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World Investment Report 2018: Key Messages and Overview

Prepared by UNCTAD

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

WORLD INVESTMENT REPORT 2018

INVESTMENT AND NEW INDUSTRIAL POLICIES

KEY MESSAGES AND OVERVIEW

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UNITED NATIONS
New York and Geneva, 2018

NOTE

The UNCTAD Investment and Enterprise Division is the focal point in the United Nations System for investment and enterprise development. As a global centre of excellence, the Division conducts leading-edge research and policy analysis, provides technical assistance to 160 member States and regional groupings, and builds international consensus among the 196 member States of the organization. Its mission is to promote investment and enterprise for sustainable and inclusive development.

The Division provides, among others,

Two flagship products:

World Investment Report

World Investment Forum

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Investment Policy Framework for Sustainable Development

Action Plan for Investing in the SDGs

Entrepreneurship Policy Framework

Reform Package for the International Investment Regime

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Responsible investment

Business facilitation

Entrepreneurship development

Accounting and reporting

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The Overview is prepared based on the in-depth analysis contained in *World Investment Report 2018: Investment and New Industrial Policies* (United Nations publication, Sales No. E.18.II.D.4).

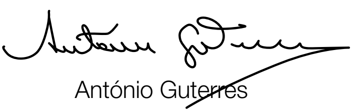
UNCTAD/WIR/2018 (Overview)

PREFACE

Global flows of foreign direct investment fell by 23 per cent in 2017. Cross-border investment in developed and transition economies dropped sharply, while growth was near zero in developing economies. With only a very modest recovery predicted for 2018, this negative trend is a long-term concern for policymakers worldwide, especially for developing countries, where international investment is indispensable for sustainable industrial development.

This troubling global investment picture underscores the importance of a conducive global investment environment, characterized by open, transparent and non-discriminatory investment policies. The theme chapter of the report shows that over 100 countries have adopted industrial development strategies in recent years. New types of industrial policies have emerged, responding to the opportunities and challenges associated with a new industrial revolution. The report presents options for investment policy tools in this new environment.

I commend this year's *World Investment Report* as a timely contribution to an important debate in the international investment and development community.



António Guterres
Secretary-General of the United Nations

FOREWORD

We are at the dawn of a fourth industrial revolution, propelled by frontier technologies and robotization advances that make production better, cheaper and faster than ever before. This new industrial revolution offers enormous opportunities for economic growth and sustainable development with potential benefits on a scale that is difficult to imagine. New technologies promise possibilities of industrial upgrading and leapfrogging. Cheaper transportation and communication, coupled with more efficient logistics, can also help developing countries better link to global value chains. Some of the most advanced emerging economies are already on the verge of becoming global technological leaders in a number of industries.

Yet, the new economic age and the accelerating pace of technological innovation could also result in serious economic disruption and more inequality. Existing investment patterns, for instance, might go through profound and far-reaching changes, in terms of both flows and content. Last year's *World Investment Report* highlighted the emerging structural impact of the digital economy on foreign direct investment.

In this context, developing countries, and least developed countries in particular, face considerable challenges. They range from structural constraints, such as the lack of adequate infrastructure and scarce access to finance, to strategic issues. Offshoring and relocation towards destinations offering cheaper domestic labour become less relevant in a world of increasingly automated manufacturing. At the same time, improving living conditions requires creating jobs, which in turn still relies heavily on manufacturing. Developing countries with small markets face additional pressure on their investment policies as companies increasingly look for investment locations offering the best conditions to deliver new and high-quality products rapidly, close to the customer and through flexible production processes.

Challenges are particularly pronounced in Africa. Despite a period of strong economic growth, the level of economic transformation has been low. The share of manufacturing in the GDP of African countries is small, and it has further declined or stagnated over the past decade. However, manufacturing has the potential of creating a large number of jobs in the formal sector and therefore raising living conditions.

Confronted with an altering global economic landscape and deep structural reconfiguration, governments around the globe have invigorated their industrial policies in recent years. There is a growing consensus that structural transformation does not occur by itself, but rather requires a proactive policy that facilitates a transition towards new sectors and activities with higher productivity and more value added, while fostering sustainable and inclusive development.

As they pursue multifaceted objectives, new industrial policies have become more complex and intertwined, wielding multiple instruments, from trade to education. Central to these industrial policies is foreign investment. Investment builds and upgrades industries. It connects to international markets. It also drives essential innovation and competitiveness. All in all, the current debate is less about whether governments should intervene, but rather how.

Industrial policies and accompanying investment policies need to revolve around a clearly articulated vision but, at the same time, they have to contain practical and detailed recommendations, a clear timeline for action and a division of responsibilities among the public and private sectors.

Against this background, the *World Investment Report 2018* aims to provide a better understanding of the interaction between new industrial policies and investment policies. It provides an overview of industrial policy models – based on an inventory of industrial policies adopted by more than 100 countries over the last decade – and the role of investment policies within each model. The Report illustrates how investment policy instruments are used differently across various models and suggests ways to improve the impact of industrial policy through more effective and efficient investment policies. Finally, the Report offers recommendations to update existing investment policy instruments, including investment incentives, special economic zones, investment facilitation and foreign investment screening mechanisms.

Building from this Report, UNCTAD will host a discussion of the interface between industrial and investment policies at its 6th World Investment Forum, which will take place in Geneva on 22–26 October 2018.

Together, let us work towards finding solutions to ensure that economic change does not create new hardships, but benefits that are widely shared and lead to a better life for all.

Mukhisa Kituyi
Secretary-General of UNCTAD

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INVESTMENT TRENDS AND PROSPECTS

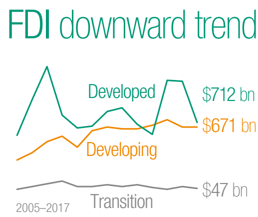
Global foreign direct investment (FDI) flows fell by 23 per cent to $1.43 trillion. This is in stark contrast to the accelerated growth in GDP and trade. The fall was caused in part by a 22 per cent decrease in the value of cross-border mergers and acquisitions (M&As). But even discounting the large one-off deals and corporate restructurings that inflated FDI numbers in 2016, the 2017 decline remained significant. The value of announced greenfield investment – an indicator of future trends – also decreased by 14 per cent.

FDI flows to developing economies remained stable at $671 billion, seeing no recovery following the 10 per cent drop in 2016.

- FDI flows to Africa continued to slide, reaching $42 billion, down 21 per cent from 2016. The decline was concentrated in the larger commodity exporters.
- Flows to developing Asia remained stable, at $476 billion. The region regained its position as the largest FDI recipient in the world.
- FDI to Latin America and the Caribbean rose 8 per cent to reach $151 billion, lifted by that region's economic recovery. This was the first rise in six years, but inflows remain well below the 2011 peak during the commodities boom.
- FDI in structurally weak and vulnerable economies remained fragile. Flows to the least developed countries fell by 17 per cent, to $26 billion. Those to landlocked developing countries increased moderately, by 3 per cent, to $23 billion. Small island developing States saw their inflows increase by 4 per cent, to $4.1 billion.

Inward FDI flows to developed economies fell sharply, by 37 per cent, to $712 billion. Cross-border M&As registered a 29 per cent decrease, with fewer of the megadeals and corporate restructurings that shaped global investment patterns in 2016. The strong decrease in inflows was in large part the effect of a return to prior levels in the United Kingdom and the United States, after spikes in 2016.

FDI flows to transition economies declined by 27 per cent, to $47 billion, the second lowest level since 2005. The decline reflects geopolitical uncertainties and sluggish investment in natural resources.



Projections for global FDI in 2018 show fragile growth. Global flows are forecast to increase marginally, by up to 10 per cent, but remain below the average over the past 10 years. Higher economic growth projections, trade volumes and commodity prices would normally point to a larger potential increase in global FDI in 2018. However, risks are significant, and policy uncertainty abounds. Escalation and broadening of trade tensions could negatively affect investment in global value chains (GVCs). In addition, tax reforms in the United States and greater tax competition are likely to significantly affect global investment patterns.

A decrease in rates of return is a contributor to the investment downturn. The global average return on foreign investment is now at 6.7 per cent, down from 8.1 per cent in 2012. Return on investment is in decline across all regions, with the sharpest drops in Africa and in Latin America and the Caribbean. The lower returns on foreign assets may affect longer-term FDI prospects.

FDI activity was lower across all sectors. M&A values were down in the primary, manufacturing and services sectors. The fall in greenfield announcements in 2017 was concentrated in services. However, over the past five years, the level of greenfield projects in manufacturing has been consistently lower than in the preceding five-year period across all developing regions. This has important implications for industrial development.

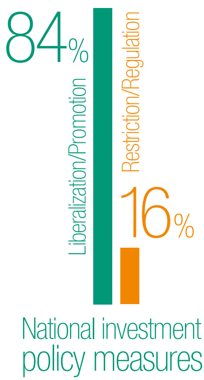
The sharp fall in global FDI contrasted with the trend in other cross-border capital flows. Total capital flows increased from 5.6 to 6.9 per cent of GDP, as bank lending and portfolio investment compensated for the FDI slump. Capital flows to developing countries increased modestly, from 4.0 to 4.8 per cent of GDP.

FDI remains the largest external source of finance for developing economies. It makes up 39 per cent of total incoming finance in developing economies as a group, but less than a quarter in the LDCs, with a declining trend since 2012.

The rate of expansion of international production is slowing down. The modalities of international production and of cross-border exchanges of factors of production are gradually shifting from tangible to intangible forms. Sales of foreign affiliates continue to grow but assets and employees are increasing at a slower rate. This could negatively affect the prospects for developing countries to attract investment in productive capacity.

Growth in GVCs has stagnated. Foreign value added in global trade (i.e., the imported goods and services incorporated in countries' exports) peaked in 2010–2012 after two decades of continuous increases. UNCTAD's GVC data shows foreign value added down 1 percentage point to 30 per cent of trade in 2017. Growth in GVC participation decreased significantly this decade compared with the last, across all regions, developed and developing. The GVC slowdown shows a clear correlation with the FDI trend and confirms the impact of the FDI trend on global trade patterns.

