of concluded cases reached 405. States won 36 percent of cases (144), and investors 27 percent (111). The remainder was either settled or discontinued.

Prospects

Although the outlook for FDI remains uncertain, an upturn in FDI flows is anticipated in 2015 and beyond. Global FDI flows are expected to reach 1.4 trillion US dollars in 2015 – an 11 percent rise. Flows are expected to increase further to 1.5 trillion US dollars and 1.7 trillion US dollars in 2016 and 2017, respectively (see Table 1).

Macroeconomic factors and firm-level factors are expected to influence flows positively. Indeed, the gradual improvement in macroeconomic conditions, especially in North America, and accommodating monetary policy, coupled with increased investment liberalization and promotion measures, are likely to improve the investment appetite of MNEs in 2015 and beyond. Global economic growth and gross fixed capital formation are expected to grow faster in 2015 and 2016 than in 2014.

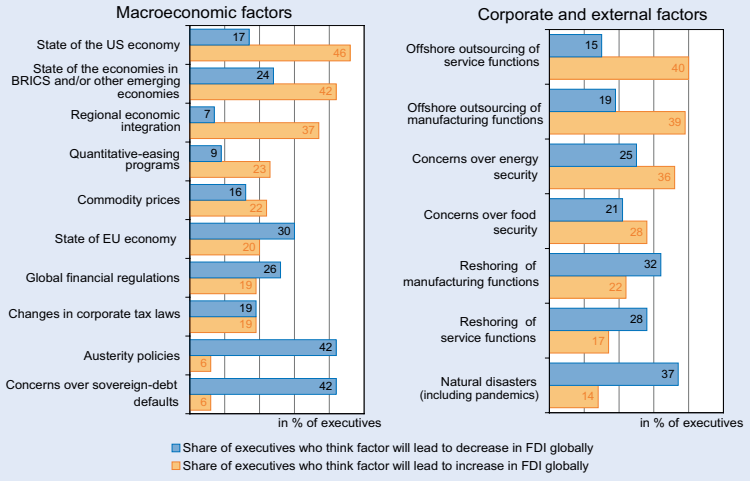
However, the FDI growth scenario could be upended by a multitude of economic and political risks, including ongoing uncertainties in the Eurozone, potential spillovers from geopolitical tensions, and persistent vulnerabilities in emerging economies.

According to UNCTAD's survey, carried out in collaboration with McKinsey & Company, of over 1,000 top managers in companies based in 89 countries, most executives expect an increase in global FDI activity in the years ahead. This positive outlook is explained by relatively good economic prospects in North America, the BRICS and other emerging economies, as well as regional integration processes and driven by corporate factors such as the expected continued offshoring of manufacturing and services functions.

Risk factors to the overall positive outlook listed by respondents include the risks of sovereign debt defaults, austerity policies and the state of the EU economy (Figure 7). They also include countertrends to

Figure 7

Factors influencing future global FDI activity



Source: UNCTAD, World Investment Report 2015.

the offshoring factors driving increased FDI, in the form of expected increases in the re-shoring of business functions.

FDI and the sustainable development challenge

Investing in the sustainable development goals

Faced with common global economic, social and environmental challenges, the international community is defining a set of Sustainable Development Goals (SDGs). The SDGs, which are being formulated by the United Nations together with the widest possible range of stakeholders, are intended to galvanize action worldwide through concrete targets for the 2015–2030 period for poverty reduction, food security, human health and education, climate change mitigation, and a range of other objectives across the economic, social and environmental pillars.

The role of the public sector is fundamental and pivotal, while the private sector contribution is indispensable. The latter can take two main forms, good governance in business practices and investment in sustainable development. Policy coherence is essential in promoting the private sector's contribution to the SDGs.

The SDGs will have very significant resource implications across the developed and developing world. Global investment needs are around 5 to 7 trillion US dollars per year. Estimates for investment needs in developing countries alone range from 3.3 to 4.5 trillion US dollars per year, mainly for basic infrastructure (roads, rail and ports; power stations; water and sanitation), food security (agriculture and rural development), climate change mitigation and adaptation, health, and education.

