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Impact of investment restrictive measures on investment¹

As the full scale of the global financial crisis emerged in 2008, G20 Leaders committed to resisting protectionism in all its forms at their 2008 Summit in Washington. At all of their subsequent summits, they have reaffirmed their pledge and have called on WTO, OECD, and UNCTAD to monitor and publicly report on G20 Members' trade and investment policy measures.

As part of their Action Plan adopted at the most recent summit in Brisbane in 2014, G20 Leaders extended this mandate. They requested analysis to “*better understand the nature of the stock of protectionist measures introduced since the global financial crisis and their impact on trade and investment*”. The present report, established by the OECD Secretariat under the responsibility of the Secretary-General of the OECD, provides analysis in response to the request.

Overall, G20 Members have lowered restrictions on FDI since 2009

Since reports on G20 Members' trade and investment policy measures began in 2009, G20 members have collectively made more than 200 amendments to their policies regarding foreign investment.² About 40% of these measures were specifically geared to alter the conditions for FDI. The remainder consists of measures affecting international capital flows generally.

The overwhelming majority of measures related to FDI have liberalised policies on foreign direct investment; only 15% of the measures introduced new restrictions to FDI.³ The overwhelming majority of the policy changes related to FDI concerned inward investment. However, the inventory also identified 10 measures related to outward FDI, 9 of which were liberalisations; the only measure that introduced a restriction for outward FDI was reversed within less than a month of its introduction.

¹ This Report is issued under the responsibility of the Secretary-General of the OECD. It has no legal effect on the rights and obligations of member states of the WTO, OECD, or UNCTAD. Nothing in this Report implies any judgment, either direct or indirect, as to the consistency of any measure referred to in the report with the provisions of any WTO, OECD, or UNCTAD agreement or any provisions thereof.

² In addition to the measures referred to here, the policy monitoring inventories list a great number of clarifications of existing policies and measures to ease the administrative burden for foreign investment.

³ One of the 14 FDI-restricting measures in the inventory was reversed during the reporting period.

The sectors in which restrictions for FDI were introduced include, in the order of frequency, real estate, in particular rural real estate; extractive industries; banking and finance as well as telecommunications, broadcasting, and (cigarette) manufacturing.

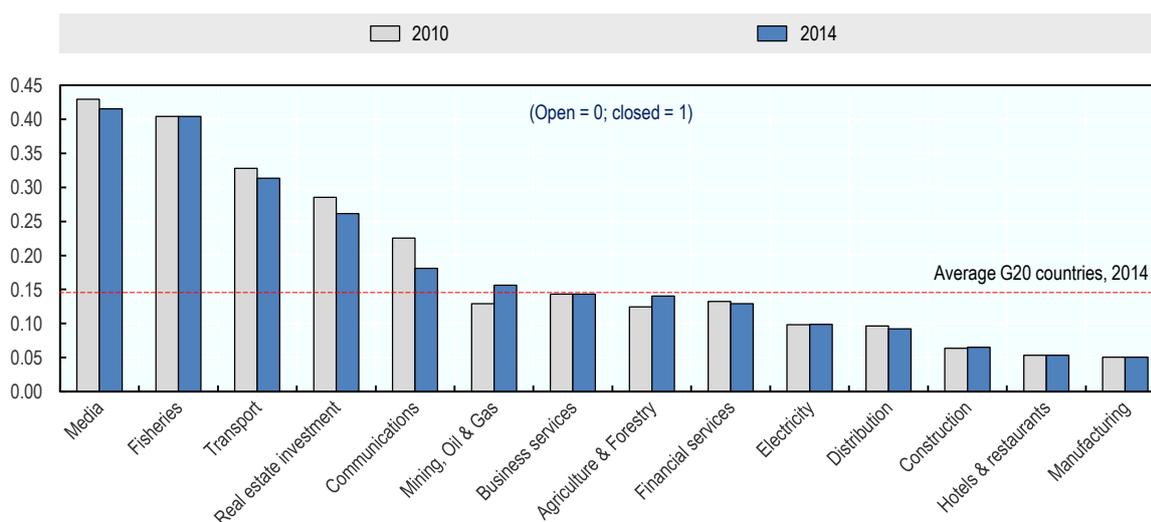
Investment policy changes were unevenly distributed among G20 Members: Nine economies among the G20 accounted for over 90% of (i) all investment policy measures; (ii) FDI-related policy measures; (iii) liberalising measures; and (iv) restricting measures.