MNEs in the global Top 100 and the developing-economy Top 100 are leading the way towards more gender-balanced boardrooms, although they have a distance to go. On average 22 per cent of board members of the Top 100s are women, better than both the S&P average and national averages.



INVESTMENT POLICY DEVELOPMENTS

Many countries continued policy efforts aimed at attracting FDI. In 2017, 65 countries and economies adopted at least 126 investment policy measures, of which 84 per cent were favourable to investors. They liberalized entry conditions in a number of industries including transport, energy and manufacturing. They also promoted and facilitated investment by simplifying administrative procedures, providing incentives and establishing new special economic zones (SEZs).

Recently, an increasing number of countries have taken a more critical stance towards foreign investment. New investment restrictions or regulations in 2017 mainly reflected concerns about national security and foreign ownership of land and natural resources. Some countries have heightened scrutiny of foreign takeovers, in particular of strategic assets and technology firms. Several countries are considering tightening investment screening procedures.

+18
in 2017
Total IIAs
3 322

Investment treaty making has reached a turning point. The number of new international investment agreements (IIAs) concluded in 2017 (18) was the lowest since 1983. Moreover, for the first time, the number of effective treaty terminations outpaced the number of new IIAs. In contrast, negotiations for megaregional agreements maintained momentum, especially in Africa and Asia.

The number of new investor–State dispute settlement (ISDS) claims remains high. In 2017, at least 65 new treaty-based ISDS cases were initiated, bringing the total number of known cases to 855. By the end of 2017, investors had won about 60 per cent of all cases that were decided on the merits.

IIA reform is well under way across all regions. Since 2012, over 150 countries have taken steps to formulate a new generation of sustainable development-oriented IIAs. For example, some have reviewed their treaty networks and revised their treaty models in line with UNCTAD's Reform Package for the International Investment Regime.

65 New
ISDS cases

Countries are also beginning to modernize the existing stock of old-generation treaties. An increasing number of countries are, for example, issuing interpretations or replacing their older agreements. Countries have also been engaging in multilateral reform discussions, including with regard to ISDS.

After improving the approach to new treaties and modernizing existing treaties, the last step in the reform process (Phase 3) is to ensure coherence with national investment policies and with other bodies of international law. Striving for coherence does not necessarily imply legal uniformity – inconsistencies and divergence may be intended – but different policy areas and legal instruments should work in synergy.

INVESTMENT AND NEW INDUSTRIAL POLICY

Industrial policies have become ubiquitous. UNCTAD's global survey of industrial policies shows that, over the past 10 years, at least 101 economies across the developed and developing world (accounting for more than 90 per cent of global GDP) have adopted formal industrial development strategies. The last five years have seen an acceleration in the formulation of new strategies.

The survey shows that modern industrial policies are increasingly diverse and complex, addressing new themes and including myriad objectives beyond conventional industrial development and structural transformation, such as GVC integration and upgrading, development of the knowledge economy, build-up of sectors linked to sustainable development goals and competitive positioning for the new industrial revolution (NIR).

UNCTAD's survey groups industrial policies into three categories: build-up, catch-up and NIR-based strategies. Some 40 per cent of industrial development strategies contain vertical policies for the build-up of specific industries. Just over a third focus on horizontal competitiveness-enhancing policies designed to catch up to the productivity frontier. And a quarter focus on positioning for the new industrial revolution.

About 90 per cent of modern industrial policies stipulate detailed investment policy tools, mainly incentives and performance requirements, SEZs, investment promotion and facilitation and, increasingly, investment screening mechanisms. Investment policy packages across the three models use similar investment policy instruments with different focus and intensity.

Modern industrial policies are thus a key driver of investment policy trends. In fact, more than 80 per cent of investment policy measures recorded since 2010 are directed at the industrial system (manufacturing, complementary services and industrial infrastructure), and about half of these clearly serve an industrial policy purpose. Most are cross-industry; about 10 per cent target specific manufacturing industries.

Incentives remain the tool most commonly used for industrial policy. Significant progress has been made in making incentives more effective instruments for industrial development. About two-thirds of incentives schemes applicable to manufacturing target multiple or specific industries, and even horizontal schemes tend to focus on defined activities, such as research and development (R&D), or on other industrial development contributions. Performance requirements (mostly conditions attached to incentives) are also widely used to maximize MNE contributions to industrial development, but much of their functionality could be achieved by better designed, cost-based incentive mechanisms.

Industrial policy
packages

Strategies and
measures

SEZs continue to proliferate and diversify. In most countries, the transition from pure export processing zones to value added zones continues, and new types of zones are still emerging. Targeted strategies to attract specific industries and link multiple zones have supported industrial development and GVC integration in some countries that have adopted build-up and catch-up industrial policies, although enclave risks remain. High-tech zones or industrial parks are also becoming a key tool for NIR-driven industrial policies.

Modern industrial policies have boosted investment facilitation efforts, which until recently played a secondary role in investment policy frameworks. Many developing countries have made investment facilitation one of the key horizontal measures in industrial development strategies. Targeted investment promotion (beyond incentives and SEZs) also remains important: two-thirds of investment promotion agencies (IPAs) are guided by industrial policies in defining priority sectors for investment promotion, and three-quarters have specific promotional schemes to upgrade technology in industry.

Investment
Policy Tools

Investment screening procedures are becoming more common. Manufacturing sectors are rarely affected by outright foreign ownership restrictions except in highly sensitive industries. However, restrictions remain common in some infrastructure and services sectors that are relevant for industrial development. Most measures adopted over the past decade have removed or relaxed foreign ownership restrictions, but entry rules – or rather procedures – have been tightened in some cases through new screening processes or requirements.

In summary, investment policies (in particular FDI policies) are a key instrument of industrial policies. Different industrial policy models imply a different investment policy mix. Build-up, catch-up and NIR-based industrial policies emphasize different investment policy tools and focus on different sectors, economic activities and mechanisms to maximize the contribution of investment to the development of industrial capabilities. The investment policy toolkit thus evolves with industrial policy models and stages of development.

Modern industrial policies, be they of the build-up, catch-up or NIR-driven variety, tend to follow a number of design criteria that distinguish them from previous generations of industrial policies. These include openness, sustainability, NIR readiness and inclusiveness. *Investment policy choices should be guided by these design criteria, and by the need for policy coherence, flexibility and effectiveness.*

In line with these developments, countries need to ensure that their investment policy instruments are up-to-date, including by re-orienting investment incentives, modernizing SEZs, retooling investment promotion and facilitation, and crafting smart mechanisms for screening foreign investment. The new industrial revolution, in particular, requires a strategic review of investment policies for industrial development.

For modern industrial policies to contribute to a sustainable development strategy, policymakers need to enhance their coherence and synergy with national and international investment policies and other policy areas, including social and environmental policies. They need to strike a balance between the role of the market and the State, and avoid overregulation. They also need to adopt a collaborative approach, open to international productive-capacity cooperation, and avoid beggar-thy-neighbor outcomes.

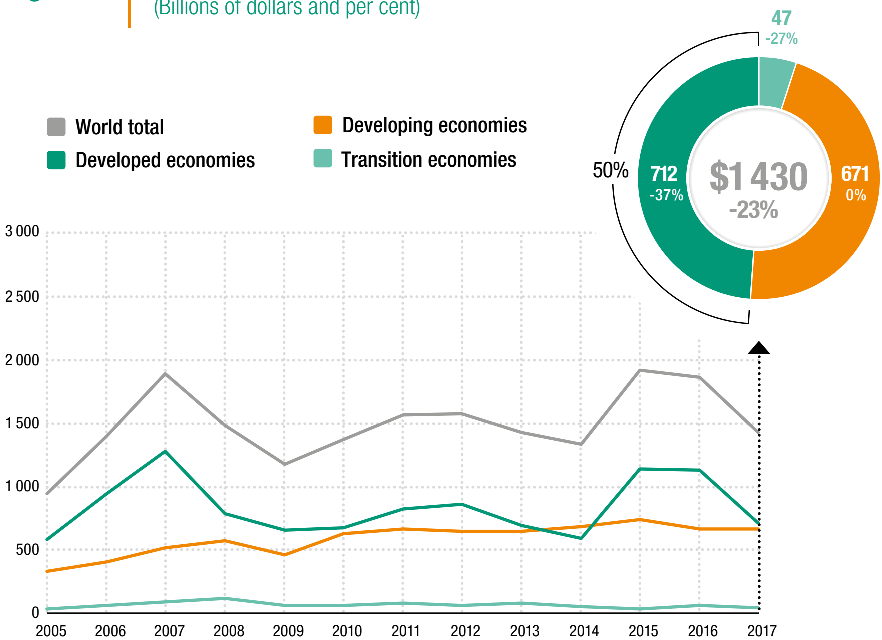
OVERVIEW

GLOBAL TRENDS AND PROSPECTS

Global FDI flows fell sharply in 2017

Global foreign direct investment (FDI) flows fell by 23 per cent in 2017, to $1.43 trillion from $1.87 trillion in 2016 (figure 1). The decline is in stark contrast to other macroeconomic variables, such as GDP and trade, which saw substantial improvement in 2017. The fall was caused in part by a 22 per cent decrease in the value of net cross-border mergers and acquisitions (M&As). But even discounting the large one-off deals and corporate reconfigurations that inflated FDI in 2016, the 2017 decline remained significant. The value of announced greenfield investment – an indicator of future trends – also fell by 14 per cent, to $720 billion.

