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(08:00 New York, 14:00 Geneva, 15:00 Nairobi)

WORLD INVESTMENT REPORT 2022

INTERNATIONAL TAX REFORMS AND SUSTAINABLE INVESTMENT

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UNITED NATIONS
Geneva, 2022

United Nations Publications
405 East 42nd Street
New York, New York 10017
United States of America

Email: publications@un.org
Website: https://shop.un.org

This publication has been edited externally.

United Nations publication issued by the United Nations Conference on Trade and Development.

UNCTAD/WIR/2022

ISBN 978-92-1-113049-2
eISBN 978-92-1-001543-1
Print ISSN 1020-2218
Online ISSN 2225-1677
Sales No. E.22.II.D.20

PREFACE

Global flows of foreign direct investment recovered to pre-pandemic levels last year, reaching $1.6 trillion. Cross-border deals and international project finance were particularly strong, encouraged by loose financing conditions and infrastructure stimulus. However, the recovery of greenfield investment in industry remains fragile, especially in developing countries.

This fragile growth of real productive investment is likely to persist in 2022. The fallout of the war in Ukraine with the triple food, fuel and finance crises, along with the ongoing COVID-19 pandemic and climate disruption, are adding stresses, particularly in developing countries. Global growth estimates for the year are already down by a full percentage point. There is significant risk that the momentum for recovery in international investment will stall prematurely, hampering efforts to boost finance for sustainable development.

The *World Investment Report* supports policymakers by monitoring global and regional investment trends and national and international investment policy developments. The report reviews investment in the Sustainable Development Goals and in climate change mitigation and adaptation. It also looks at sustainable finance trends in capital markets and among institutional investors.

The coming years will see the implementation of fundamental reforms in international taxation. These reforms are expected to have major implications for investment policy, especially in countries that make use of fiscal incentives and special economic zones. The report of this year provides a guide for policymakers to navigate the complex new tax rules and to adjust their investment strategies.

I commend this report to all engaged in promoting investment in sustainable development.

António Guterres
Secretary-General of the United Nations

FOREWORD

The global environment for international investment changed dramatically with the onset of the war in Ukraine, which occurred while the world was still reeling from the impact of the pandemic. The war is having effects well beyond its immediate vicinity, causing a cost-of-living crisis affecting billions of people around the world, with rising prices for energy and food reducing real incomes and aggravating debt stress. Investor uncertainty and risk aversity could put significant downward pressure on global FDI this year.

The effects on investment flows to developing countries in 2022 and beyond are difficult to anticipate. Apart from direct effects on countries in Central Asia with close investment ties in the region, the impact on others will be mostly indirect and depend on the extent of their exposure to the triple crisis – in food, fuel and finance – caused by the conflict and their consequent economic and political instability – key determinants of international private investment. If the past is an indication, the last time food prices were this high – during the 2007–2008 food crisis – there were riots in more than 60 countries.

The outcome will be of enormous significance for development prospects. The need for investment in productive capacity, in the Sustainable Development Goals (SDGs) and in climate change mitigation and adaptation is enormous. Current investment trends in these areas are not unanimously positive. Although global FDI flows rebounded strongly in 2021, industrial investment remains weak and well below pre-pandemic levels, especially in the poorest countries; SDG investment – project finance in infrastructure, food security, water and sanitation, and health – is growing but not enough to reach the goals by 2030; and investment in climate change mitigation, especially renewables, is booming but most of it remains in developed countries and adaptation investment continues to lag well behind.

Worryingly, some emerging indicators suggest that the war in Ukraine could become a setback in the energy transition, with increased fossil fuel production in countries previously committed to reducing emissions. In the first quarter of 2022, most of the 5,000 largest multinational enterprises revised downward their earnings forecasts for 2022. Alarmingly, while extractive industries revised upwards their expected earnings, with oil and gas at +22 per cent and coal at +32 per cent of expected earnings, renewable energy companies released downward revisions of an average of -22 per cent of expected earnings, lending credence to the intuition that current conditions risk reversing years of progress towards investing in sustainable energy. This is especially worrying as global CO2 emissions from energy combustion and industrial processes rebounded in 2021 to reach their highest ever annual level.