Despite the number of measures recorded since 2009, and despite major reforms in individual sectors in some economies, the policy changes have had a relatively minor effect on G20 Members' overall restrictiveness to inward FDI, when assessed according to the OECD's FDI Regulatory Restrictiveness Index.⁴

Restrictions have been reduced most in key network sectors, but remain above average

Restrictions saw greatest reductions in network sectors such as transport and telecommunications, which play a key role for overall productivity gains. However, restrictions in these sectors remain above the average of sectors in G20 economies (Figure 1). Across all sectors, foreign equity restrictions remain by far the most frequent type of restriction.

Figure 1: Restrictiveness score in G20 Members by sectors, 2010 vs. 2014



Source: OECD FDI Regulatory Restrictiveness Index, <http://www.oecd.org/investment/fdiindex.htm>.

Remaining FDI regulatory restrictions can influence a country's ability to attract FDI. In the light of OECD's empirical findings showing that anti-competitive product market regulations – notably barriers to entry and to trade and competition – are negatively associated with investment stocks and

⁴ Changes in the OECD FDI Regulatory Restrictiveness Index (*FDI Index*) were assessed by comparing the Regulatory Restrictiveness scores as of December 2010 and December 2014. The FDI Index, which gauges the restrictiveness of a country's FDI rules rather than providing a full measure of a country's investment climate, aggregates and weights scores for 22 individual sectors of the economy. For each sector, it assesses (1) the level of foreign equity ownership permitted; (2) screening and approval procedures applied to inward foreign direct investment; (3) restrictions on key foreign personnel; and (4) other restrictions such as on land ownership, corporate organisation (*e.g.* branching). For the monitoring of G20 Investment policy measures, the discriminatory nature of measures, *i.e.* when they apply to foreign investors only, is a central criterion for scoring a measure. Details on the methodology are available at www.oecd.org/investment/index. The European Union as well as non-G20 EU Member countries are not included in the presentation of this data.

capital accumulation (Alesina et al., 2005; Nicoletti et al, 2003; Nicoletti and Scarpetta, 2005),⁵ it would seem that reforms facilitating the entry and operations of foreign direct investment could have significant and sizeable impacts on the level of inward FDI. Recent OECD estimates suggest that FDI restrictions as measured by the FDI Regulatory Restrictiveness Index have a clear negative impact on inward FDI stock levels and on capital investment by firms operating in infrastructure sectors (Fournier, 2015; Blundell-Wignall and Roulet, 2015, respectively).⁶ Thus, while restrictions may not totally preclude FDI, they may prevent countries from attracting foreign direct investment to its full potential.

Development of FDI flows in perspective

Annual figures for FDI flows from 1999 to 2014 show a pattern of FDI flows leading up to and after the global slowdown of 2001.⁷ They can serve as a comparison for the experience since the global recession in 2008 to 2009.⁸ Figure 2 is based on annual figures for FDI flows from 1999 to 2014. It shows that FDI flows fell substantially from the peak levels seen before the financial crisis that began in the second half of 2008. In 2009, FDI flows were 45% lower than the peak in 2007 – less in relative terms than in the earlier crisis, which saw FDI flows drop by 60% in 2003 compared to the peak in 2000.