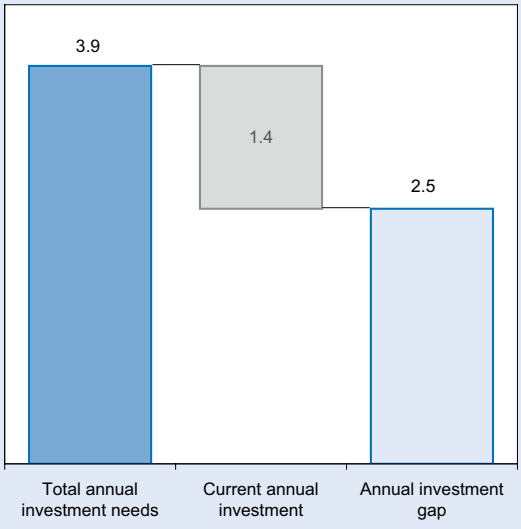
The SDGs will require a step-change in the levels of both public and private investment in all countries. At current levels of investment in SDG-relevant sectors, developing countries alone face an annual gap of 2.5 trillion US dollars (Figure 8). In developing countries, especially in least developed countries (LDCs) and other vulnerable economies, public finances are central to investment in SDGs. However, they cannot meet all SDG-implied resource demands. The role of private sector investment will be indispensable.

Today, the participation of the private sector in investment in SDG-related sectors is relatively low. Only a fraction of the assets invested worldwide of banks, pension funds, insurers, foundations and endowments, as well as transnational corporations, is in SDG sectors. Their participation is even lower in developing countries, particularly the poorest ones.

Figure 8

Estimated annual investment needs in key SDG sectors, 2015–2030

annual average in trillon US dollars



Source: UNCTAD, World Investment Report 2014.

In LDCs, a doubling of the growth rate of private investment would be a desirable target. Developing countries as a group could see the private sector cover approximately that part of SDG investment needs corresponding to its current share in investment in SDG sectors, based on current growth rates. In that scenario, however, they would still face an annual gap of about 1.6 trillion US dollars. In LDCs, where investment needs are most acute and where financing capacity is lowest, about twice the current growth rate of private investment is needed to give it a meaningful complementary financing role next to public investment and overseas development assistance (ODA).

Increasing the involvement of private investors in SDG-related sectors, many of which are sensitive or of a public service nature, leads to policy dilemmas. Policymakers need to find the right balance between creating a climate conducive to investment and removing barriers to investment on the one hand, and protecting public interests through regulation on the other. They need to find mechanisms for providing sufficiently attractive returns to private investors while guaranteeing accessibility and affordability of services for all. And the push for more private investment must

be complementary to the parallel push for more public investment.

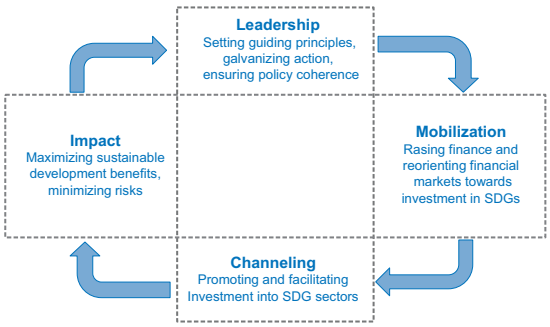
UNCTAD's proposed Strategic Framework for Private Investment in the SDGs addresses key policy challenges and options related to (i) guiding principles and global leadership to galvanize action for private investment, (ii) the mobilization of funds for investment in sustainable development, (iii) the channeling of funds into investments in SDG sectors, and (iv) maximizing the sustainable development impact of private investment while minimizing risks or drawbacks involved (Figure 9).

