1
Trends in FDI Flows and Policy in 2020

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A. Introduction

1.01 The flow and regulation of foreign direct investment (FDI) stand at a crossroads. The coronavirus (COVID-19) and its related global economic crisis have made apparent the extent to which the future of global production networks and ownership over those networks is uncertain. Even before COVID-19, there were signs that the macroeconomic and political factors that had facilitated the development of highly fragmented global value chains (GVCs) and increasingly multinational ownership structures were shifting in fundamental ways. As FDI growth rates have stagnated, it has become clear that investment flows are no longer responding in expected ways to macro fundamentals.[1] Governments have undertaken substantial changes to FDI regulatory policy in recent years, and a growing number of investment-related measures treat inward investment more cautiously. As the global political climate has become increasingly skeptical of open borders, particularly in advanced economies, multinationals have had to rethink their supply chain strategies.[2]

1.02 This chapter contextualizes the current moment by reflecting on three important narrative and statistical trends, and proceeds in four parts. Section B provides a brief descriptive overview of statistical trends in FDI in 2020. What emerges is a picture of underlying uncertainty; FDI has fallen dramatically in 2020, and it is not obvious what post-COVID-19 investment trends will look like. Section C addresses macroeconomic trends and FDI flows and considers the extent to which we can expect FDI flows to follow the dynamics of recovery seen after previous economic downturns. Section D contemplates the extent to which COVID-19 has had a lasting effect on the structure of GVCs. GVC reorientation complicates expectations for post-COVID-19 investment because, if lead firms

[1] Ilan Strauss, 'Explaining Global Trends in FDI in 2015 and Beyond' in Lisa Sachs, Lise Johnson, and Jesse Coleman (eds), *Yearbook on International Investment Law & Policy 2015–2016* (Oxford University Press 2018); Ilan Strauss, '2019 Trends in FDI Flows and Policy' in Lisa Sachs, Lise Johnson, and Jesse Coleman (eds), *Yearbook on International Investment Law & Policy 2019* (Oxford University Press 2021) 1 (hereafter Strauss, '2019 Trends').

[2] Christine Arriola and others, 'Efficiency and Risks in Global Value Chains in the Context of COVID-19' (2020) OECD Economics Department Working Paper No 1637 <www.oecd-ilibrary.org/economics/efficiency-and-risks-in-global-value-chains-in-the-context-of-covid-19_3e4b7ecf-en> accessed 26 May 2021.

determine they must restructure their supply chains, we should not expect economic recovery to correspond with a return to a *status quo ante* pattern of investment. Section E reflects on how the securitization of investment policy could affect patterns of FDI flows post-COVID-19. The trend towards enhanced national security investment screening preceded COVID-19, but pandemic politics made the passage of stronger review mechanisms easier. As screening procedures proliferate, they raise questions about the viability of large, multijurisdictional cross-border mergers and acquisitions (M&A) when such deals require lengthy investigations by multiple authorities. The chapter concludes with Section F and offers questions for future study.

B. Statistical Trends

1.03 As Table 1.1 attests, FDI flows were decimated in 2020; net inflows fell by an estimated 42 per cent to USD 859 billion.[3] This spectacular collapse means FDI inflows in 2020 were 30 per cent below flows in the aftermath of the 2008 global financial crisis (GFC). The COVID-19-related decline follows multiple years of weak FDI flows; inflows have declined year over year since their peak in 2016. Weak FDI inflows affected all regions, though unequally. FDI also posted declines across all sectors and all forms of investment. However, close examination of these trends also underscores how broad measures of FDI do not provide a particularly useful assessment of economic activity or capital formation. Instead, observers should focus on more fine-grained data to better assess trends in economic growth and development. Counts of M&A and greenfield projects, as provided in Table 1.1, therefore, are often more revelatory than inflow measures calculated from balance of payments statistics.

1.04 As much as 80 per cent of the recent decline in FDI inflows is attributable to developed economies. These countries posted a 69 per cent drop in inflows to a low of USD 229 billion, which is equal to a third of inflows in the most recent FDI trough of 2009. These declines were driven by a reduction in new projects and equity investments, a crash in net M&A activity, and balance sheet tightening by multinational enterprises (MNEs) that required affiliates to pay back intrafirm loans. North America and Europe both experienced major declines, 46 and 100 per cent respectively. As a whole, Europe experienced net outflows of USD 4 billion, contra to net inflows of USD 344 billion the year before.

1.05 Collectively, developing countries' FDI inflows fared better, though all regions posted declines. Developing Asia displayed the most resilience; flows here declined by a modest 4 per cent, buoyed by China's 4 per cent increase in FDI inflows year over year, and Hong Kong's rebound from political unrest-related lows in 2019. Latin America and the Caribbean faced declines of 37 per cent, while Africa experienced an 18 per cent drop. South Asia posted a 10 per cent increase in FDI on the strength of India's success in attracting new investment in its technology sector. Transition economies experienced a 77 per cent drop in inflows.

[3] UNCTAD, 'Investment Trends Monitor' (2021) UNCTAD/DIAE/IA/INF/2021/1, 1 (hereafter UNCTAD, 'Investment Trends Monitor'). Section B as a whole draws heavily upon this document, which provides estimates of 2020 FDI statistics based on official sources in 153 economies. Anything that is not otherwise cited individually has been obtained from the UNCTAD 2021 report.

