YASED UNITED EVENT ON "GLOBAL FDI BEYOND THE PANDEMIC" WITH THE PARTICIPATION OF MR. RICHARD BOLWJIN, UNCTAD HEAD OF INVESTMENT RESEARCH

MINUTES OF MEETING

June 16, 2020 / Video Call

Participants:

Number of participants:
Guest Speaker: Mr. Richard Bolwjin, UNCTAD Head of Investment Research
Moderator: Mr. Serkan Valandova, Secretary General of YASED

Discussion Topics:

The webinar began with the opening speeches of YASED Chairperson Ms. Ayşem Sargın ,YASED Secretary General Mr. Serkan Valandova, and UNCTAD Head of Investment Research, Mr. Richard Bolwjin.

Global FDI Trends:

- In the earlier publication of UNCTAD (Special Edition of Global Investment Trends Monitor) in January, the forecast of -30%--40% for FDI in 2020 was already predicted. We don't see a recovery until 2021.
- We foresee this range to climb up to -40% this year, and it does not stop there. FDI reacts to a recession or crisis with a slight delay. For instance in the global financial crisis, the effects actually took 1-1.5 years. The same will happen with the crisis caused by Covid-19. We do not foresee a recovery next year, we see a further decline in 2021 and a recovery possibility in 2022, which could be driven by several factors, such as restructuring of global supply chains.
- The major decline in FDI after the Pandemic is actually a continuation of several years of declining FDI flows at the global level. There are various transmission mechanisms for this crisis to influence international direct investments:

1) FDI Stuck in the Lockdown:

- There is the physical impossibility to make an investment or to build construction projects as a result of the lockdown. We saw this firstly in China. February data showed almost 25% decline in capital formation in China. That was the immediate impact of physically not being able to get to work.

2) Tightening Margins for Re-investment:

- When you look at the earnings forecast of MNEs, which are the vehicles for FDI, earnings revisions since the 1st of February until the end of May shows a -40% decline for 2020 at the global level.
- For Turkish multinationals (based in Turkey and investing abroad), the earnings decline prediction is around -30%. What we see here is the big gap between the impact on MNEs

and SMEs. MNEs have a bigger earnings revision but not a negative revision on average. This could be very different for smaller-medium size enterprises.
- Re-invested earnings make up 52% of FDI. This is actually why the impact of crisis usually appears after 1 year, but this time around, because of the physical impact of the Pandemic and because of the downwards earnings revisions, the impact will be immediately heavy in 2020 and continue in 2021.

3) New Investment Restrictions:
- New investment restrictions were adopted especially in developed countries. Certain sensitive sectors have been the subject of new investment screening measures and blockages of M&As and/or slowdowns of approval mechanisms for M&As.

4) Long term Implications:
- There is already a lot of talk about needs to increase supply chain resilience. The role of MNEs here is to create more resilient and diversified supply chains.
- There is also a part for the policy makers, and that is to bring some production home, especially in critical sectors for critical supplies (i.e pharmaceuticals, medical equipment, medical supplies, personal protection equipments).
- We have already seen measures introduced already regarding these but it should not stop at that. In other sectors we experienced productions stops because of supply shortages of electronic components or automotive components coming from factories abroad. The idea that regions around the world are highly dependent on continued supplies from abroad is going to change, which will have long term implications for the trade and investment policies at the global level.

Summary of 2019:

Global FDI flows:

- Global FDI inflows increased marginally, by 3%. Most of this increase was driven by reversals of negative flows in a number of countries (i.e. Ireland, Switzerland).
- A number of countries in 2018 had extremely low FDI (negative flows) due to repatriations of reinvested earnings by United States multinationals but that trend got reversed in 2019 and that helped FDI to plateau in 2019. But this does not mean that a structural increase in investment in 2019 and an increase in productive investments because some of the largest economies saw a decline in FDI inflows (i.e. United States, Hong Kong China, Netherlands).

Turkey:

- Turkey had a decline of 35% in FDI inflows in 2019, which is after several years of weakening flows. (i.e. the overall decline since 2015 is more than 55%). However, over the 5 year period, greenfield investments held up better.
- The impact of the Pandemic on Turkey could be quite serious from the point of GVC participation. Global value chain intensive industries are an important feature of the FDI profile of Turkey, which makes Turkey relatively vulnerable to the impact of the Pandemic. The expected impact of the Pandemic by industry shows that services will be the most hard hit but services sector (leisure, tourism) covers a small part of FDI globally, which is the opposite for Turkey.
- More importantly, biggest impacts are on natural resources because of the dual shock both of the Pandemic and of the collapse in oil prices and the prices of other key

commodities. The next most impacted industry is GVC intensive industries, especially automotive and electronics.