Figure 1. **FDI inflows, global and by group of economies, 2005–2017**
(Billions of dollars and per cent)



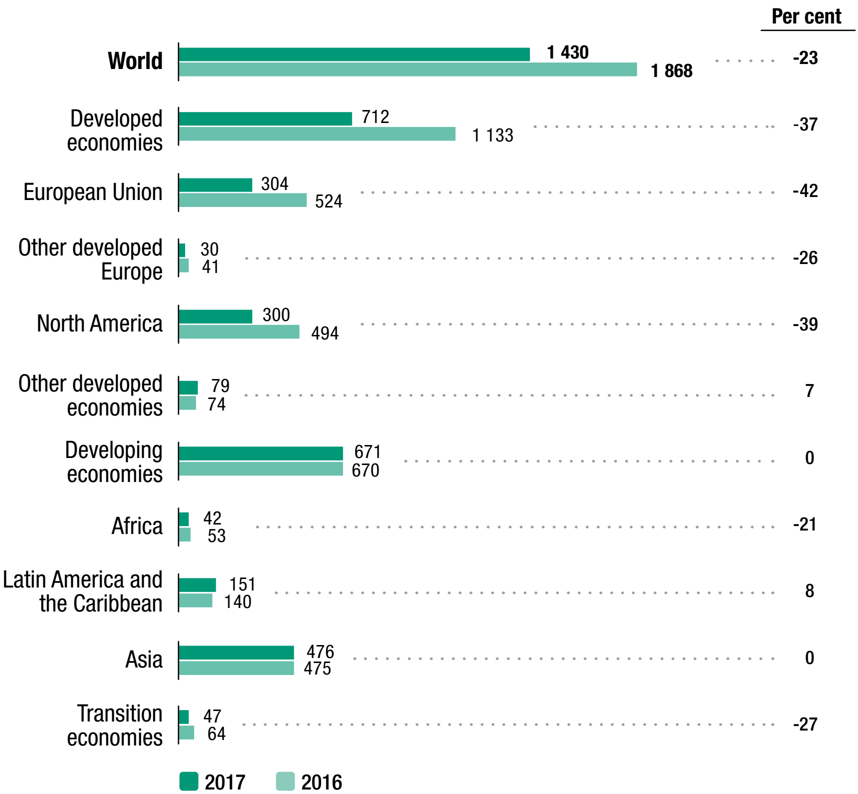
Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

The fall was concentrated in developed economies

FDI flows fell in developed economies and economies in transition while those to developing economies remained stable. As a result, developing economies accounted for a growing share of global FDI inflows in 2017, absorbing 47 per cent of the total, compared with 36 per cent in 2016.

Flows to developed economies dropped by more than one-third, to $712 billion (figure 2). The fall can be explained in large part by a decline from high inflows in the preceding year caused by cross-border M&As and corporate reconfigurations. A significant reduction in the value of such transactions resulted in a decline of 40 per cent in flows in the United States to $275 billion,

Figure 2. FDI inflows, by region, 2016–2017 (Billions of dollars and per cent)



Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

and 92 per cent in the United Kingdom to $15 billion. Reinvested earnings rose by 26 per cent, buoyed by United States MNEs in anticipation of tax relief on the repatriation of funds.

FDI inflows to developing economies remained close to their 2016 level, at $671 billion, showing no signs of recovery after the 10 per cent decline in 2016. FDI flows to Africa continued to slide, flows to developing Asia remained stable, and flows to Latin America and the Caribbean increased moderately.

FDI flows to transition economies in South-East Europe and the Commonwealth of Independent States (CIS) declined by 27 per cent in 2017, to $47 billion, the second lowest level since 2005.

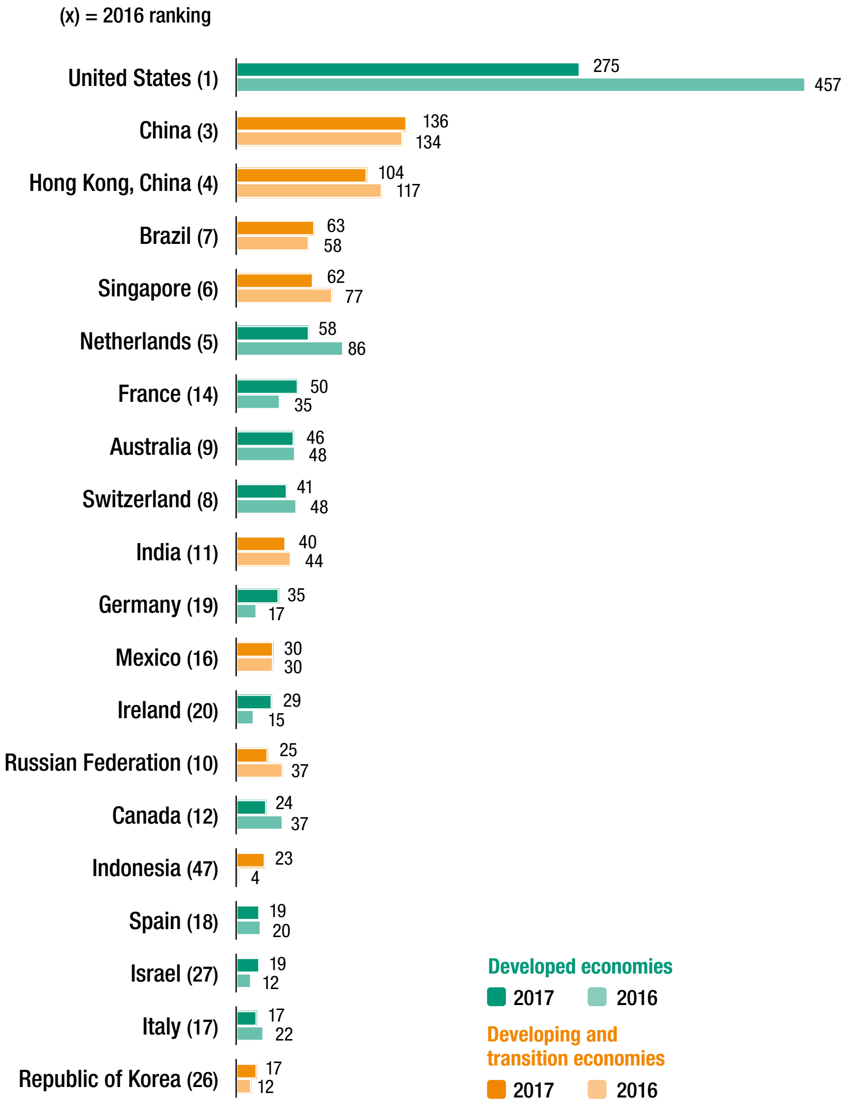
Half of the top 10 host economies are developing economies (figure 3). The United States remained the largest recipient of FDI, attracting $275 billion in inflows, followed by China, with record inflows of $136 billion, despite an initial slowdown in the first half of 2017. France, Germany and Indonesia made significant upward jumps in the list.

The top outward investors are still mostly developed economies (figure 4). MNEs from those countries reduced their overseas investment activity only marginally. The flow of outward investment from developed economies declined by 3 per cent to $1 trillion in 2017. Their share of global outward FDI flows was unchanged at 71 per cent. Flows from developing economies fell 6 per cent to $381 billion, mainly because outflows from China declined for the first time in 15 years (down 36 per cent to $125 billion) as a result of restrictive policies in reaction to significant capital outflows during 2015–2016. Outflows from transition economies rose 59 per cent to $40 billion.

Returns on FDI are in decline across all regions

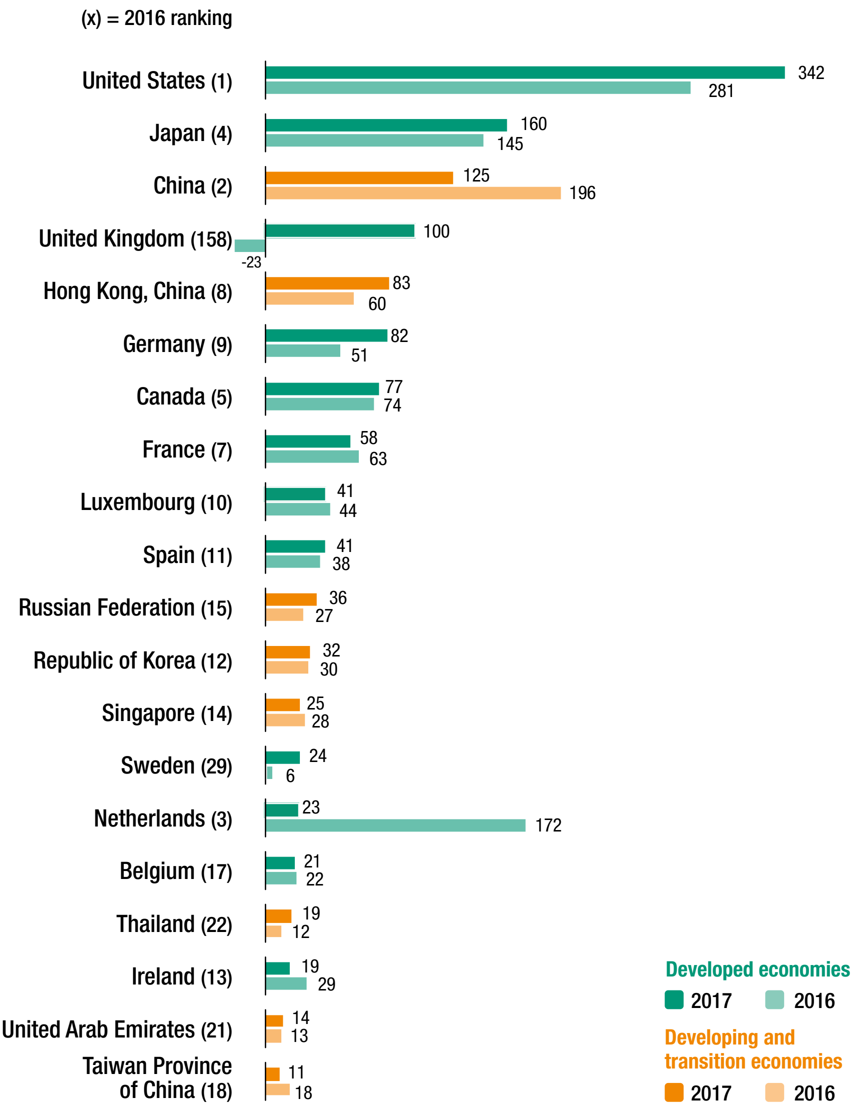
The negative FDI trend was caused by several factors. Asset-light forms of overseas operations are causing a structural shift in FDI patterns (see *WIR17*). Another major factor is a significant decline in rates of return on FDI over the past five years. In 2017, the global rate of return on inward FDI was down to 6.7 per cent (table 1). Although rates of return remain higher on average in developing and transition economies, most regions have not escaped the erosion. In Africa, for instance, return on investment dropped from 12.3 per cent in 2012 to 6.3 per cent in 2017. Because the decline is especially strong in regions that depend on commodity-related FDI, it can be partly explained by the fall in commodity prices during the period.