Table 1.1 Investment trends in 2020 by type and region as per cent change from 2019[4]

	Total Inflows	Cross-border M&A	Greenfield Projects
World	–42	–10	–35
Developed Economies	–69	–11	–19
Europe	–100	26	–15
North America	–46	–43	–29
Developing Economies	–12	–4	–46
Africa	–18	–45	–63
Latin America & Caribbean	–37	–67	–51
Asia	–4	31	–38
Transition Economies	–77	147	–60

1.06 Regional trends are better contextualized by industry and investment mode trends. The primary sector was most negatively affected by the COVID-19-induced crisis, with M&A down 52 per cent, and announced greenfield investment down 45 per cent. Low oil prices and weak demand for commodities help explain these figures. Therefore, countries and regions for which the primary sector comprises a large proportion of their FDI—Latin America, Africa, and Transition Economies—all experienced steep declines in investment. In contrast, investment in services seems most resilient to COVID-19 disruptions. Service M&A was only down 6 per cent year over year and posted a substantial, but less dramatic, decline in announced greenfield investment of 26 per cent. The manufacturing sector presents a more mixed picture: cross-border M&A was down a modest 8 per cent, but announced greenfield investment declined 44 per cent. There is some evidence that GVC-related manufacturing FDI may rebound faster than other forms of investment. Southeast Asia, where much of this activity is centred, accounted for the largest volume of new greenfield investment projects in developing regions, and Singapore registered an increase in newly announced projects towards the end of the year.

1.07 Finally, it is worth noting that aggregated FDI data taken from balance of payments accounts are often very poor measures of the phenomena most academics and policy makers are interested in. First, official balance-of-payment statistics are often inaccurate, both because governments often misreport their investment figures and because services trade and FDI have made accurate reporting conceptually and technically more challenging over time.[5] Second, aggregated FDI statistics are often driven largely by paper flows that do not provide useful information about productive capital formation.[6]

1.08 This mismatch is due to a variety of factors that compound when we compare trends in developed countries to those in developing ones, because the drivers of net flows are often quite different in the latter than they are in the former. For instance, even in normal times,

[4] ibid, Figure 1.2 and Table 1.1. UNCTAD's source of data, relied on herein, are its cross-border M&A database, the Financial Times Ltd, and FDI Markets for greenfield projects announced in the first eleven months of 2020.

[5] Lukas Linsi and Daniel K Mügge, 'Globalization and the Growing Defects of International Economic Statistics' (2019) 26 Review of International Political Economy 361 (hereafter Linsi and Mügge, 'Globalization').

[6] Andrew Kerner, 'What We Talk About When We Talk About Foreign Direct Investment' (2014) 58 International Studies Quarterly 804 (hereafter Kerner, 'What We Talk About When We Talk About FDI').

fluctuations in cross-border M&A often drive major swings in FDI statistics. This is because M&As have much larger values than do greenfield investment, particularly in advanced economies. Take the 2020 figures as an example: while North American cross-border M&A declined by 43 per cent, Europe posted an increase in M&A value of 26 per cent.[7] This was largely driven by Unilever's corporate restructuring which changed very little about the company's operations but shifted USD 81 billion from the United Kingdom to the Netherlands.

1.09 Another reason why FDI inflows to developed economies faired so poorly in 2020 is because much of the investment to these countries occurs through intrafirm loans, and MNEs drew down on these loans as investors sought to clean up their balance sheets.[8] But, while topline numbers posted much larger FDI declines in developed economies overall, developing economies saw a steeper decline in new greenfield investment—often the type of investment that governments are most keen to attract since it involves brand new capital formation rather than the changing of ownership of existing capital stock.[9]

1.10 In general, while FDI statistics provide us a useful macro-overview as to where capital is booked in the world, it can be misleading. For instance, FDI flows include retained earnings from MNEs operating in a host economy. Retained earnings can be used to invest in productive equipment and technology. However, these assets often sit as cash, avoiding repatriation for tax purposes. If you are interested in components of investment that are associated with capital formation and economic growth and development, it is more illuminating to look at project-level data and measures that differentiate between MNEs' activities. These measures, unlike aggregated flow data, provide information about what investment is being used for, and can differentiate between flows that are mostly records of where financial flows are booked, and instances in which cross-border investment transfers actually increase domestic capital formation.

C. Macroeconomic Trends

1.11 As with other previous downturns in the global business cycle, the economic fallout from the global pandemic has weakened the macroeconomic climate for FDI. Global gross domestic product (GDP) declined by over 4 per cent in 2020.[10] While Asian economies have been relatively more resilient compared to other regions, the COVID-19 recession is broadly shared. Sixty-one per cent of the 100 largest MNEs reported earnings warnings in 2020, and the top 5,000 MNEs issued downward revisions of earnings estimates that averaged roughly 30 per cent over the same time period.[11] With depressed demand and low earnings, the business rationale for new investment projects remains low. FDI flows also tend to exhibit characteristics of overhang because of the long lead times needed to realize new projects, and because an increasing percentage of FDI flows are intrafirm loans. As a larger percentage of

[7] UNCTAD, 'Investment Trends Monitor' (n 3) 5.
[8] ibid 7.
[9] ibid.
[10] OECD, *Turning hope into reality—OECD Economic Outlook, December 2020* <www.oecd.org/economic-outlook/december-2020/> accessed 22 May 2021 (hereafter OECD, 'Turning hope into reality—OECD Economic Outlook').
[11] UNCTAD 'World Investment Report 2020: International Production beyond the Pandemic' (2020) UNCTAD/WIR/2020, 1 (hereafter UNCTAD, 'World Investment Report 2020').

investment flows have become attributable to intrafirm loans and retained earnings, we can expect longer recovery paths.