Greenfield Investments:

- The largest three greenfield investments in Turkey in 2019 were in automotive and natural resources. Industry profile of investment in Turkey is relatively vulnerable to the impact of the Pandemic. The first quarter data of 2020 for Turkey shows the value of greenfield investment projects down to 75%. This is the first sign of a very significant impact on FDI in Turkey already.

Outward Investments:

- Regarding outward investment in 2019, Japan had a significant increase last year. Most of that increase was due to one acquisition of a large pharmaceutical company buying a Japanese enterprise.
- Japan is the largest global international direct investor for the second year in a row. Chinese outward investment is on the decline because of discouraging policies by the Chinese government on outward investment.

Regional FDI Inflows:

- Most of the increase in FDI inflows was recorded in Europe, mainly because of the increase in Ireland and Switzerland. Developing economies as a whole declined slightly, as well as in East and South-East Asia.

<u>Where is International Production Going? International Production Beyond Covid-19:</u>

- This year's edition is the 30th year edition of the World Investment Report. In the 30 year life span, we have seen itwo decades of rapid growth and one decade of stagnation.
- GVC share of trade stopped growing from its top level in 2007, 2008 , 2009 and 2010.
- In the 1990s the growth rates of FDI was over 15%, 8% in the 2000s and 0.8% in 2010s. There is a real stagnation taking place there. This applies to trade and GVCs, as well.

Trend That Will Influence the Next 10 Years:

- The Covid-19 Pandemic arrived on top of 3 existing megatrends shaping international production. The key elements influencing global supply chains in regards to industrial revolution are: advanced robotics and robotics based automation, digitalization in the supply chain and 3D printing.
- Regarding policy and economic governance trends, already in the last decade we have seen an increase in economic nationalism, more interventionism in investment and trade policies and the trade war.
- There are also sustainability concerns with many new policies springing up around the world (green deals, policies aimed at reducing emissions, policies aimed at improving social and environmental impact on global supply chains). Many of these policies were already ongoing but now they are reaching the tipping point. We see the Corona virus Pandemic as a potential accelerator of the impact of the mentioned trends on international production.

Four Trajectories:

- **Reshoring** and bringing home production in capital exporting developed market economies is one trajectory. Another one is **diversification**, the search for supply chain resilience and the search for new suppliers of goods.
- **Regionalization** and **replication** are the other two. **Replication** is the duplication of supply chains across different regions also for resilience purposes but also due to technology changes. These trajectories are differentiated by industry. For example, extractive industries and agro-based industries are heading towards regionalization. The same goes for regional processing industries., which are chemicals, food and beverage.
- High tech GVC industries (automotive, electronics) and lower tech GVC industries (apparel) will follow more the re-shoring near-shoring and diversification trends. Regarding regional hubs, we will see it amplify through the process of replication around the world.

Impact of the Four Trajectories:

- The impact of **re-shoring** might lead to a possible shock of restructuring, including divestments, relocations, investment diversion and we have already seen some of this taking place in East Asia and South East Asia with investment and trade diversion going towards nearby countries with similar production structures and similar factors of productions.
- We see a shrinking pool of efficiency-seeking FDI's (greenfield investment and manufacturing). This is a problem for countries aiming to attract FDI in GVC intensive industries as part of their industrial development strategy.
- **Diversification** might lead to more platform based management of GVCs by MNEs; so an increased use of e-platforms to attract suppliers and through that have the MNEs have the ability to diversify supplies around the world. For countries, this means that there are going to be a lot more asset light investment. In fact, we don't see a long term structural decline in FDI after the Pandemic crisis, but much of that investment might be in intangibles, rather than in productive physical assets. There is likely to be a shift towards intangibles and services based global value chain investments.
- **Regionalization** is a potential opportunity. The shift from a shrinking pool of global efficiency seeking investments to an increasing pool of market seeking and resilience seeking investments is likely, which might yield opportunities for investment in the context of regionalization and near shoring trends. This implies getting closer to the big regional trading blocs. For Turkey that might be the EU.
- **Replication** is the small scale distributed manufacturing opportunity and this will lead to a shift from building big infrastructure (building large scale industrial zones) to attract FDI to smaller scale distributed manufacturing investments.