Figure 3. **FDI inflows, top 20 host economies, 2016 and 2017**
(Billions of dollars)



Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

Figure 4. **FDI outflows, top 20 home economies, 2016 and 2017**
(Billions of dollars)



Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

Table 1. Inward FDI rates of return, 2012–2017 (Per cent)

Region	2012	2013	2014	2015	2016	2017
World	**8.1**	**7.8**	**7.9**	**6.8**	**7.0**	**6.7**
Developed economies	**6.7**	**6.3**	**6.6**	**5.7**	**6.2**	**5.7**
Developing economies	**10.0**	**9.8**	**9.5**	**8.5**	**8.1**	**8.0**
Africa	12.3	12.4	10.6	7.1	5.4	6.3
Asia	10.5	10.8	10.6	9.9	9.5	9.1
East and South-East Asia	11.5	11.8	11.7	11.0	10.3	10.1
South Asia	7.2	6.7	6.1	5.5	6.4	5.7
West Asia	5.5	5.4	4.9	4.6	4.6	3.4
Latin America and the Caribbean	7.9	6.7	6.6	5.2	5.3	5.6
Transition economies	**14.4**	**13.9**	**14.6**	**10.2**	**11.1**	**11.8**

Source: UNCTAD based on data from IMF Balance of Payments database.

But the widespread nature of the decline suggests that structural factors, mainly reduced fiscal and labour-cost arbitrage opportunities in international operations, are also at work.

Greenfield is down, and manufacturing in a multiyear slowdown

FDI activity was lower across all sectors. M&A values were down in the primary, manufacturing and services sectors. Greenfield project announcements also fell, by 14 per cent, to $720 billion. Although the 2017 decline was concentrated in services and investment project activity picked up in some manufacturing industries, such as chemical products and electronics, overall greenfield announcements in the manufacturing sector remained relatively depressed from a longer-term perspective. Investment project activity in manufacturing has been consistently lower during 2013–2017 than during the previous five-year period across Africa, Latin America and the Caribbean, and developing Asia. This could have important implications for FDI-supported industrial development.

The FDI slump affects the largest source of finance for developing economies

The sharp fall in global FDI contrasted with the trend in other cross-border capital flows. Total capital flows increased from 5.6 to 6.9 per cent of global GDP, as bank lending and portfolio investment (mostly debt) flows compensated for the FDI slump. Capital flows to developing economies increased more modestly, from 4.0 to 4.8 per cent of GDP, because they rely relatively more on FDI.

Developing countries can draw on a range of external sources of finance, including FDI, portfolio equity, long-term and short-term loans (private and public), official development assistance, remittances and other official flows. FDI has been the largest source of external finance for developing economies over the past decade, and the most resilient to economic and financial shocks. It makes up 39 per cent of total incoming finance in developing economies as a group, but less than a quarter in the least developed countries (LDCs). Moreover, FDI in LDCs is showing a downward trend, with a 17 per cent fall in 2017, the second consecutive year of decline.

International production and GVCs are slowing down

International production is still expanding, but the rate of expansion is slowing and the modalities of cross-border transactions and exchanges of goods, services and factors of production are shifting (table 2). The average annual growth rates over the past five years of foreign affiliates' sales (1.5 per cent), value added (1.5 per cent) and employment (2.5 per cent) were all lower than during the equivalent period before 2010 (at 9.7, 10.7 and 7.6 per cent, respectively). This is in line with the loss of growth momentum in the longer-term FDI trend.

Sales of foreign affiliates are growing at twice the rate of assets and employees, in a continuation of the asset-light international production trend described in *WIR17*. The average annual growth rates over the past five years of royalties and licensing fee receipts (almost 5 per cent) compared to trade in goods and FDI (less than 1 per cent) show how international production is shifting from tangible cross-border production networks to intangible value chains. This could negatively affect the prospects for developing countries to attract investment in productive capacity.

Growth in global value chains (GVCs) has also stagnated. Foreign value added (FVA) in trade – the imported goods and services incorporated in a

Table 2. Selected indicators of FDI and international production, 2017 and selected years

Item	Value at current prices (Billions of dollars)				
	1990	2005–2007 (pre-crisis average)	2015	2016	2017
FDI inflows	205	1 415	1 921	1 868	1 430
FDI outflows	244	1 452	1 622	1 473	1 430
FDI inward stock	2 196	14 487	25 665	27 663	31 524
FDI outward stock	2 255	15 188	25 514	26 826	30 838
Income on inward FDI	82	1 027	1 461	1 564	1 581
Rate of return on inward FDI	*5.4*	*9.2*	*6.8*	*7.0*	*6.7*
Income on outward FDI	128	1 101	1 394	1 387	1 553
Rate of return on outward FDI	*7.8*	*9.5*	*6.1*	*5.8*	*6.2*
Net cross-border M&As	98	729	735	887	694
Sales of foreign affiliates	6 755	24 217	27 559	29 057	30 823
Value added (product) of foreign affiliates	1 264	5 264	6 457	6 950	7 317
Total assets of foreign affiliates	5 871	54 791	94 781	98 758	103 429
Employment by foreign affiliates (thousands)	27 034	57 392	69 683	71 157	73 209
Memorandum					
GDP	23 433	52 383	74 407	75 463	79 841
Gross fixed capital formation	5 812	12 426	18 561	18 616	19 764
Royalties and licence fee receipts	31	174	299	312	333
Exports of goods and services	4 414	14 957	20 953	20 555	22 558

Source: UNCTAD.

country's exports, and a key measure of the importance of GVCs – appears to have peaked in 2010–2012 after two decades of continuous increase. UNCTAD's GVC data shows it down 1 percentage point to 30 per cent of trade in 2017. The rate of growth in GVC participation decreased significantly this decade compared with the last, across all regions, developed and developing (figure 5). The slowdown shows clear correlation with the FDI trend and confirms the impact of FDI on global trade patterns.

Top MNEs are leading the way to more gender-balanced boardrooms

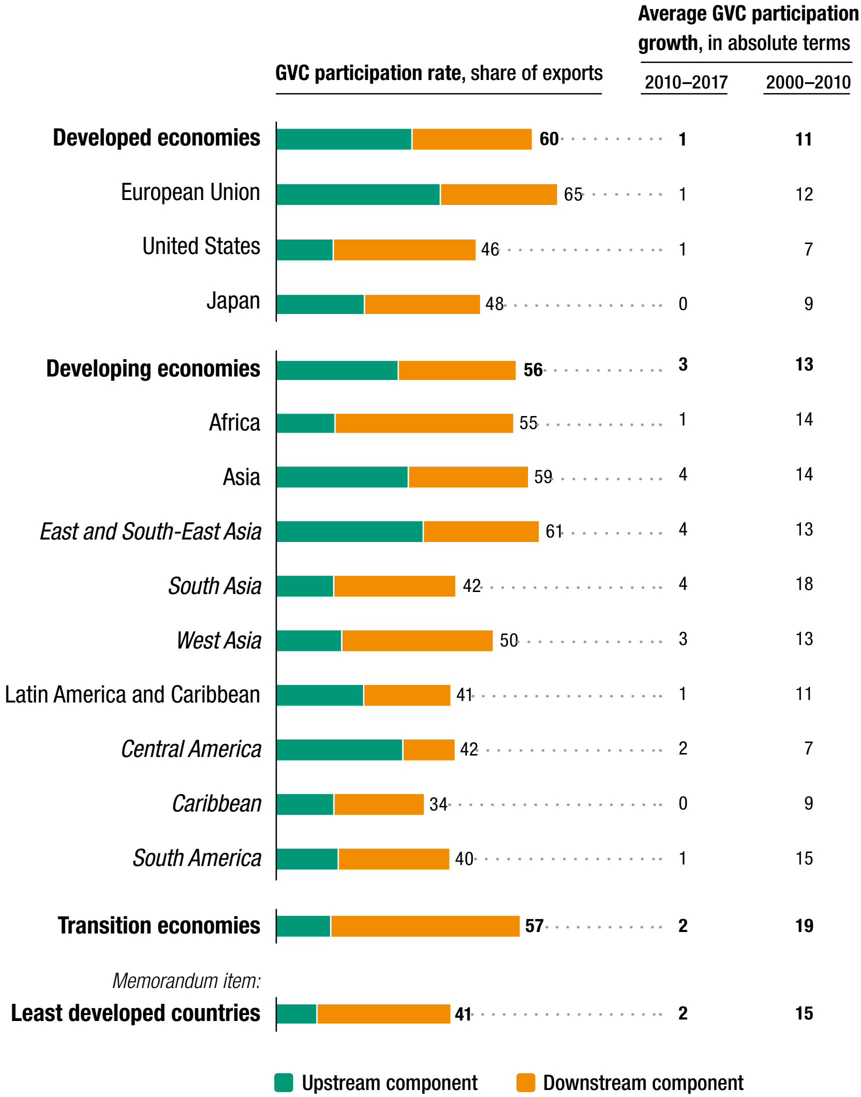
MNEs in the global top 100 and the developing-economy top 100 are leading the way towards more gender-balanced boardrooms, although they have a distance to go. At the end of 2017, women held an average of 22 per cent of board seats in the top 100 MNEs, and five corporations had a female CEO. Board representation is slightly better than the S&P 500 average and compares favourably with national averages in almost all countries in the world.