1.12 Previous experiences with global recessions suggest that post-crisis FDI recovery paths are highly dependent on policy responses.[12] The FDI recovery path after the 2001 recession was relatively immediate and steep, aided by the fact that the economic downturn was more concentrated in developed economies, commodity prices remained strong through this period, and an increasingly open policy environment towards trade made the construction of new GVCs possible. At that time, global FDI inflows peaked in 2000 at USD 1.4 trillion, declined for three years, and then rose consecutively for four years, topping off at just below USD 2 trillion in 2007. The 2008 GFC subsequently caused another contraction in FDI flows.[13] In contrast to the post-2001 experience, the GFC recovery was much softer. After cratering to roughly USD 1.2 trillion in 2009, inflows rose modestly over the next two years before declining slightly once again. In 2014, global inflows were approximately USD 1.23 trillion, meaning that they were below the levels in 2000, albeit being fourteen years later. The slow recovery after the financial crisis is well explained by inadequate fiscal stimulus—especially in Europe, and to a lesser extent, the US, where FDI inflows skyrocketed in 2015 back to around USD 2 trillion, driven by a rash of cross-border M&As in the US and Europe. FDI flows then began a decline to USD 1.5 trillion in 2019, before the COVID-19 crisis almost halved that number. In other words, the experience of the last twenty years of FDI inflows is one of considerable stagnation: FDI inflows peaked in 2007, experienced a long decline and recovery so that it took eight years to recover back to that peak, and are now below the numbers as they were in 2000.

1.13 One might argue that current macro-fundamentals suggest FDI will continue to experience a major period of sustained decline.[14] And, while developed economies seem far more willing to use expansive fiscal policy to support recovery than in 2009, macro growth trajectories will be largely dependent on the capacity of middle- and lower-income countries to pursue their own fiscal stimulus, as well as the pace and comprehensiveness of vaccine rollouts. This process will likely exhibit a great deal of inequality, with developing countries' access to vaccines lagging behind high-income economies.[15]

1.14 Of course, net inflows miss important aspects of investment. Firstly, gross flows—which are challenging to compile—would provide valuable information about how globally engaged firms are shifting activities and ownership patterns. Theoretically, firms could be becoming increasingly multinational in scope and ownership, while net FDI flows remain low, if all countries send and receive an equal amount of FDI. Secondly, focusing on flows obscures just how much the global ownership network has changed over the previous twenty years. Global inward stock of FDI in 2000 was approximately USD 7.4 trillion.[16] Global inward

[12] Statistics used in this section are compiled from various issues of UNCTAD's annual World Investment Report including UNCTAD/WIR/2008, UNCTAD/WIR/2015, and UNCTAD/WIR/2020.

[13] UNCTAD, 'World Investment Report 2009: Transnational Corporations, Agricultural Production and Development' (2009) E.09.II.D. 15.

[14] Strauss, '2019 Trends' (n 1).

[15] The news that the US will support intellectual property waivers on vaccines does suggest that vaccine access will not be as limited as originally feared. See Thomas Kaplan, Sheryl Gay Stolberg, and Rebecca Robbins, 'Taking "Extraordinary Measures," Biden Backs Suspending Patents on Vaccines' *The New York Times* (New York, 5 May 2021).

[16] UNCTAD, 'World Investment Report 2020' (n 11) 242.

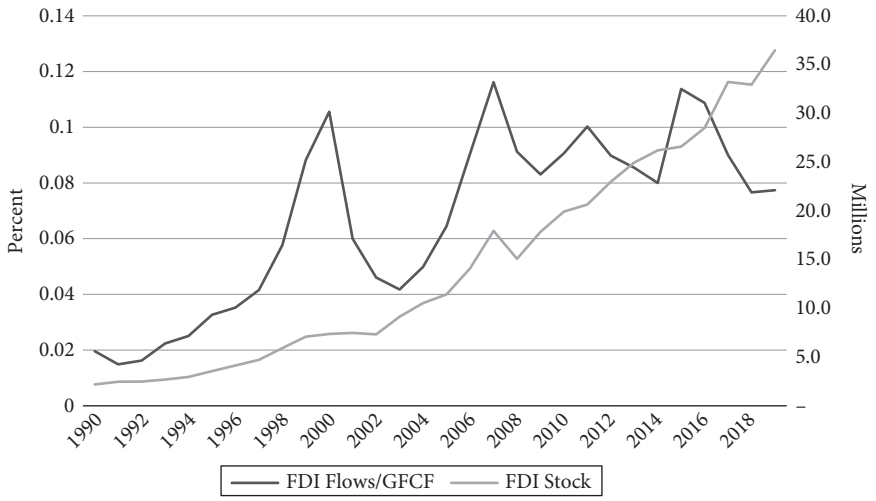

Figure 1.1 FDI flows as a percentage of gross fixed capital flows (left y-axis) and FDI stock (right y-axis) during 1990–2018[17]

Sources: https://unctad.org/statistics; World Bank's World Development Indicators database

FDI stock in 2020 was roughly USD 36.5 trillion, or almost a 500 per cent increase over the time period.[18] As Figure 1.1 illustrates, the global trends in FDI over the past twenty years is complicated; FDI stock has climbed substantially, while FDI flows as a percentage of gross fixed capital formation (GFCF) has been volatile, and only registered 8 per cent in 2019, 20 per cent lower than in 2000 when FDI accounted for 10 per cent of GFCF. The GFCF almost doubling over this time period suggests that the decline in importance of FDI as a portion of global investment is driven by increased domestic investment.