Despite their steeper fall, FDI flows increased rapidly after 2003 and, by 2006, exceeded the levels of 2000. In comparison, FDI flows increased between 2009 and 2011 but fell in 2012 and have stalled since then. In 2014, FDI flows remain more than one-third lower than the peak in 2007. This difference could be due in part to the fact that the global economy grew faster during those years of rapid growth in FDI flows – 2004 through 2006 – than it has in the last few years. According to the OECD, the annual growth in global GDP ranged between 4.6% and 5.2% for 2004 through 2006, but only ranged from 3.1% to 3.3% for 2012 through 2014.⁹

⁵ Alesina, A., S. Ardagna, G. Nicoletti, and F. Schiantarelli (2005), “Regulation and Investment”, *Journal of the European Economic Association*, Vol. 3, pp. 1-35; Nicoletti, G., S. Golub, D. Hajkova, D. Mirza and K-Y. Yoo (2003), “The Influence of Policies on Trade and FDI”, *OECD Economic Studies*, No. 36, OECD Publishing: Paris; Nicoletti, G. and S. Scarpetta (2005), “Regulation and Economic Performance: Product Market Reforms and Productivity in the OECD”, *OECD Economics Department Working Papers*, No. 460, OECD Publishing: Paris.

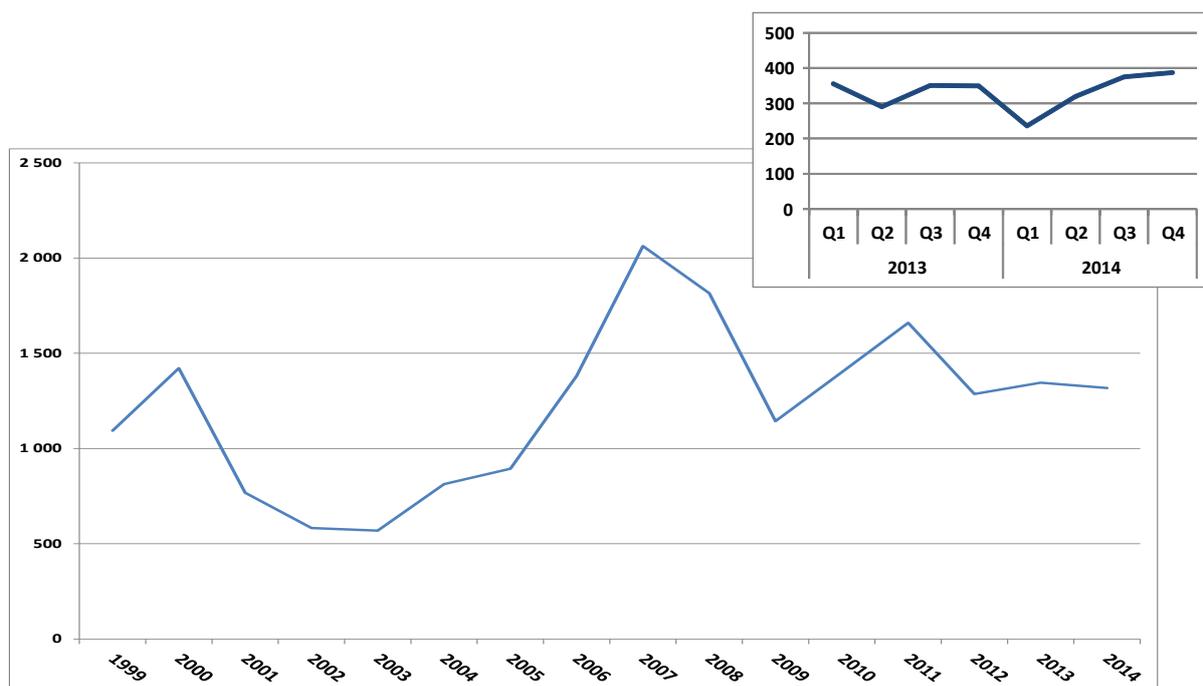
⁶ Fournier, J. (2015), “The negative effect of regulatory divergence on foreign direct investment”, *OECD Economics Department Working Papers*, OECD Publishing, Paris (forthcoming); Blundell-Wignall, A. and C. Roulet (2015), “Infrastructure versus other investments in the global economy and stagnation hypotheses: What do company data tell us?”, *OECD Journal: Financial Market Trends*, Vol. 2014/2.