The MNEs with the most diverse boards are from Europe, where some countries have introduced quotas and targets, followed by North America, where the appointment of women is not regulated. Among developing economies, South African corporations have a comparable share of women on their boards of directors. Companies in other developing economies, along with Japanese corporations, lag significantly behind their Western and South African counterparts.

FDI prospects: fragile growth

Prospects remain muted; projections for global FDI in 2018 show fragile growth. Global flows are forecast to grow marginally, by up to 10 per cent, but remain below the average over the past 10 years. Higher economic growth projections, trade volumes and commodity prices would normally point to a larger potential increase in global FDI in 2018. However, risks are significant and policy uncertainty abounds. Escalation and heightening of trade tensions could negatively affect investment in GVCs. In addition, tax reforms in the United States and increased tax competition are likely to significantly affect global investment patterns. Moreover, longer-term forecasts for macroeconomic variables contain important downsides, including the prospect of interest rate rises in developed economies, with potentially serious implications for emerging-market currencies and economic stability.

Figure 5. GVC participation rate, by region, 2017 and growth rates, 2010–2017 and 2000–2010 (Per cent)



Source: UNCTAD; based on data from UNCTAD-EORA GVC database.

REGIONAL TRENDS

FDI in Africa at a 10-year low

FDI flows to Africa slumped to $42 billion in 2017, a 21 per cent decline from 2016. Weak oil prices and harmful lingering effects from the commodity bust saw flows contract, especially in the larger commodity-exporting economies. FDI inflows to diversified exporters, including Ethiopia and Morocco, were relatively more resilient.

FDI flows to *North Africa* were down 4 per cent to $13 billion. Investment in Egypt was down, but the country continued to be the largest recipient in Africa. FDI into Morocco was up 23 per cent to $2.7 billion, including as a result of sizeable investments in the automotive sector. FDI flows to *Central Africa* decreased by 22 per cent to $5.7 billion. FDI to *West Africa* fell by 11 per cent to $11.3 billion, due to Nigeria's economy remaining depressed. FDI to Nigeria fell 21 per cent to $3.5 billion. *East Africa*, the fastest-growing region in Africa, received $7.6 billion in FDI in 2017, a 3 per cent decline from 2016. Ethiopia absorbed nearly half of this amount, with $3.6 billion (down 10 per cent), and is now the second largest recipient of FDI in Africa. Kenya saw FDI increase to $672 million, up 71 per cent, due to strong domestic demand and inflows into information and communication technology (ICT) sectors. In *Southern Africa*, FDI declined by 66 per cent to $3.8 billion. FDI to South Africa fell 41 per cent to $1.3 billion, due to an underperforming commodity sector and political uncertainty. In contrast, FDI into Zambia increased, supported by more investment in copper.

The beginnings of a commodity price recovery, as well as advances in interregional cooperation through the signing of the African Continental Free Trade Area agreement, could encourage stronger FDI flows in 2018, provided the global policy environment remains supportive.

FDI flows to developing Asia held steady

FDI flows to developing Asia in 2017 remained at the level of 2016 ($476 billion). Strong investment in the high-tech sector in China and increases in most ASEAN countries were enough to offset declines in other large recipient economies in the region, including Hong Kong (China), Singapore, India and Saudi Arabia, in that order. The region regained its position as the largest FDI recipient as its share in global inflows rose from 25 per cent in 2016 to 33 per cent in 2017.

FDI in *East Asia* was stable at $265 billion, with a decline in inflows to Hong Kong (China) and an all-time high in China. In *South-East Asia*, FDI in the ASEAN countries rose by 11 per cent to $134 billion, propelled by an increase in flows to most member countries and a strong rebound in Indonesia. Inflows to *South Asia* contracted by 4 per cent to $52 billion, with a decline in FDI to India. FDI to *West Asia* continued its downward trend (to $26 billion), with inflows to the region declining almost continuously since 2008.

Outward FDI flows from developing Asia declined by 9 per cent to $350 billion in 2017, owing to a reversal in outflows from China for the first time since 2003. Despite the decline, the region remained a major source of FDI worldwide, still accounting for nearly a quarter of global outflows.

In 2018, FDI inflows in the region are expected to remain at a similar level. Inflows to China could see continued growth, as a result of recently announced plans to facilitate and attract foreign investment. Other sources of growth could be greater intraregional FDI, including to relatively low-income economies in the region, most notably the CLMV countries (Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam). In West Asia, the evolution of oil prices, the efforts of oil-rich countries to promote economic diversification, and geopolitical uncertainties will shape FDI inflows.

A modest increase in FDI in Latin America and the Caribbean

FDI flows to Latin America and the Caribbean increased by 8 per cent in 2017 to $151 billion. This was the first rise in six years, although inflows remained well below the peak reached in 2011 during the commodity boom. Outflows from the region bounced back 86 per cent to $17.3 billion in 2017 as Latin American MNEs resumed their international investment activity.

FDI to *South America* increased by 10 per cent as recessions in two leading economies, Argentina and Brazil, ended. FDI to Brazil increased by 8 per cent to $63 billion supported by a significant influx in the energy sector. In Argentina flows more than trebled, to $12 billion, on the back of the economic recovery and new policies to attract investment and upgrade infrastructure. Investment in Colombia increased by 5 per cent to $14.5 billion, supported by the year-end recovery in oil prices, infrastructure investment and rising domestic demand. Investments in *Central America* grew marginally to $42 billion. Despite uncertainty about the outcome of the renegotiation of the North American Free Trade Agreement, inflows to Mexico remained stable at $30 billion, supported by record-high investments into the automotive industry.

FDI in the *Caribbean* subregion grew to $5 billion, driven by flows to the Dominican Republic, up by 48 per cent to $3.6 billion, bolstered by booming investment in trade activities and positive flows to telecommunication and energy industries.

Investment flows to Latin America and the Caribbean are expected to remain stagnant or decline marginally, at about $140 billion. Economic growth in the region is expected to remain tepid, challenged by many downside risks, including economic and policy uncertainty associated with upcoming elections in some of the largest economies, and possible negative spillovers from international financial market disruptions.

A significant decline in flows to transition economies

FDI flows to the transition economies of South-East Europe and the Commonwealth of Independent States (CIS) declined by 27 per cent, to $47 billion, the second lowest level since 2005. Most of the decline was due to sluggish FDI in four major recipient economies (the Russian Federation, Kazakhstan, Azerbaijan and Ukraine). In contrast, outflows rebounded by 59 per cent to $40 billion, due to significant greenfield investments and a few large acquisitions by MNEs based in the Russian Federation.

FDI to *South-East Europe* recovered by 20 per cent, to $5.5 billion, after the decline in 2016. Inward FDI was lifted by robust GDP growth, support for private sector job creation and growing cooperation with the EU. In Serbia, the largest economy of the subregion, foreign investment grew by 22 per cent, to $2.9 billion, mostly through reinvestment in existing foreign affiliates. Flows to the *CIS* and *Georgia* contracted by 31 per cent, to $41 billion, after their rebound in 2016. Policy uncertainty remained high, linked in part to geopolitical concerns. As a result, flows declined, especially to the Russian Federation (by 32 per cent, to $25.3 billion). Natural resources continued to dominate inward FDI in the country.

Prospects for 2018 are moderately positive, bolstered by firmer commodity prices and higher macroeconomic growth. In the medium term, the firmness and structural diversification of announced greenfield projects could lead to a rise in manufacturing FDI.

FDI in developed economies drops by one-third

FDI flows to developed economies fell by 37 per cent to $712 billion. The growth in FDI over 2015–2016, when annual inflows to developed economies exceeded $1 trillion, came to an abrupt end. Large reductions in FDI flows to the United Kingdom, following an exceptionally high value of M&As in 2016, and to the United States, where authorities clamped down on tax inversions, were the major factors behind the decline. Outflows from developed economies remained similar to the levels observed in 2016. Increases from the United States, due to reinvested earnings, and Japan, where MNEs continued to seek growth abroad, offset an aggregate decline from Europe.

FDI inflows to France and Germany bounced back in 2017, but overall flows to *Europe* declined due to a normalization of FDI to the United Kingdom. In *North America*, diminishing intracompany loans and divestments shrank inflows. In *Asia-Pacific* inflows held steady, in contrast to the global trend.

In Europe, combined outflows fell by 21 per cent to $418 billion. Outflows from Germany and the United Kingdom rose sharply. Those from France maintained their high level. FDI outflows from the Netherlands – the largest source country in Europe in 2016 – declined by $149 billion to just $23 billion, mainly due to declining M&A purchases. Outflows from North America rose by 18 per cent. As the prospect of tax reform became more certain towards the end of 2017, United States MNEs postponed the repatriation of overseas earnings, adding to reinvestment. In Asia-Pacific, outflows from Japan continued to expand, to $160 billion.

FDI to developed economies is projected to increase moderately in 2018. The rise in the value of announced greenfield projects (up 25 per cent to $318 billion) is a positive sign. However, current tensions in global trade policymaking create uncertainty. The repatriation of accumulated profits by United States MNEs as a result of the tax reform is likely to reduce FDI outflows from the United States, with mirror effects elsewhere.

FDI flows to the structurally weak economies remain fragile

FDI inflows to the *least developed countries (LDCs)* as a group declined by 17 per cent to $26 billion, representing 4 per cent of FDI flows to all developing economies. Although Asian LDCs registered robust FDI growth and two-thirds of African LDCs attracted more FDI flows than the previous year, the contractions posted by Angola and Mozambique were severe.