1.15 If we are primarily interested in the financial accounting components of FDI, it seems reasonable to anticipate that net FDI flows will continue to stagnate as firms engage in less intrafirm lending, as advanced economies restructure their taxation policies to repatriate offshore profits,[19] and as governments become increasingly wary of M&A bids from acquirers in competitor countries. If, however, we are interested in FDI statistics because we want to uncover patterns of cross-border ownership and production, we may be on the verge of a rather substantial reorientation of GVCs that will have profound implications for where global firms locate and relocate productive assets. For these reasons, it is increasingly important that scholars and practitioners look beyond top line, aggregated FDI flow data to better understand developing trends in the geography of global ownership structures. Below, the way in which the coming years may experience a fundamental reordering of the location, ownership, and activity patterns of these GVCs, is further contextualized.

[17] The data regarding FDI flow and Stock are from UNCTAD FDI/MNE database (<https://unctad.org/statistics>); whilst the GFCF data are from the World Bank's World Development Indicators database.

[18] ibid.

[19] See the OECD-led efforts on tax governance at OECD, *International collaboration to end tax avoidance* <www.oecd.org/tax/beps/> accessed 22 May 2021.

D. Trends in Global Value Chains

1.16 The early part of the 21st century was the period of 'lean' and 'just in time' supply chain logistics. China entered the World Trade Organization (WTO) at the end of 2001, unleashing a sea change in the way the global economy was structured. The multi-year phase out of the Multifiber Arrangement (MFA) ended in 2004. Bilateral investment treaties (BITs) and free trade agreements proliferated. Governments progressively liberalized their domestic investment regulatory environment, invested in investment promotion agencies to attract investment, and provided MNEs with generous tax incentive packages.[20] Many of these legal and regulatory trends began in the 1990s or even the 1980s, but the early 2000s represented a deepening of economic liberalization and the legalization of a trade and investment regime that incentivized firms to go global and develop increasingly complex GVCs built on efficiency and lean design principles.

1.17 The explosion of GVCs drove many of the trends in economic statistics over the time period. As technological innovations and a permissive regulatory environment made it possible for global businesses to internationalize their supply chains, we first saw the growth of 'factory Asia', in which China and other Southeast Asian countries became sites of final product assembly.[21] This coincided with the buoyant FDI flows, trade (especially in intermediate goods), and GDP growth that characterized the early aughts. Advanced economies' exports to the developing world expanded by over 400 per cent over the time period, from USD 1 trillion in 1995 to USD 4.2 trillion in 2017.[22]

1.18 Overtime, emerging economies in Asia have built up investment stock—both foreign and domestic, technologies, infrastructure, and know-how to build vertically integrated domestic industries. In doing so, they have captured more value-add domestically, and also concentrated production chains in certain sectors domestically. This process is in many ways an extension of the increased global character of economic activity, but from a statistical perspective, it led to retrenchment in trade intensity in goods because these countries have become less reliant on imported intermediate products.[23] Thus, the decoupling of traditional macro-fundamentals from FDI inflows discussed above is at least partially explained by the maturation of industrial capacity in developing markets, particularly in Asia.

[20] Sonal Pandya, 'Political Economy of Foreign Direct Investment: Globalized Production in the Twenty-First Century' (2016) 19 Annual Review of Political Science 455 (hereafter Pandya, 'Political Economy of FDI').

[21] Latin America and Africa have been less successful in developing a central position in GVCs, and regional FDI trends reflect this fact. See Juan Blyde and Danielle Trachtenberg, 'Global Value Chains and Latin America: A Technical Note' (2020) Inter-American Development Bank Technical Note No 1853 <https://publications.iadb.org/publications/english/document/Global_Value_Chains_and_Latin_America_A_Technical_Note_en.pdf> accessed 26 May 2021; Neil Foster-McGregor, Florian Kaulich, and Robert Stehrer, 'Global Value Chains in Africa' (2015) United Nations Industrial Development Organization, Inclusive and Sustainable Industrial Development Working Paper Series Working Paper 4/2015 <www.unido.org/api/opentext/documents/download/9928077/unido-file-9928077> accessed 26 May 2021.

[22] McKinsey & Company, 'Globalization in Transition: The Future of Trade and Value Chains' (2019) Report 13 <www.mckinsey.com/~/media/mckinsey/featured%20insights/innovation/globalization%20in%20transition%20the%20future%20of%20trade%20and%20value%20chains/mgi-globalization%20in%20transition-the-future-of-trade-and-value-chains-full-report.pdf> accessed 26 May 2021.

[23] McKinsey & Company, 'Globalization in Transition: The Future of Trade and Value Chains' (2019) Report 12 <www.mckinsey.com/~/media/mckinsey/featured%20insights/innovation/globalization%20in%20transition%20the%20future%20of%20trade%20and%20value%20chains/mgi-globalization%20in%20transition-the-future-of-trade-and-value-chains-full-report.pdf> accessed 26 May 2021; The World Bank, 'World Development Report 2020—Trading for Development in the Age of Global Value Chains' (2020) <www.worldbank.org/en/publication/wdr2020> accessed 22 May 2021.