⁷ World totals for FDI flows (tables 1 and 2) are based on available FDI data as reported to OECD and IMF. Missing data for non OECD and non G20 countries for Q3 and Q4 2014 were estimated using the overall growth rate observed between, respectively Q2 2014 and Q3 2014, as well as between Q3 2014 and Q4 2014, on OECD, non OECD G20 countries and respectively, 35 and 15 non OECD and non G20 countries.

⁸ The IMF defines a global recession as a contraction in world real per capita GDP accompanied by a broad decline in various other measures of global economic activity. Using these criteria, the IMF has identified four global recessions since 1962 – in 1975, 1982, 1991, and 2009. The 2001 slowdown just avoided meeting the definition of a global recession because real per capita GDP growth remained positive. See Kenneth Rogoff, “The Recessions that Almost Was,” *Financial Times*, 5 April 2002 available here: www.imf.org/external/np/vc/2002/040502.htm.

⁹ World GDP growth rates from the OECD Economic Outlook Number 96 Database.

Figure 2: Global FDI Flows from 1999 to 2014 (USD billion)



Source: OECD International Direct Investment Statistics database and IMF

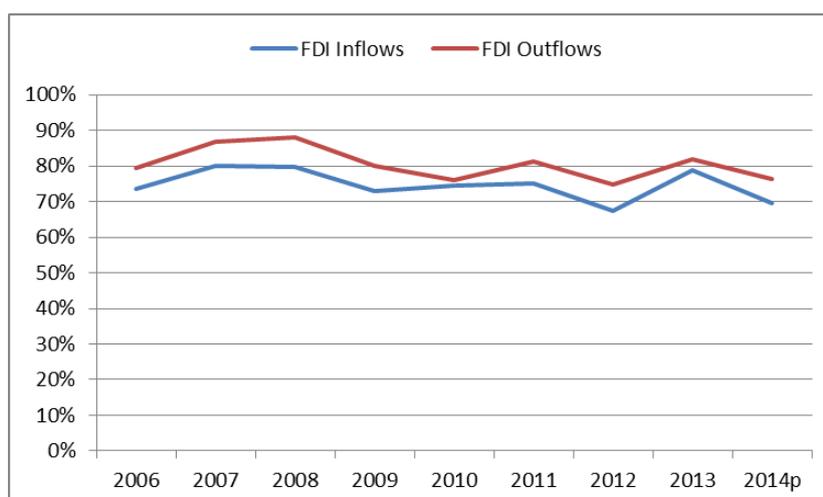
The experiences of different countries and regions have varied significantly since the financial crisis. For example, EU inflows and outflows in 2014 are about three-fourths lower than their pre-crisis peaks in 2007. In contrast, United States inflows are down more than half from their 2008 peak, but this is largely due to the Vodafone-Verizon transaction in 2014;¹⁰ in 2013 they were down by one quarter. United States outflows are down about one seventh from their 2007 peak. At the same time, P.R.China's role as both a destination and a source of FDI has continued to grow. Since the beginning of the crisis, P.R.China's FDI inflows have increased by about 85%, and its outflows are up considerably, over three times higher in 2014 than in 2007, albeit from low levels.

Figure 3 shows the share of the G20 Members in global FDI inflows and outflows from 2006 to 2014.¹¹

¹⁰ Verizon bought out Vodafone's investment in its United States operations for about USD 130 billion, which reduced both inward investment in the United States and outward investment from the United Kingdom.

¹¹ Data for the EU includes flows from and to all EU Member States including non-G20 countries.