FDI to LDCs could see a recovery, pulled by the expected increase of FDI in Africa. However, the value of greenfield FDI projects announced in 2017 – a key indicator of future investment activity – fell to a four-year low.

Foreign investors, mostly from Asian developing economies, scaled down their capital spending plans, especially in the services sector targeting Bangladesh, Cambodia and Myanmar. This weakens FDI prospects for the Asian LDCs.

FDI flows to the 32 *landlocked developing countries (LLDCs)* rose by 3 per cent in 2017, to $23 billion. This modest increase still left total flows to LLDCs almost 40 per cent below the peak in 2011. All LLDC subgroups by region, except for those in transition economies, registered gains.

FDI to LLDCs could recover further in 2018, but uncertainty and fragility remain. The value of announced greenfield projects, the main indicator for future projects, declined in 2017. FDI flows to most of the LLDC economies remain vulnerable to adverse external factors, and their investment potential is tied to developments in neighbouring countries through which exports and imports transit.

FDI flows to the *small island developing States (SIDS)* increased for a second year to $4.1 billion, led by 9 per cent growth in the Caribbean SIDS. FDI in other SIDS shrank.

FDI flows into SIDS will remain fragile. The stagnating volumes of greenfield FDI projects announced in 2016-2017 underscore a persisting challenge for SIDS to attract and sustain FDI. Services will continue to dominate, but FDI flows to the sector are slowing down. Given the highly concentrated distribution of announced projects and public-private partnerships in infrastructure development, only a few SIDS are expected to see growth in FDI in the near term.

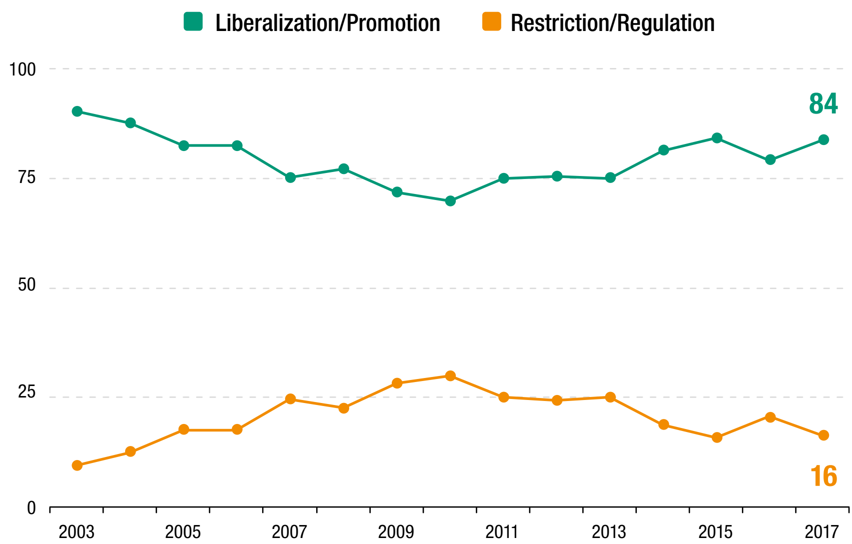
INVESTMENT POLICY TRENDS

Scrutiny of foreign takeovers is intensifying

New national investment policy measures continue to be geared mostly towards investment liberalization and promotion. UNCTAD data show that, in 2017, 65 countries and economies adopted at least 126 investment policy measures affecting foreign investment – the highest numbers of countries and policy changes over the past decade. Of these measures, 93 related to the liberalization and promotion of investment, while 18 introduced restrictions or regulations (the remaining 15 measures were neutral). Liberalization and promotion thus accounted for 84 per cent of investment policy changes (figure 6).

Entry restrictions for foreign investment were eased in a number of industries, including transport, energy and manufacturing, with emerging economies in Asia most active. Numerous countries encouraged investment by simplifying administrative procedures, providing incentives and establishing new special economic zones. New investment restrictions or regulations mainly reflected

Figure 6. | Changes in national investment policies, 2003–2017 (Per cent)



Source: UNCTAD.

concerns about national security and foreign ownership of land and natural resources.

Despite the overall trend towards liberalization or promotion measures in 2017, the share of restrictive and regulatory investment policy measures increased significantly in recent months. From October 2017 to April 2018, about 30 per cent of newly introduced investment measures were of a restrictive or regulatory nature. Some countries are taking a more critical stance towards foreign takeovers, in particular when they relate to national security or the sale of strategic domestic assets and technology firms. In addition, options to further strengthen foreign investment screening mechanisms are being discussed in several countries.

Investment treaty making has reached a turning point

The number of new international investment agreements (IIAs) concluded in 2017 was the lowest since 1983. Countries concluded 18 new IIAs – 9 bilateral investment treaties (BITs) and 9 treaties with investment provisions (TIPs). The most active economy was Turkey, concluding four treaties, followed by Hong Kong, China with two. Between January and March 2018, three additional IIAs were signed.

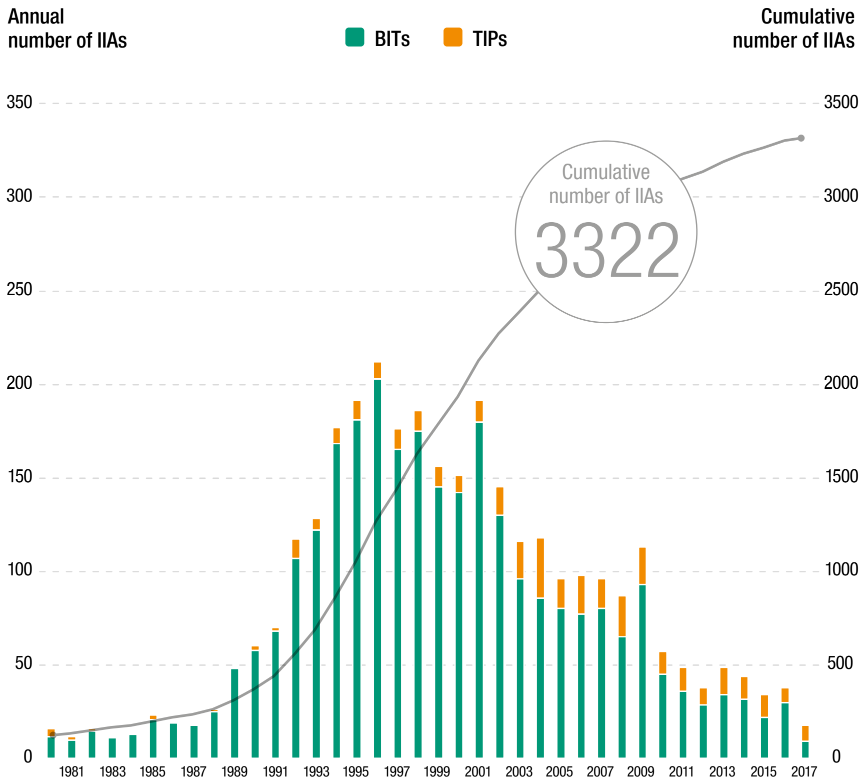
Moreover, for the first time, the number of effective treaty terminations (22) outpaced the number of new IIA conclusions (18). Particularly active in terminating treaties were India and Ecuador. This brought the size of the IIA universe to 3,322 agreements (2,946 BITs and 376 TIPs), of which 2,638 are in force as of year-end (figure 7).

Negotiations for megaregional agreements maintained momentum, particularly in Africa and Asia. The EU continued several FTA negotiations, including with Japan. The renegotiation of NAFTA, including the chapter on investment, began. In addition, a number of country groups are developing non-binding guiding principles for investment policy making.

The number of new treaty-based ISDS cases remains high

In 2017, at least 65 new treaty-based ISDS cases were initiated, bringing the total number of known cases to 855 (figure 8). So far, 113 countries have been respondents to one or more known ISDS claims. In 2017, ISDS tribunals rendered at least 62 substantive decisions in investor–State disputes. Of the total number of known cases decided on the merits, investors have won about 60 per cent.

Figure 7. | Trends in IIAs signed, 1980–2017

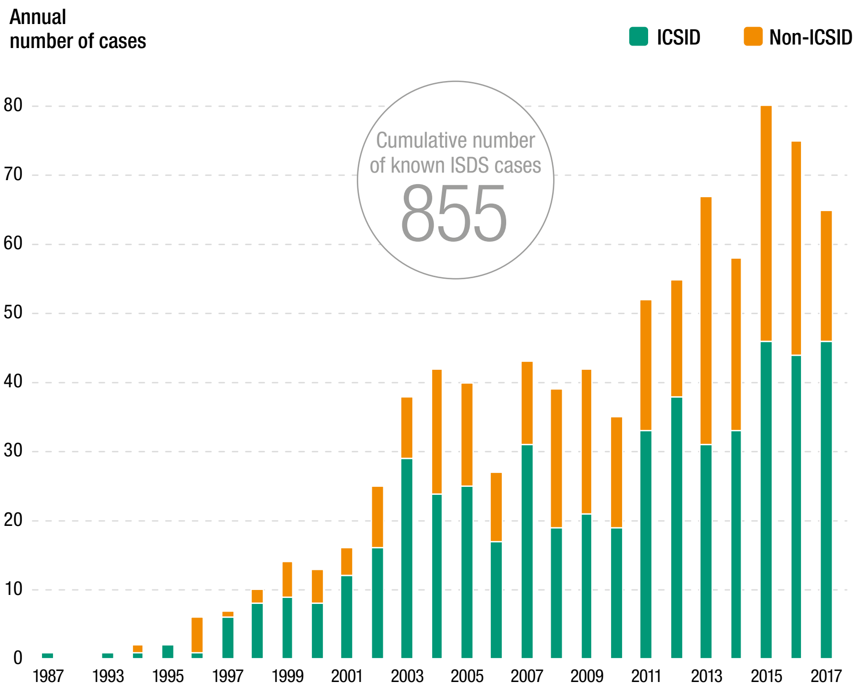


Source: UNCTAD, IIA Navigator.