1.19 As production networks first fragmented and then solidified in Southeast Asia, they also generated fragilities. Certain industries—particularly electronics and semiconductors—are more susceptible to supply disruptions because they are the least diversified. When just one or a few countries produce most or all key components in a supply chain, supply bottlenecks can be incredibly disruptive and costly. These bottlenecks can be generated by a variety of economic, natural disaster, and policy-induced shocks. As these supply chain shocks become more frequent, firms face increasing incentives to restructure their logistics networks. As a result, as much as 16–25 per cent of global exports, worth USD 2.9 to 4.6 trillion, could shift across borders in the next three to five years.[24]

1.20 COVID-19 has likely accelerated the process of structural change in GVCs along two channels: (1) internal firm choices regarding logistics and supply chain design; and (2) government policy-induced changes. The former channel relates to how firms may revisit supply chain design principles due to a greater appreciation for the latent risks associated with current production networks. While 'lean' supply chain management principles reigned supreme in the efficiency-driven 1990s and 2000s, firms are increasingly embracing 'resiliency' principles as they rebuild and restructure logistics systems that seized up during the early stages of pandemic-related lockdowns.[25] To some extent, this shift towards more robust supplier networks preceded COVID-19 in some industries. Major auto brands had already worked to expand their supplier base and diversify the geographic origin of inputs after experiencing the market costs of natural disaster-related supply chain shocks, such as the 2011 tsunami-induced nuclear accident at Fukushima.[26] But, the pandemic serves as an important inflection point because it made explicit the—usually latent—risks of complex GVCs characterized by geographic bottlenecks and lean designs that provide little cushion against supply chain disruptions. A recent McKinsey Institute study found that 93 per cent of global supply chain leaders, surveyed in May 2020, plan to privilege resilience in their supply chains, and that they expect to do so through a variety of tactics including expanding sourcing, increasing inventories, nearshoring and expanding their supplier base, and regionalizing supply chains that have become too concentrated in a single country.[27]

1.21 With regard to the latter channel of policy-related reasons for supply chains to reorganize, unease with the depth and breadth of global production structures, particularly in advanced industrial economies, had already been growing in recent years. However, the pandemic and the immediate—likely demand driven—shortages of medical equipment, personal protective equipment, and toilet paper provided vivid examples of how global supply chains can fail. Many political leaders leveraged this concern as they pushed forward a variety of

[24] McKinsey & Company, 'Risk, Resilience, and Rebalancing in Global Value Chains' (2020) Report 1 <www.mckinsey.com/business-functions/operations/our-insights/risk-resilience-and-rebalancing-in-global-value-chains?cid=other-eml-nsl-mip-mck&hlkid=adc58eff0fc94b4ab75aaa0b0e82dbee&hctky=11801264&hdpid=c7533413-0bda-4b1d-8c5a-d4d66a414da3> accessed 22 May 2021 (hereafter McKinsey & Company, 'Risk, Resilience and Rebalancing in GVCs').

[25] Note, however, that much of the supply chain failures that occurred early on during the pandemic, particularly of medical and personal protective equipment, were attributable more to demand shocks than to supply chain failures. See OECD, 'Turning hope into reality—OECD Economic Outlook' (n 10).

[26] Masato Abe and Linghe Ye, 'Building Resilient Supply Chains against Natural Disasters: The Cases of Japan and Thailand' (2013) 14 Global Business Review 56; Bill Canis, 'Motor Vehicle Supply Chain: Effects of the Japanese Earthquake and Tsunami' (2011) Congressional Research Service Report for Congress 1, 16 <www.everycrsreport.com/files/20110523_R41831_e03cde8ed505d3d94a36ad9bd9f85139921cdcd1.pdf> accessed 26 May 2021. See also Naomi Tajitsu, 'Five Years after Japan Quake, Rewiring of Auto Supply Chain Hits Limits' (*Reuters*, 30 March 2016) <www.reuters.com/article/us-japan-quake-supplychain/five-years-after-japan-quake-rewiring-of-auto-supply-chain-hits-limits-idUSKCN0WW09N> accessed 22 May 2021.

[27] McKinsey & Company, 'Risk, Resilience and Rebalancing in GVCs' (n 24).

proposals designed to restructure and re-shore supply chains of special concern. Both the US and the European Union have introduced legislation designed to re-shore semiconductor manufacturing in the name of self-reliance.[28] A proliferation of new and enhanced investment screening mechanisms—mostly in high-income economies, but also in some emerging economies such as India—may also shape the possible futures for supply chains, especially in GVCs adjacent to dual-use technologies and sensitive personal data. A changing international trade legal regime, which is even more regionalized, may also drive multinationals to make lasting changes to their supply chain structures. As developed economies flex their regulatory muscle to manage global commerce and investment, developing countries seem even more determined to promote and attract foreign investment that aligns with their industrial policy priorities. These policy developments have the potential to further regionalize global production networks, thereby driving FDI flow patterns in the near future as businesses shift the location of their capital stock and economic activities. The next section explores these trends in greater detail.

E. Policy Trends

1.22 Investment policy trends also suggest major structural shifts in the global investment climate are on the horizon. In this section, three important trends are focused on: (1) increased scrutiny of inward FDI primarily by advanced economies; (2) a further embrace of regional trade agreements; and (3) continued but more targeted use of investment promotion and facilitation strategies by developing countries. The overarching danger to the viability of a globally integrated economy is that mounting rivalries and distrust will lead to fully decoupled GVCs, in which a Chinese-led network operates separately from one led by the US, possibly in tandem with the EU. A full break is still an outside possibility; there are many commercial interests that will continue to organize to keep markets integrated. However, it is worth considering what the maximalist outcome of the current policy environment could be. In particular, a bifurcated global market would create great difficulties for developing economies, as countries would largely be forced to choose which market they wanted to operate within.