To achieve the SDGs it is imperative that more funds are channeled to where they are most needed, on the ground, in developing countries. But also an important effort will have to come from domestic resource mobilization. From that perspective, the ongoing international tax reforms led by the G20 and the OECD, which we study extensively in this report, are a major step forward. They aim to ensure that multinationals pay their fair share of taxes where they operate, and they have the potential to give a significant boost to tax revenues in developing countries.

However, the war in Ukraine has further complicated domestic resource mobilization in developing countries, already worsened by the COVID-19 pandemic and the increased frequency of natural disasters in the context of climate change. In the midst of rising and unsustainable debt levels, without adequate multilateral mechanisms for restructuring, countries are being forced to reduce their fiscal space at a time when they should be increasing it.

The International Labour Organization suggests that the social protection financing gap stands at $1.2 trillion per year in developing countries, part of the $4.3 trillion we at UNCTAD estimate as the yearly gap in SDG financing. And even with food and energy import bills, and worsening costs of borrowing due to higher interest rates, developing countries' primary fiscal balance has shrunk by $315 billion since the start of the war.

That is why international investment plays a critical complementary role to domestic public investment. And the new tax rules will affect how countries have traditionally promoted – and often competed – for international investment, through low tax rates, fiscal incentives and special economic zones.

The tax reforms are an opportunity for developing countries, not only from a revenue perspective, but also from an investment attraction perspective. Strategically, tax competition will decrease. Practically, the need to review the investment promotion toolkit is a chance to make costly incentives more sustainable.

There will be challenges. Developing countries face constraints in their responses to the reforms, because of a lack of technical capacity to deal with the complexity of the tax changes, and because of investment treaty commitments that could hinder effective fiscal policy action. The international community has the obligation to help. It can do so through technical assistance, by agreeing a solution to problems caused by international investment agreements, and by putting in place safeguards that protect the tax revenues of the poorest countries. These efforts should be part of a broader multilateral endeavor towards reining in illicit financial flows, especially in the developing world. This report points the way.

It is important that we act now. Even though countries face very alarming immediate problems stemming from the cost-of-living crisis, it is important we are able to invest in the long term. Because the short term and long term start at the same time. And the time is now.

Rebeca Grynspan
Secretary-General of UNCTAD

ACKNOWLEDGEMENTS

The *World Investment Report 2022* was prepared by a team led by James X. Zhan. The team members included Richard Bolwijn, Bruno Casella, Joseph Clements, Berna Dogan, Hamed El Kady, Kumi Endo, Anastasia Leskova, Massimo Meloni, Anthony Miller, Abraham Negash, Yongfu Ouyang, Diana Rosert, Amelia U. Santos-Paulino, Changbum Son, Astrit Sulstarova, Claudia Trentini, Joerg Weber and Kee Hwee Wee.

Research support and inputs were provided by Gregory Auclair, Hamidreza Bakhtiarizadeh, Magdalena Bulit Goñi, João de Camargo Mainente, Malou Celander, Antoine Cornevin, Juliette Gailly, Tiffany Grabski, Vicente Guazzini, Maxime Ladrière, Corli Le Roux, Iana Miachenkova, Josef Ostřanský, Hayley Marie Pallan, Sang Hyun Park, Lisa Remke, Samuel Ringier, Rita Schmutz, Baptiste Souillard, Irina Stanyukova, Ilan Strauss, Yihua Teng and Anqi Wang.

Comments and contributions were provided by Yoseph Asmelash, Chantal Dupasquier, Isabel Garza Rodriguez and Paul Wessendorp, as well as the Office of the Secretary General.

Statistical assistance was provided by Mohamed Chiraz Baly and Bradley Boicourt. IT assistance was provided by Chrysanthi Kourti.

The manuscript was copy-edited by Lise Lingo. The design of the charts and infographics, and the typesetting of the report were done by Thierry Alran, assisted by Alexandra Sonia Garcês. Production of the report was supported by Elisabeth Anodeau-Mareschal and Katia Vieu. Additional support was provided by Nathalie Eulaerts and Sivanla Sikounnavong.

Michael Keen acted as principal advisor on the theme chapter of the report. The theme chapter also benefited from the collaboration with the team at the WU Global Tax Policy Centre of Vienna University of Economics and Business led by Jeffrey Owens, including Ivan Lazarov, Belissa Ferreira Liotti, Ruth Wamuyu Maina and Joy Waruguru Ndubai.

At various stages of the preparation of the theme chapter, in particular during the kick-off event at the World Investment Forum and various expert meetings organized