IIA reform is well under way across all regions

Since 2012, over 150 countries have taken steps to formulate a new generation of sustainable development-oriented IIAs (phase 1 of IIA reform). For example, they have reviewed their treaty networks and revised treaty models in line with UNCTAD's Reform Package for the International Investment Regime. In striking contrast to the treaties concluded at the turn of the millennium, all treaties concluded in 2017 contain at least six "reform features", and some provisions that were considered innovative in pre-2010 IIAs now appear regularly (table 3). Highlights of modern treaty making include a sustainable development orientation, preservation of regulatory space and improvement (or omission) of ISDS.

Figure 8. | Trends in known treaty-based ISDS cases, 1987–2017



Source: UNCTAD, ISDS Navigator.

Countries are also modernizing their existing stock of old-generation treaties (phase 2 of IIA reform). A small but growing number of countries are, for example, issuing interpretations or replacing their old-generation agreements. Countries have also been engaging in multilateral reform discussions, including with regard to ISDS. The more than 3,000 first-generation treaties today (representing some 90 per cent of the IIA universe) present further opportunity for reform actions.

After reform of old and new treaties, one more step…

After improving the approach to new treaties and modernizing existing treaties, the last step in the reform process (Phase 3) is to ensure coherence with national investment policies and with other bodies of international law.

Table 3. Reform-oriented provisions in IIAs concluded in 2000 and in 2017

2000

	1	2	3	4	5	6	7	8	9	10	11
Austria–Bangladesh BIT	No	No	No	No	Yes	No	No	No	No	Yes	Yes
Belarus–Singapore BIT	No	No	No	No	No	No	Yes	No	No	No	Yes
Brunei Darussalam–China BIT	No	No	No	No	No	No	No	No	No	No	Yes
Chile–Dominican Republic BIT	No	No	No	No	No	Yes	No	No	No	No	No
Cuba–Paraguay BIT	No	No	No	No	Yes	No	No	No	No	No	No
Ethiopia–Turkey BIT	No	No	No	No	No	Yes	No	No	No	No	No
Greece–Mexico BIT	No	Yes	No	No	Yes	No	No	No	No	Yes	No
India–Lao People's Democratic Republic BIT	No	No	No	No	No	Yes	No	No	No	No	Yes
Italy–Libya BIT	No	No	Not applicable	No	No	Yes	No	No	No	No	No
Malaysia–Saudi Arabia BIT	No	No	Not applicable	No	No	Yes	No	No	No	No	No
Mongolia–Philippines BIT	No	No	No	No	No	No	No	No	No	No	Yes
Nigeria–Switzerland BIT	No	No	No	No	No	No	No	No	No	No	Yes
Rwanda–South Africa BIT	No	No	No	No	No	No	No	No	No	No	Yes

2017

	1	2	3	4	5	6	7	8	9	10	11
Argentina–Chile FTA	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
ASEAN–Hong-Kong, China Investment Agreement	No	Yes	Yes	Yes	Yes	Yes	Yes	No	No	Yes	Yes
Burundi–Turkey BIT	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	No
China–Hong Kong, China Investment Agreement	No	Yes	Yes	Yes	Yes	No	Yes	Yes	No	Yes	Yes
Colombia–United Arab Emirates BIT	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	No
Intra-MERCOSUR Investment Facilitation Protocol	Yes	Yes	Not applicable	Not applicable	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Israel–Japan BIT	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	No	Yes	No
Jordan–Saudi Arabia BIT	Yes	No	Yes	No	Yes	Yes	No	Yes	No	No	Yes
Mozambique–Turkey BIT	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	No
Pacific Agreement on Closer Economic Relations Plus	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Rwanda–United Arab Emirates BIT	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Turkey–Ukraine BIT	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	No
Turkey–Uzbekistan BIT	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	No	Yes	No

Selected aspects of IIAs Yes No Not applicable

The scope and depth of commitments in each provision varies from one IIA to another.

1 References to the protection of health and safety, labour rights, environment or sustainable development in the treaty preamble

2 Refined definition of investment (e.g. reference to characteristics of investment; exclusion of portfolio investment, sovereign debt obligations or claims to money arising solely from commercial contracts)

3 Circumscribed fair and equitable treatment (with reference to customary international law (CIL), equated to the minimum standard of treatment of aliens under CIL or clarified with a list of State obligations

4 Clarification of what does and does not constitute an indirect expropriation

5 Detailed exceptions from the free-transfer-of-funds obligation, including balance-of-payments difficulties and/or enforcement of national laws

6 Omission of the so-called "umbrella" clause

7 General exceptions, e.g. for the protection of human, animal or plant life or health; or the conservation of exhaustible natural resources

8 Explicit recognition that parties should not relax health, safety or environmental standards to attract investment

9 Promotion of corporate and social responsibility standards by incorporating a separate provision into the IIA or as a general reference in the treaty preamble

10 Limiting access to ISDS (e.g. limiting treaty provisions subject to ISDS, excluding policy areas from ISDS, limiting time period to submit claims, omitting an ISDS mechanism)

11 Specific proactive provisions on investment promotion and/or facilitation

Source: UNCTAD.

Because national legal frameworks for investment in many countries cover the same establishment, treatment and protection issues as IIAs, effective reform of the latter may require parallel steps in national laws. In turn, the national policy framework may inspire reform of IIAs (e.g. concerning investment facilitation, investor obligations and settlement of disputes). Countries can improve the synergistic functioning of the two by strengthening cooperation between national and international investment policymakers and by clarifying the interaction between the two regimes (e.g. by establishing the precedence of one regime over the other).

More can also be done to improve coherence between IIAs and other bodies of international law and policy. Specific reform steps can mitigate risks relating to the limitation of regulatory space and to dispute settlement, and they can reduce administrative complexity (for both States and investors). For example, IIA negotiators can include exceptions for other areas of policymaking, use cross-referencing and guide the interpretation of treaty provisions by tribunals.

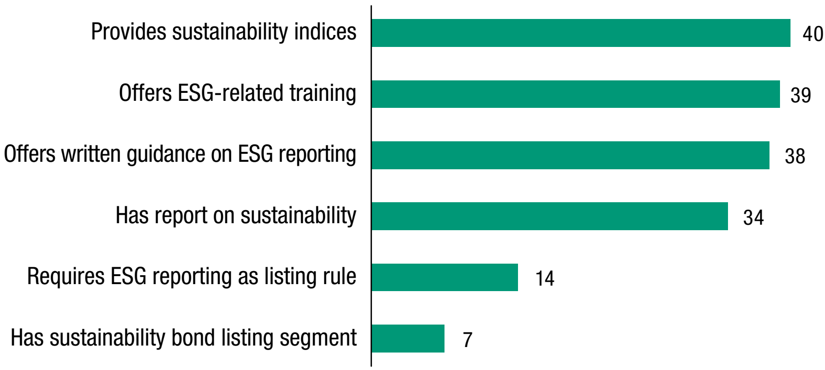
Striving for coherence does not necessarily imply legal uniformity – inconsistencies and divergence may be intended. Shaping the interaction therefore requires a solid understanding of the structural and contextual differences between different regimes. In the absence of a multilateral framework for investment, comprehensive regime reform would benefit from intensified backstopping. As the United Nations' focal point for international investment, UNCTAD, through its three pillars of work – research and policy analysis, technical assistance and intergovernmental consensus-building – can play a key role. UNCTAD's October 2018 High-level IIA Conference during the World Investment Forum will be a milestone in this regard.

Financial markets increasingly promote investment in sustainable development

Capital market policies and instruments designed to promote investment in sustainable businesses and support the achievement of the SDGs are an increasingly important feature of the investment landscape. Capital markets play a critical role in the investment chain that ultimately finances MNEs and their international activities. Market innovations related to sustainable development continue to attract interest from portfolio investors, and the positive track record of sustainability-themed products is reinforcing asset managers' views that environmental, social and governance (ESG) issues are material to long-term investment performance. As these sustainable investment trends take root and expand, they can have a stronger influence on the relationship between listed MNEs and their shareholders, and in turn the operational policies and practices of MNEs relative to sustainable development.

An examination of stock exchange-related instruments around the world focusing on ESG factors shows 54 exchanges with at least one mechanism for promoting corporate ESG practices (figure 9). Some 40 stock exchanges provide sustainability indices and 39 exchanges provide ESG-related training. By Q1 2018, there were 38 stock exchanges in the world providing voluntary guidance on ESG disclosure (up from 32 at the end of Q1 2017) and 14 exchanges where ESG disclosure was a mandatory rule (up from 12 last year). The United Nations Sustainable Stock Exchanges (SSE) initiative now includes 72 exchanges (up from 63 at the end of Q1 2017); these exchanges collectively list over 45,000 companies with a market capitalization of over $80 trillion.

Figure 9. **Overview of sustainability mechanisms used by stock exchanges** (Number of exchanges)



Source: UNCTAD, SSE initiative database.

INVESTMENT AND NEW INDUSTRIAL POLICIES

Industrial policies are becoming ubiquitous

UNCTAD's global survey of industrial policies shows that, over the past 10 years alone, at least 101 economies – both developed and developing, and accounting for more than 90 per cent of global GDP – have adopted formal industrial development strategies. The last five years have seen an acceleration in the formulation of new strategies.

Modern industrial policies are increasingly diverse and complex, addressing new themes and including myriad objectives beyond conventional industrial development and structural transformation. They include GVC integration and upgrading, development of the knowledge economy, build-up of sectors linked to sustainable development goals, and competitive positioning for the new industrial revolution (NIR).