1. Investment Screening

1.23 While the 1980s and 1990s saw a concerted effort to break down barriers to FDI entry and the dismantling of investment screening regimes, advanced economies have recently rebuilt and strengthened review mechanisms, mostly for cross-border M&A. Most of these measures are scoped to essential security concepts,[29] that is screening authorities are only empowered to block or amend investment transactions if governmental review panels conclude that the transaction represents a credible risk to national security or public order. Figure 1.2 illustrates the extent to which investment screening and approval processes have been

[28] For the US' activity, see Govtrack, *H.R. 7178 116th Congress: CHIPS for America Act* <www.govtrack.us/congress/bills/116/hr7178> accessed 22 May 2021; for the EU's activity, see Politico, *Europe looks to go it alone on microchips amid US-China clash* <www.politico.eu/article/europe-seeks-to-decouple-from-us-china-chip-war/> accessed 22 May 2021.

[29] The precise essential security concept differs among countries, largely due to legal context. The US and Australia, eg, use the concept of national security, whilst most European countries use the concept of public security and public order.

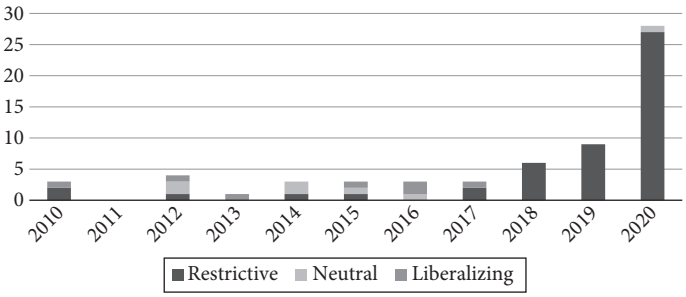

Figure 1.2 New investment screening and approval measures in OECD countries during 2010–20[30]

embraced amongst advanced economies in recent years. Many governments have framed these new governmental authorities in the context of COVID-19. While the EU countries have been most prominent in this area, Japan, New Zealand, Canada, and India have all recently strengthened their investment screening mechanisms and have invoked COVID-19 as justification for these developments.[31] Indeed, 2020 saw a marked increase in the number of restrictive measures passed in these countries: twenty-seven. However, the extended timeline shows that the shift towards more restrictions really started in 2017 and 2018, and is closely associated with the rapid rise in Chinese investments into developed markets, a phenomenon that peaked in 2016. Much of the 2020 activity was in response to the EU's investment screening regulation, which entered into force in May 2019 and gave member states eighteen months to put in place the mandated operational requirements at the state level.[32] The EU regulation does not mandate investment screening, but does require information sharing amongst member states, and sets standards that member states must follow if they do implement investment screening.

1.24 Investment screening for essential security purposes need not be restrictive in intent or effect, and could instead be indicative of a regulatory environment as open as possible to FDI with necessary guardrails.[33] These screening tools may also be a bargaining chip for governments to leverage in order to open up new markets for investment.[34] Moreover, screening transactions for essential security concerns may reflect a more liberal policy choice if the alternative is placing equity restrictions on all investment into sectors that touch upon essential

[30] Figure generated by the author, based on UNCTAD's Investment Policy Monitor Tool. A few reported measures were removed because they were automatic processes (such as Canada, as monetary thresholds for review are automatically recalculated each year based on a set formula), or because they were reports of a transaction prohibition. The measures counted are changes in law or regulation that influence the process through which FDI is screened and the authorities governments possess to prohibit or amend FDI transactions. See Investment Policy Hub, *Investment Policy Monitor* <https://investmentpolicy.unctad.org/investment-policy-monitor> accessed 22 May 2021 (hereafter *Investment Policy Monitor*).

[31] OECD, *Investment screening in times of COVID-19 and beyond* <www.oecd.org/coronavirus/policy-responses/investment-screening-in-times-of-covid-19-and-beyond-aa60af47/> accessed 22 May 2021.

[32] European Commission, *EU foreign investment screening mechanism becomes fully operational* <https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1867> accessed 22 May 2021.

[33] Sarah Bauerle Danzman, 'Investment Screening in the Shadow of Weaponized Interdependence' in Daniel Drezner, Henry Farrell, and Abraham Newman (eds), *The Uses and Abuses of Weaponized Interdependence* (Brookings Institution Press 2021) 257.

[34] Stephan Schill, 'The European Union's Foreign Direct Investment Screening Paradox: Tightening Inward Investment Control to Further External Investment Liberalization' (2019) 46 Legal Issues of Economic Integration 105.

security concerns. Accordingly, we should not equate the development and strengthening of investment screening tools as synonymous with a restrictive investment climate.

1.25 At the same time, governments have expanded investment screening authorities in recent years to cover more sectors, to apply to smaller investments both in terms of deal value and equity stake in the business, and to evaluate risks through an increasingly expansive interpretation of essential security concepts. The expansion of investment screening into emerging technologies and businesses that collect personal data may be justified from a security standpoint, but also means that a growing percentage of the most dynamic sectors of the global economy are subject to such reviews. This will very likely mean that cross-border M&A in these sectors will further concentrate ties between North America, Europe, and advanced democracies in the Pacific, whilst decreasing M&As between these locations and businesses in China and Russia.

2. Regional Trade and Investment Agreements

1.26 Bilateral trade and investment deal-making continues at a slow pace. Twenty one agreements with investment provisions were signed in 2020, twelve of which are United Kingdom treaties meant to re-establish treaty obligations lost through its exit from the EU.[35] Eleven agreements with investment provisions came into force in 2020, having been signed at an earlier date.[36]

1.27 The details of these treaties are covered in Chapters 14–18. Here, I will focus briefly on several important regional trade and investment deals, though another important development in the investment treaty landscape is the continued negotiations over BIT and investor-state dispute settlement reforms in plurilateral fora, most notably the United Nations Commission on International Trade Law Working Group III.[37]

1.28 Mega-deal treaty-making is largely a response to the difficulties of pursuing multilateral governance efforts through the WTO and will likely further regionalize trade and FDI patterns. The United States–Mexico–Canada Agreement, an update of the North American Free Trade Agreement, came into force in July 2020.[38] The African Continental Free Trade Area Agreement went into effect in January 2021,[39] and has the potential to powerfully shape trade and investment flows throughout the African continent.