Increasing private investment in SDGs will require leadership at the global level, as well as from national policymakers, to provide guiding principles to deal with policy dilemmas; to set targets, recognizing the need to make a special effort for LDCs; to ensure policy coherence at national and global levels; to galvanize dialogue and action, including through appropriate multi-stakeholder platforms; and to guarantee inclusiveness, providing support to countries that otherwise might continue to be largely ignored by private investors.

Challenges to mobilizing funds in financial markets include start-up and scaling problems for innovative financing solutions, market failures, a lack of transparency on environmental, social and corporate governance performance, and misaligned rewards for market participants. Key constraints to channeling funds into SDG sectors include entry barriers, inadequate risk-return ratios for SDG investments, a lack of information and effective packaging and promotion of projects, and a lack of investor expertise. Key challenges in managing the impact of private investment in SDG sectors include the weak absorptive capacity in some developing countries, social and environmental impact risks, and the need for stakeholder engagement and effective impact monitoring.

Figure 9

Strategic framework for private investment in the SDGs



Source: UNCTAD, World Investment Report 2014.

UNCTAD's Action Plan for Private Investment in the SDGs presents a range of policy options to respond to the mobilization, channeling and impact challenges. A focused set of action packages can help shape a Big Push for private investment in sustainable development. The Action Plan focuses on:

- A new generation of investment promotion and facilitation,
- SDG-oriented investment incentives,
- Regional SDG Investment Compacts,
- New forms of partnership for SDG investments,
- Enabling innovative financing mechanisms and a reorientation of financial markets,
- Changing the business mindset and developing SDG investment expertise.

UNCTAD's Investment Policy Framework for Sustainable Development

Cross-border investment policy is made in a political and economic context that, at the global and regional levels, has been buffeted in recent years by a series of crises in finance, food security and the environment, and that faces persistent global imbalances and social challenges, especially with regard to poverty alleviation. These crises and challenges are having profound effects on the way policy is shaped at the global level. Firstly, current crises have accentuated a longer-term shift in economic weight from developed countries to emerging markets. Secondly, the financial crisis in particular has boosted the role of governments in the economy, in both the developed and the developing world. Thirdly, the nature of the challenges, which no country can address in isolation, makes better international coordination imperative. And fourthly, the global political and economic context and the challenges that need to be addressed – with social and environmental concerns taking center stage – are leading policymakers to reflect on an emerging new development paradigm that places inclusive and sustainable development goals on the same footing as economic growth. At a time of such persistent crises and pressing social and environmental challenges, mobilizing investment and ensuring that it contributes to sustainable development objectives is a priority for all countries.

Against this background, a new generation of foreign investment policies is emerging, with governments

Table 2

Core Principles for investment policymaking for sustainable development

Area	Core Principles
1. Investment for sustainable development	• The overarching objective of investment policymaking is to promote investment for inclusive growth and sustainable development.
2. Policy coherence	• Investment policies should be grounded in a country's overall development strategy. All policies that impact on investment should be coherent and synergetic at both the national and international levels.
3. Public governance and institutions	• Investment policies should be developed involving all stakeholders, and embedded in an institutional framework based on the rule of law that adheres to high standards of public governance and ensures predictable, efficient and transparent procedures for investors.
4. Dynamic policymaking	• Investment policies should be regularly reviewed for effectiveness and relevance and adapted to changing development dynamics.
5. Balanced rights and obligations	• Investment policies should be balanced in setting out rights and obligations of States and investors in the interest of development for all.
6. Right to regulate	• Each country has the sovereign right to establish entry and operational conditions for foreign investment, subject to international commitments, in the interest of the public good and to minimize potential negative effects.
7. Openness to investment	• In line with each country's development strategy, investment policy should establish open, stable and predictable entry conditions for investment.
8. Investment protection and treatment	• Investment policies should provide adequate protection to established investors. The treatment of established investors should be non-discriminatory.
9. Investment promotion and facilitation	• Policies for investment promotion and facilitation should be aligned with sustainable development goals and designed to minimize the risk of harmful competition for investment.
10. Corporate governance and responsibility	• Investment policies should promote and facilitate the adoption of and compliance with best international practices of corporate social responsibility and good corporate governance.
11. International cooperation	• The international community should cooperate to address shared investment-for-development policy challenges, particularly in least developed countries. Collective efforts should also be made to avoid investment protectionism.