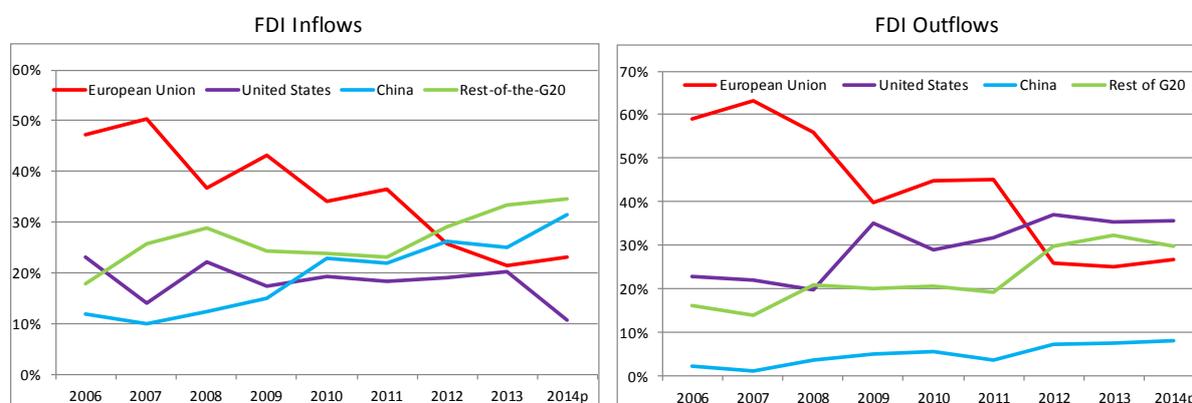
Figure 3: Share of G20 Countries in Global FDI Inflows and Outflows, 2006-2014



Source: OECD International Direct Investment Statistics database and IMF.

Looking at the shares can shed light on whether there are shifts in the source and destination countries for FDI. During the years from 2006 to 2014, G20 countries accounted for between 75% and 88% of FDI outflows, and for between 67% and 80% of FDI inflows.¹² Figure 4 shows the shares in total G20 FDI inflows and outflows accounted for by the EU, the United States, P.R.China, and the rest of the G20 in the years from 2006 to 2014.

Figure 4: Share of EU, US, China and the Rest-of-the-G20 in G20 FDI Flows, 2006 to 2014



Source: OECD International Direct Investment Statistics database

For FDI inflows, the figure shows the decline of the EU as a destination for FDI, from around 50% of FDI inflows to less than a quarter. The share of the United States has generally been pretty stable over the period, while the share of P.R.China and the rest of the G20 has risen. For FDI outflows, the figure indicates a decline in the EU as a source of FDI, from around 60% to just 27%. The shares of the United States, P.R.China, and the rest of the G20 have all risen.

¹² The fact that the shares in 2013 and 2014 do not appear significantly lower than earlier years may indicate that the wider adoption of the new international standards under the OECD Benchmark Definition of Foreign Direct Investment, 4th edition within the G20 countries may not have had a significant impact on their share of global FDI flows. Looking at the shares of different countries and regions within the G20 should be less problematic because of the more consistent FDI statistics.

Impact of policy changes on FDI flows remains uncertain

The impact of the policy measures that G20 members have taken since 2009 on FDI flows remains difficult to assess for multiple reasons: FDI data is highly aggregated across sectors and – unlike trade data for instance – cannot easily be associated with liberalisations or restrictions in policy; also, individual transactions can have a great impact on FDI flows. Further complications arise from the recent change of the method for collecting FDI data (see Box 1).¹³

Nevertheless, a careful analysis of the figures yields insights into the longer term trends in FDI and reveals that FDI flows remain below the record-high levels reached in 2007, prior to the financial crisis. Overall, there is no significant decline in the share of FDI flows accounted for by the G20, but, within the G20, there has been a decline in the importance of the EU as both a source and destination of FDI.