1.29 Asian economies also advanced an ambitious treaty agenda in 2020. The Regional Comprehensive Economic Partnership (RCEP) was signed in November 2020.[40] RCEP, along with the Comprehensive and Progressive Agreement for Trans-Pacific Partnership,[41]

[35] See Investment Policy Hub, *International Investment Agreements Navigator* <https://investmentpolicy.unctad.org/international-investment-agreements> accessed 22 May 2021.

[36] ibid.

[37] UNCITRAL, *Working Group III: Investor-State Dispute Settlement Reform* <https://uncitral.un.org/en/working_groups/3/investor-state> accessed 26 May 2021.

[38] United States–Mexico–Canada Agreement (signed 30 November 2018, entered into force 1 July 2020); North American Free Trade Agreement (signed 17 December 1992, entered into force 1 January 1994, terminated 1 July 2020).

[39] African Continental Free Trade Area Agreement (signed 21 March 2018, entered into force 30 May 2019), with trade commencing from 1 January 2021.

[40] Regional Comprehensive Economic Partnership (signed 15 November 2020).

[41] Comprehensive and Progressive Agreement for Trans-Pacific Partnership (signed 8 March 2018, entered into force 30 December 2018).

create trade and policy environments that will further incentivize supply chain integration within East Asia, and especially around China and Japan. The European Union–China Comprehensive Agreement on Investment (CAI) was also agreed to in principle in December 2020, but has not yet been ratified.[42]

1.30 It is hard to reconcile these developments—and especially the CAI—with the increase in investment screening. On the one hand, mega trade agreements in Asia as well as the CAI could make it increasingly challenging for China hawks in the US and the EU to successfully argue for decoupling. On the other hand, RCEP does not have a chapter on state-owned enterprises (SOEs), and is generally considered a shallower agreement because it is focused squarely on lowering tariffs in a region in which 70 per cent of trade is already tariff-free, rather than addressing non-tariff barriers to trade that are generally more constraining.[43] The CAI is not yet ratified and has hit significant barriers in implementation.[44] One of the biggest selling points of the deal is that it purports to lock in China's concessions on access to the Chinese financial sector. Despite this, China issued an order in January 2021 that requires China-based companies to not comply with the US sanctions and export restrictions, and allows them to sue companies that do comply.[45] If strictly enforced, this ruling will make it impossible for financial firms, or most technology firms, to simultaneously do business in China and in the US. In other words, these deals may not actually provide firms new access to Chinese markets unless they are willing to forgo the US market and the US financial system.

3. Investment Promotion

1.31 Finally, while much of the policy activity in advanced economies has centred around restricting investments that generate essential security concerns, policy developments in developing countries have reflected far different concerns. Instead, low- and middle-income countries have mostly continued to hone their investment promotion and facilitation toolkit.[46] According to the United Nations Conference on Trade and Development's (UNCTAD) investment policy monitor, governments have implemented 401 measures related to promotion and facilitation since 2010, and countries not from the Organisation for Economic Co-operation and Development (OECD) were responsible for 75 per cent of these measures. In 2020, non-OECD governments implemented forty-one new measures related to promotion and facilitation, while OECD governments registered zero such measures. Figure 1.3 illustrates the breakdown of these promotion and facilitation measures from 2020. Tax incentives were the most commonly passed measure (twenty-two passed), but measures designed to facilitate investment through streamlining procedures and providing

[42] European Union–China Comprehensive Agreement on Investment (agreed to in principle on 30 December 2020).

[43] See eg the Asian Development Bank's chief economist's analysis of the deal. Asian Development Bank, *RCEP: What's in it for Asia and the Pacific?—Yasuyuki Sawada* <www.adb.org/news/op-ed/rcep-what-s-it-asia-and-pacific-yasuyuki-sawada> accessed 22 May 2021.

[44] As of early May 2021, reporting suggests that the European Commission has suspended ratification processes, though it is unclear if this is a temporary or permanent move. See DW, *EU-China investment deal put on ice over sanctions* <www.dw.com/en/eu-china-investment-deal-put-on-ice-over-sanctions/a-57427703> accessed 22 May 2021.

[45] Amy Qin, 'China's New Rules Could Hit U.S. Firms and Send a Message to Biden' *The New York Times* (New York, 24 January 2021).

[46] While I only address investment promotion in this chapter, please see Chapter [X] for a comprehensive treatment of advances in multilateral negotiations over investment facilitation.

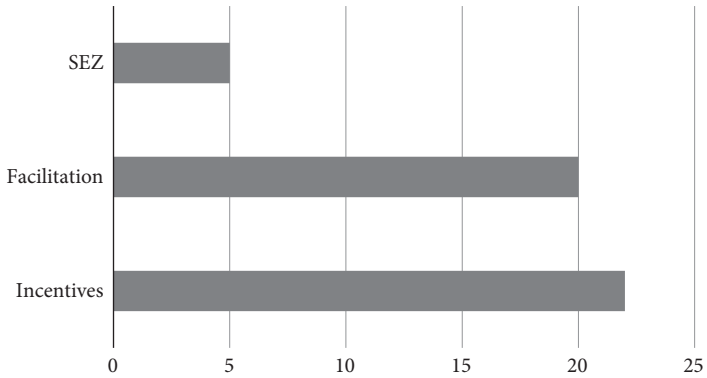

Figure 1.3 Number of new investment promotion and facilitation measures by type during 2020[47]

investors with more information about local markets were also popular (twenty passed). Governments implemented five measures related to special economic zones (SEZs).