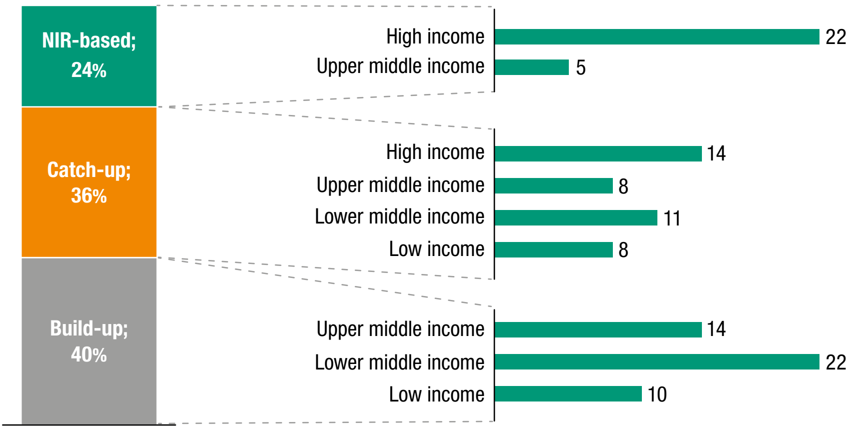
Investment policies (in particular FDI policies in developing countries) have always been a key instrument of industrial policies. Different industrial policy models come with a different investment policy mix. New themes in modern industrial policies need to be reflected in investment policies. The NIR, especially, requires a strategic review of investment policies for industrial development.

Modern industrial policy packages are increasingly complex

In its recent incarnation, industrial policy is best seen as a package of interactive strategies and measures aimed at (i) building enabling industrial systems (infrastructure, financial systems) and productive capacity (including assets, technology and skills), and (ii) supporting the development of internal and export markets. These objectives require initiatives at the firm, industry and cross-industry levels. Each of these components has investment policy elements.

UNCTAD's survey shows that some 40 per cent of recently adopted industrial development strategies contain vertical policies for the build-up of specific industries (figure 10). Just over a third focus on horizontal competitiveness, enhancing policies designed to catch up to the productivity frontier. And a quarter focus on positioning for the NIR.

Figure 10. **Recent industrial policy models**
Share of sample (per cent), and number of strategies per country grouping



Source: UNCTAD.

Build-up, catch-up and NIR-based strategies are all modern versions of industrial policy, appropriate for sequential stages of development. They are not discrete models; all build-up policies contain horizontal measures to enhance competitiveness, catch-up models promote innovation and the adoption of new technologies, and NIR-based models use build-up mechanisms for new industries.

About 90 per cent of industrial policies stipulate detailed investment policy tools, mainly fiscal incentives and special economic zones (SEZs), performance requirements, investment promotion and facilitation, and, increasingly, investment screening mechanisms (table 4). Investment policy packages across the three models use similar instruments, with different focus and intensity.

Industrial policy is a key driver of investment policy practice

More than 80 per cent of investment policy measures recorded since 2010 are directed at the industrial system (manufacturing, complementary services and industrial infrastructure), and about half of these clearly serve an industrial policy purpose. Most are cross-industry; about 10 per cent target specific manufacturing industries. In line with industrial policy models, the

Table 4. Investment policy tools in industrial development strategies, by type (Per cent of sample)

Industrial policy model	Incentives	Special zones/ incubators	Investment facilitation	Entry and establishment		Performance requirements
				Liberalization	Restriction	
Build-up	87	85	85	20	7	30
Catch-up	93	76	88	17	2	5
NIR-based	100	74	48	4	0	4

Source: UNCTAD.

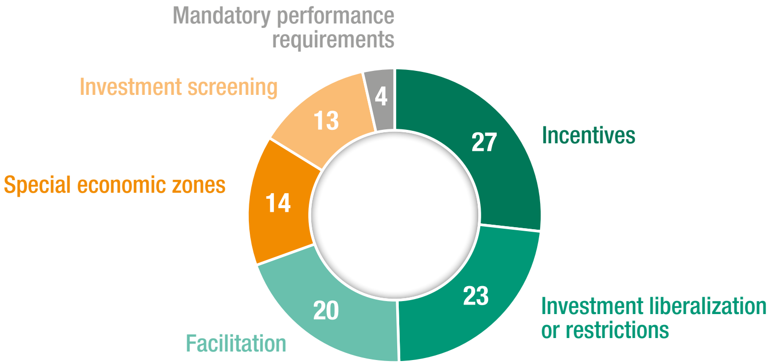
most frequent measures relate to incentives and performance requirements, SEZs, investment facilitation and investor targeting, and investment screening procedures.

Incentives remain the most commonly used tool for industrial policy (figure 11). Significant progress has been made in making incentives more effective instruments for industrial development. About two-thirds of incentives schemes applicable to manufacturing target multiple or specific industries, and even horizontal schemes tend to focus on defined activities, such as research and development (R&D), or on other industrial development contributions. *Performance requirements* (mostly conditions attached to incentives) are also widely used to maximize MNE contributions to industrial development, but much of their functionality could be achieved by better designed, cost-based incentive mechanisms.

SEZs continue to proliferate and diversify. In most countries, the transition from pure export processing zones to value added zones continues, and new types of zones are still emerging. Targeted strategies to attract specific industries and link multiple zones have supported industrial development and GVC integration in some countries that have adopted build-up and catch-up industrial policies, although enclave risks remain. High-tech zones or industrial parks are also becoming a key tool for NIR-driven industrial policies.

Modern industrial policies have boosted *investment facilitation*, which until recently played a secondary role in investment policy frameworks. Many developing countries, especially, have made investment facilitation one of the key horizontal measures in their industrial development strategies. *Targeted investment promotion* (beyond incentives and SEZs) also remains important:

Figure 11. **Investment policy measures for industrial policy purposes, by type, 2010–2017** (Per cent of total, n = 387)



Source: UNCTAD.

two-thirds of investment promotion agencies are guided by industrial policies in defining priority sectors for investment promotion, and three-quarters have specific promotional schemes to upgrade technology in industry.

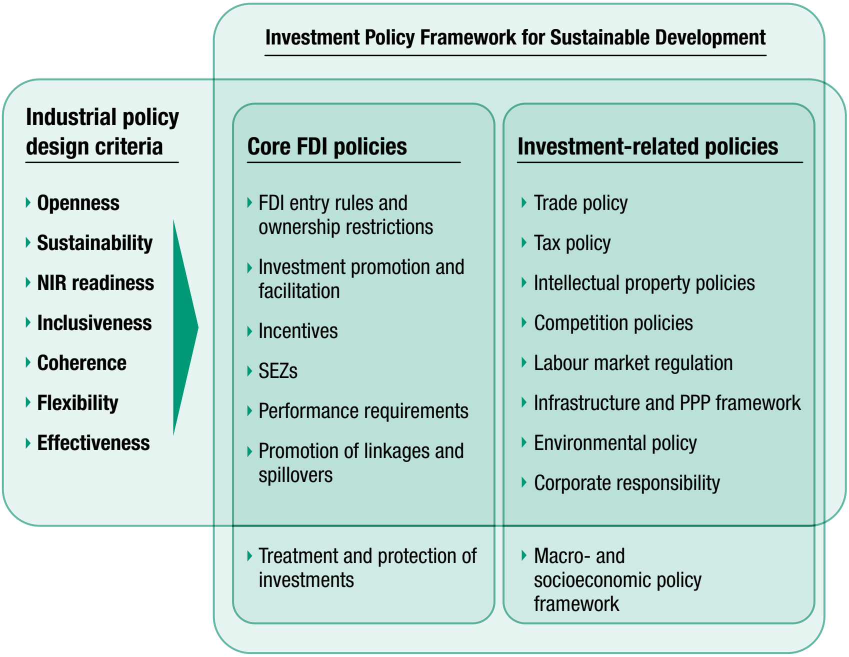
Manufacturing sectors are rarely affected by outright *restrictions on foreign ownership*. Restrictions remain common in some infrastructure and services industries that are relevant for industrial development, however. Most measures adopted over the last decade have removed or relaxed foreign ownership restrictions, but entry rules – or rather, procedures – have still been tightened in some cases through new *screening processes* or requirements, including in developed economies, following NIR-driven industrial policy models.

IIAs can both support and constrain industrial policy. They can foster investment by protecting it and liberalizing rules, but they can also limit policy space by precluding the use of certain restrictions or performance requirements. A number of flexibility mechanisms exist to mitigate the constraining effect of IIAs.

Investment policies need to evolve with industrial policies

As industrial policy is proliferating and becomes the mainstream of development strategy, a key challenge is emerging for policymakers today:

Figure 12. **UNCTAD's IPFSD and the interaction between industrial and investment policies**



Source: UNCTAD.

new industrial policies need to make more effective use of investment policy instruments, and investment policies need to modernize in line with new industrial development strategies.

Modern industrial policies, be they of the build-up, catch-up or NIR-driven variety, tend to follow a number of design criteria. These include openness, sustainability, NIR readiness and inclusiveness. Investment policy choices should be guided by these design criteria and by the need for policy coherence, flexibility and effectiveness (figure 12).

Policy practice shows how build-up, catch-up and NIR-based industrial policies emphasize different investment policy tools and focus on different sectors, economic activities and mechanisms to maximize the contribution of investment to the development of industrial capabilities. The investment policy toolkit evolves with industrial policy models and stages of development.

Countries need to ensure that their investment policy instruments are up-to-date, including by reorienting investment incentives, modernizing SEZs, retooling investment promotion and facilitation, and crafting smart foreign investment screening and monitoring mechanisms. The new industrial revolution, in particular, requires a strategic review of investment policies for industrial development.

For modern industrial policies to contribute to a sustainable development strategy, policymakers need to enhance their coherence with national and international investment policies and other policy areas, including social and environmental policies. They need to take a "whole of government" approach, to create synergy. They also need to strike a balance between the roles of the market and the State and to avoid overregulation. Finally, they need to adopt a collaborative approach that is open to international productive-capacity cooperation, and avoid beggar-thy-neighbour outcomes.

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