Box 1: OECD Benchmark Definition of Foreign Direct Investment, 4th edition

The financing structures of MNEs have become more complex over time in response to several factors, including the need to manage global production networks and the desire to minimize tax and regulatory burdens. MNEs often structure their financing to channel investments through one or more countries before it reaches its ultimate destination. This complexity inflates FDI statistics because each flow into and out of each country is counted even if the capital is just passing through. The OECD's Benchmark Definition of Foreign Direct Investment, 4th edition (BMD4), makes recommendations that result in more meaningful measures of FDI. Specifically, BMD4 includes two recommendations to improve the measurement of FDI statistics by reducing the double-counting of FDI flows and positions that are just passing-through economies. First, it recommends that the statistics be compiled separately for FDI associated with resident Special Purpose Entities (SPEs). BMD4 also recommends use of the extended directional principle to better capture the direction and degree of influence of the investment and to remove some of the double-counting in FDI statistics when debt passes through affiliated entities. However, the new statistics come at a cost as they can cause breaks in series that make it difficult to analyse FDI over time.

Separately Compiling FDI Statistics for Resident SPEs

MNEs often use SPEs in their ownership structures. SPEs are entities that have little or no employment, physical presence, or operations in a country but do provide services to the MNE, such as holding assets and liabilities or raising capital. While there is no strict definition of an SPE, an enterprise is usually considered to be an SPE if it has little or no employment or physical operations, is ultimately owned by a non-resident, almost all of its assets and liabilities represent investments in or from other countries, and its core business is group-financing and holding and not managing and directing. Examples of SPEs include brass plate companies, financing subsidiaries, conduits, holding companies, shelf companies, and shell companies.

BMD4 recommends that countries compile their FDI statistics excluding resident SPEs, and, then, separately for resident SPEs. This recommendation provides a more meaningful measure of direct investment into and out of an economy by removing FDI that involves funds simply passing through the economy via SPEs on their way to other destinations. Such funds—also called pass-through capital or capital-in-transit—distort the country patterns of FDI statistics and cause double-counting in the statistics. For the country hosting the SPEs, this recommendation improves the measurement of FDI by excluding inward FDI that has little or no real impact on their economies and by excluding outward FDI that did not originate from their economies. At the global level, it reduces the double-counting of FDI by excluding funds that just pass through SPEs.

Extending the Directional Principle

FDI statistics presented according to the directional principle capture the direction of the investment—either inward or outward—and the degree of influence of the direct investor. BMD4 recommends extending the directional principle to transactions and positions between fellow enterprises. Fellow enterprises are

¹³ The change of methodology leads to breaks in the series for some countries and differences in reporting across countries as they adopt the new standards at different times. While the new method for compiling FDI data will result in more meaningful FDI data – see Box 1 –, these circumstances make an assessment of the impact of policy changes on FDI flows for the period since the financial and economic crisis more challenging.

enterprises that have no direct investment relationship themselves but that have a direct investor in common, that is, they are both affiliates of the same MNE. Even though there is no direct investment relationship between fellow enterprises, transactions and positions between fellows are relevant to FDI statistics because such transactions likely resulted from the influence of their common direct investor. BMD4 recommends extending the directional principle to flows and positions between fellow enterprises to better reflect the direction of influence. The previous edition of the *Benchmark Definition of FDI*, BMD3, called for recording lending by a resident fellow enterprise to a foreign fellow under outward investment and borrowing by a resident fellow enterprise from a foreign fellow under inward investment. However, this treatment did not accurately reflect the direction and degree of influence exerted by resident and non-resident direct investors in the reporting economy. For example, a resident fellow did not achieve any influence over a foreign fellow if it made a loan to that foreign fellow—the influence remained with the direct investor common to both fellows. So, if the direct investor is not resident in the economy, such loans should not be recorded as outward investment. Similarly, a foreign fellow did not achieve any influence over a resident fellow by extending a loan to it—the influence remained with the direct investor common to the fellows.