F. Conclusion

1.32 The above discussion makes it clear that FDI has stagnated in key ways since the 2008 Global Recession. The global pandemic has highlighted and accelerated these trends, which are likely to be long-lasting. The forward outlook for investment flows is highly uncertain. UNCTAD anticipates a continued decline in FDI in 2021 of 5 to 10 per cent.[48] Greenfield announcements are useful forward measures of flows since investment projects often experience long lag times. In 2020, such announcements were 35 per cent lower than 2019 announcements, suggesting that pandemic overhang could stifle a global recovery of new capital formation.[49] On the other hand, the pandemic may lead to substantial FDI flows generated by further global concentration in key sectors and the restructuring of GVCs around design principles of resilience. Cross-border M&A announcements rebounded in the second half of 2020, largely driven by the technology and healthcare sectors. Reorienting supply chains could substantially, but temporarily, increase FDI flows—both inward and outward—as firms move production facilities to new locations. In addition, the continued securitization of GVCs and FDI will likely mean that patterns of cross-border M&A will shut Chinese investment out of Western markets.

1.33 As the global environment for FDI shifts, it is even more imperative for scholars and practitioners to look beyond FDI figures taken from balance of payments statistics, towards other measures that better capture MNE activity, variations in investment patterns across sectors and modes of entry, and gross measures that better account for 'churn' rather than net investment. The shift towards disaggregated measures has already occurred among social scientists

[47] Figure generated by the author, based on data compiled from UNCTAD's Investment Policy Monitor. See *Investment Policy Monitor* (n 32). Some measures simultaneously related to both incentives and facilitation. Only non-OECD countries passed promotion and facilitation measures in 2020, and only two measures were restrictive in nature: Namibia and Argentina both reduced investment incentives.

[48] UNCTAD, 'World Investment Report 2020' (n 11) x.

[49] UNCTAD, 'Investment Trends Monitor' (n 3) 2.

interested in the determinants of investment,[50] and the proliferation of new datasets that collect more granular data or use discrepancies among reporting agencies to discover 'phantom' FDI make a shift away from balance of payment figures much more feasible than even five or ten years ago.[51] Using these more nuanced data will help researchers and policymakers detect where global firms are deploying actual productive investment and centring their value-creating activities rather than provide a mere accounting of where cash is booked to. As more MNE activities relate to digital services, these more discerning data will be even more essential for understanding where capital and technology formation is occurring.

1.34 Despite the great uncertainty that characterizes FDI in the short to medium term, there are clear areas in which it seems global trends will demand more research. Here, I will highlight two in closing. First, while FDI has always been much more regional than has trade, it seems that regionalism in investment and trade will only intensify as GVCs restructure into multiple neighborhoods, as trade governance continues to deepen at the regional rather than multilateral level, and as advanced economies pursue policies of re- and near-shoring. We will need new research to explain GVC reconfiguration, pathways for regional governance to expand into more inclusive cooperative frameworks, and how governments can resolve national security and economic anxiety issues in order to engage in deeper integration. We will also need more research on how developing countries can best navigate a disintegrating global economy, and the effect of regionalization on developing markets.

1.35 Second, a related area of research concerns state power in the contemporary global economy. For decades, within the comparative and international political economy disciplines, the central issue in the study of FDI and the global economy in general was how states could still assert a right to regulate in an era of hypermobility.[52] The academic discourse around BITs and concerns that these instruments empowered firms at the expense of states is a clear illustration of this concern. The past couple of years, in contrast, have shown that many states—at least those governing wealthy and large markets—are reasserting their authority.[53] Proliferating investment screening rules demonstrate this, as do more discerning industrial policies. As geopolitical concerns increasingly play out in economic spheres, we will need much more research on how states use or misuse their authority in global markets, how international cooperative agreements can best adapt to the growing use of national security exceptions, and how globally oriented firms engage as political actors in domestic, foreign, and transnational arenas.

[50] Sarah Bauerle Danzman, 'Contracting with Whom? The Differential Effects of BITs on Mitigating Sources of Investment Risk' (2016) 42 International Interactions 452; Kerner, 'What We Talk About When We Talk About FDI' (n 6); Linsi and Mügge, 'Globalization' (n 5); Pandya, 'Political Economy of FDI' (n 20).

[51] See eg OECD, *AMNE Database—Activity of Multinational Enterprises* <www.oecd.org/sti/ind/amne.htm> accessed 22 May 2021.> On phantom FDI, see Jannick Damgaard, Thomas Elkjaer, and Niels Johannesen, 'What Is Real and What Is Not in the Global FDI Network?' (2019) International Monetary Fund Working Paper No 19/274 <www.imf.org/en/Publications/WP/Issues/2019/12/11/what-is-real-and-what-is-not-in-the-global-fdi-network> accessed 26 May 2021.

[52] Suzanne Berger, 'Globalization and Politics' (2000) 3 Annual Review of Political Science 43; Nancy Brune and Geoffrey Garrett, 'The Globalization Rorschach Test: Economic Integration, Inequality, and the Role of Government' (2005) 8 Annual Review of Political Science 399; Mark Andreas Kayser, 'How Domestic is Domestic Politics? Globalization and Elections' (2007) 10 Annual Review of Political Science 341; Pandya, 'Political Economy of FDI' (n 20).

[53] Stefanie Walter, 'The Backlash against Globalization' (2021) 24 Annual Review of Political Science 421.