Source: UNCTAD, World Investment Report 2012.

pursuing a broader and more intricate development policy agenda, while building or maintaining a generally favourable investment climate. This new generation of investment policies has been in the making for some time and is reflected in the dichotomy in policy directions over the last few years – with simultaneous moves to further liberalize investment regimes and promote foreign investment, on the one hand, and to regulate investment in pursuit of public policy objectives, on the other. It reflects the recognition that liberalization, if it is to generate sustainable development outcomes, has to be accompanied – if not preceded – by the establishment of proper regulatory and institutional frameworks.

'New generation' investment policies place inclusive growth and sustainable development at the heart of efforts to attract and benefit from investment. Although these concepts are not new in and by themselves, they have not been systematically integrated in mainstream investment policymaking to date. 'New generation' investment policies aim to operationalize sustainable development in concrete measures and mechanisms at the national and international levels, and at the level

of policymaking and implementation. Broadly, 'new generation' investment policies strive to:

- Create synergies with wider economic development goals or industrial policies, and achieve seamless integration in development strategies;
- Foster responsible investor behaviour and incorporate principles of CSR;
- Ensure policy effectiveness in their design and implementation and in the institutional environment within which they operate.

In this context, UNCTAD has developed a comprehensive Investment Policy Framework for Sustainable Development (IPFSD), consisting of (i) a set of Core Principles for foreign investment policymaking, (ii) guidelines for investment policies at the national level, and (iii) options for the design and use of IIAs. The IPFSD has been updated in the summer of 2015 and will be published on UNCTAD's Investment Policy Hub website (http://investmentpolicyhub.unctad.org/ipfsd).

The Core Principles for investment policymaking aim to guide the development of national and international investment policies. To this end, they translate the policy challenges into a set of 'design criteria' for investment policies (Table 2). Overall, they aim to mainstream sustainable development in investment policymaking, while confirming the basic principles of sound development oriented investment policies, in a balanced approach.

The Core Principles are not a set of rules *per se.* They are an integral part of the IPFSD, which attempts to convert them, collectively and individually, into concrete guidance for national investment policymakers and options for negotiators of IIAs. As such, they do not always follow the traditional policy areas of a national investment policy framework, nor the usual articles of IIAs. The overarching concept behind the principles is sustainable development; the principles should be read as a package, because interaction between them is fundamental to the IPFSD's balanced approach.

The IPFSD's national investment policy guidelines translate the Core Principles for investment policymaking into numerous concrete and detailed guidelines that aim to address the 'new generation' challenges for policymakers at the domestic level. While national investment policymakers address these challenges through rules, regulations, institutions and initiatives, at the international policy level this is done through a complex web of IIAs (including, principally, BITs, FTAs with investment provisions, economic partnership agreements and regional integration agreements).

UNCTAD's IPFSD comes at a time when the development community is looking for a new development paradigm, of which cross-border investment is an essential part; when most countries are reviewing and adjusting their regulatory frameworks for such investment; when regional groupings are intensifying their cooperation in terms of investment; and when policymakers and experts are seeking ways and means to factor sustainable development and inclusive growth into national investment regulations and international negotiations.

The IPFSD may serve as a key point of reference for policymakers in formulating national investment policies and in negotiating or reviewing IIAs. It may also serve as a reference for policymakers in areas as diverse as trade, competition, industrial policy, environmental policy or any other field where investment plays an important role. The IPFSD can also serve as the basis for capacity-building on investment policy. And it may come to act as a point of convergence for international cooperation on investment issues.