Questions & Answers:

1) **In the past year, as the gap between rates of return (ROI) of developed and developing countries closed, it was expected that developed countries will emerge as the competitors of developing countries. Do you think this trend is continuing and developing countries are in threat in terms of attracting FDI?**

The perceived risk may become lower and lower as more developing countries become emerging markets and of course with the reduced perceived risk ROI tends to decrease. The huge availability of capital around the world is another thing to mention. These have all led to some convergence in the ROI, but unfortunately all this availability of capital isn't leading to a big increase neither in investment in productive assets nor in investment in infrastructure or domestic services.

2) **In your presentation you stated that there is a 30% downwards revenue revision for companies. Are they the multinationals operating in Turkey?**

We have done this analysis for the top 5000 multinationals based on their foreign assets, foreign employees and foreign sales. Those are the multinationals that set the trend, they account for the vast majority of global FDI (aside from financial services). Their earnings revisions are for their headquarters. The Turkish companies in that top 5000 multinationals have a downward revision of 30% and that has bigger implications for outward investment from Turkey.

3) **You also talked about the increasing autonomy in world economies, in terms of bringing production home. You also names some critical sectors that the production is going to be carried back or extended at home for many countries. This brings us to the issue of what is happening in China. China was the first country to enter the Pandemic but also the first to get out. Based on your analysis, is China coming back stronger?**

It is very difficult to predict. China had a big drop in capital expenditures in the first quarter and had a relatively limited drop in FDI (15% of decline in FDI in the first quarter). However, our projections show that FDI will drop significantly in China this year. It is really hard to forecast the Chinese economy due to its huge market size, it will always be a huge magnet for FDI, but it might change in nature. It might be less GVC FDI both because of the Pandemic and because of the trade tensions around the world. It might be more market seeking FDI but China will continue to be a magnet for new investment. However, FDI to China has to come from somewhere and with the huge impact on multinationals in the major investor countries in China, it is very hard to say that they will keep up investment flows as much as they have in the last few years. China reached a record inflow level again in 2019 but we do expect there to be a decline this year, keeping in mind the 15% decline in the first quarter of 2020.

4) **Regarding the nature of the competition for FDI, we observed that many Investment Promotion Agencies of countries are increasing the pace of their activities lately but with budgetary constraints, what will be the winner moves to attract FDI? You already named some of them like special economic zones but when we consider the budgetary constraints of developing countries, what can be the winner moves to attract more FDI?**

With the Turkish investment profile, with a significant reliance on GVC intense industries, one key element is to make an assessment of the vulnerability of existing investment to the crisis and to the re-shoring trend or to any of the other four trajectories. What does the investment portfolio in Turkey really look like should we place it next to the expected trajectories we project for the next 10 years. This will really focus the attention of investment authorities and special economic zone authorities on where the action should be in terms of retention strategies. When it comes to attracting new investments, same assessment will apply there. What are the type of industries and type of activities that still has sizeable opportunities and what are the determinants or the prerequisites that we need to put in place to continue to attract investment. For example, for the diversification trend, it is very much driven by the digitalization of global supply chain and to be able to compete in that area, you need strong and technologically capable small and medium-sized enterprises, the digital infrastructure to be able to compete, and special economic zones with special facilities. It is important for policy-makers to make a very clear assessment of the current portfolio and of the current targets for investment promotion and to make sure the prerequisites are really in place for the next 10 years to continue to compete in these areas.

5) Digital and business services attracted the most FDI in the recent years and digital transformation gained even more momentum in the post-Covid-19 era. Do you have any projections regarding the FDI attractiveness of the digital and business services sector for 2020?

The problem is that, the highlights are captured by the $ numbers. They are captured by the investments in big physical assets and digital investment isn't one of those. The attraction of digital companies can be a huge boom for the economy, can help increase the productivity in an economy, it can to some extent generate high quality employment. It is extremely important for the economy to compete in the area but what you don't get through is big industrial investments with mass employment generating opportunities. We described this trend in our 2017 World Investment Report, when we first saw the huge impact of the predominance of digital MNEs in the world on FDI because of the trend of asset light FDI. Number of projects might be there, but the value isn't there. If you look at the last 10 years, we saw the number of high tech digital companies in the top 100 MNEs increase from only 4 from a decade ago to 16 in 2019. Just this fact that the top 100 and top 10 of the MNEs are now being really populated by their colleagues from China, has a huge impact on physical FDI flows around the world.