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Prospects for Foreign Direct Investment and the Strategies of Transnational Corporations

2005-2008

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Acknowledgements

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Executive summary

Prospects for global foreign direct investment (FDI) are promising in both the short term (2005-2006) and the medium term (2007-2008). The overall positive outlook, indicated by the Global Investment Prospects Assessment (GIPA) 2005 surveys and the business environment depicted by various leading indicators for FDI, all point to increased investment in the future.

The stage for the expected FDI growth is set by the foreseeable macroeconomic climate, which is largely favourable to FDI, and growing corporate profits that increase the availability of investible funds for corporate future expansion. Furthermore, investment liberalisation continues apace at both national and international levels. Competition to attract FDI through various promotion and facilitation measures has also escalated further. All this has set the scene for increased FDI flows over the next few years. At the same time, there are also risk factors that can be potentially detrimental to future FDI growth rates. The following is a summary of the findings by UNCTAD's global surveys of transnational corporations (TNCs), international FDI experts and investment promotion agencies (IPAs):

- *Overall short- and medium-term FDI prospects*. The main message from the 2005 survey is positive. More than half of TNCs and expert respondents, and 81% of IPAs, expected short-term (2005-2006) growth in FDI flows, while almost all other respondents expected flows to remain steady. Only a small fraction of respondents thought that FDI would decrease in the immediate future. Opinions on medium-term (2007-2008) FDI prospects are equally optimistic. TNCs and IPAs are confident regarding FDI growth, with 57% of experts, 65% of TNCs, and 83% of IPAs expecting FDI to increase. Again, most other respondents expected FDI levels to remain the same.

- *Risk factors for global FDI growth*. Respondents indicated a number of reasons to be cautious about FDI growth prospects in the short and medium term. Protectionism, lower-than-expected growth in industrialised countries, financial instability in major source economies, global terrorism, and the volatility of petroleum and other raw material prices were all regarded as potential risk factors.

- *Regional pattern of FDI flows*. Investors' attention appears to be shifting away from traditionally important locations in developed countries in favour of certain emerging markets. Asia and South-eastern Europe are the two regions with the most favourable FDI prospects. FDI in Latin America is likely to continue its recovery. FDI flows to Africa are expected to remain stable at recent levels. Developed countries as a group are expected to see some recovery in FDI but this will be modest in the short run. The United States is expected to remain the most attractive destination for FDI in the developed world, but expectations are less positive for the major European economies.

- *The most attractive global locations for FDI*. Half of the top ten countries ranked by both experts and TNCs alike belong to the developing world. China is considered an attractive location by 87% of TNCs and 85% of experts - at least 30 percentage points above the ranking of the next best performer. The other countries in the top five tier were the United States, India, the Russian Federation and Brazil.

- *FDI prospects by industry*. Prospects for FDI vary significantly by industry. The outlook for the services sector will continue to be more positive than for the manufacturing or primary sectors. The industries expected to be at the forefront of FDI growth are computing and ICT, public utilities, transportation and tourism-related services in the services sector; electrical and electronic products, machinery and metals in the manufacturing sector; and mining and petroleum in the primary sector.

- *Expected leading sources of FDI*. IPAs expect the United States to be by far the most important source of global FDI flows, followed by the United Kingdom, Germany and China. Along with China, a number of other developing countries feature in the top fifteen source countries, including South

Africa, India, Brazil, Malaysia and the Republic of Korea. Some of these countries are important sources of FDI only for their immediate neighbours. Overall, these findings confirm the current trend towards developing country TNCs becoming global players through outward investment.

- *Prospects for TNCs' mode of entry*. More than half of respondents expected mergers and acquisitions to be the primary vehicle for FDI in 2005-2006. In contrast, most IPAs, the majority of which are from developing countries and concentrate on non-M&A FDI, expected greenfield investment to be the most important mode of entry. Non-equity investment, such as through strategic alliances or licensing, is also expected to remain significant.

- *Prospects for the relocation of corporate functions*. Production in goods and services is the corporate function rated most likely to be relocated. Well over 80% of those surveyed expected to see such activity transferred overseas. Next in line, logistics and support services are the functions most likely to relocate offshore, followed by distribution and sales.

- *Future policy developments*. As competition for FDI increases, countries worldwide are becoming more proactive in their investment promotion efforts. The majority of IPAs intend to continue increasing the number and range of FDI-attracting initiatives over the next two years. In particular, given limited resources, most IPAs signaled their intention to employ a more targeted approach to investment promotion.

In summary, although there are some potential risks, which may weaken momentum in the near future, FDI growth is likely to continue. The recovery is increasingly fuelled by investment into, and from, developing countries. The overall mood is one of cautious optimism.

Table 1. Summary of survey results

	Global prospects	Regional prospects: Developed countries	Africa	Asia and the Pacific	Latin America and the Caribbean	Southeast Europe and CIS
Prospects for FDI flows in 2005-2006 (Increase/remain the same/ decrease)	Experts					
	(59%/41%/0%)	(30%/55%/15%)	(37%/49%/14%)	(85%/13%/2%)	(41%/48%/11%)	(86%/12%/2%)
	IPAs					
	(81%/15%/5%)	(72%/28%/0%)	(88%/4%/8%)	(96%/4%/0%)	(63%/29%/8%)	(91%/0%/9%)
	TNCs					
	(56%/42%/2%)	(27%/59%/14%)	(24%/55%/21%)	(89%/8%/3%)	(36%/58%/5%)	(88%/12%/0%)
Most attractive business location (TNC responses)	1. China 2. India 3. United States 4. Russian Federation 5. Brazil	1. United States 2. Canada 3. United Kingdom 4. Germany 5. France	1. South Africa 2. Egypt 3. Morocco 4. Nigeria 5. Tunisia	1. China 2. India 3. Thailand 4. Republic of Korea 5. Malaysia	1. Brazil 2. Mexico 3. Argentina 4. Chile 5. Venezuela	1. Russian Federation 2. Romania 3. Ukraine 4. Kazakhstan 5. Croatia
Expected leading sources of FDI in 2005-2006 (IPA responses)	1. United States 2. United Kingdom 3. Germany	1. United States 2. Germany 3. United Kingdom	1. South Africa 2. China 3. United Kingdom	1. United States 2. China 3. Japan	1. United States 2. Spain 3. Brazil	1. United States 2. Netherlands 3. United Kingdom
Industries with most positive outlook for 2005-2006 (IPA responses)	- Computing and ICT - Electricity, gas and water - Transportation - Tourism, hotels and restaurants - Electrical and electronic products - Mining and petroleum	- Computing and ICT - Tourism, hotels and restaurants - Transport - Electrical and electronic products - Business services - Retail and wholesale	- Tourism, hotels and restaurants - Computing and ICT - Mining and petroleum - Construction - Electrical and electronic products - Electricity, gas and water	- Construction - Computing and ICT - Tourism, hotels and restaurants - Business services - Education and health - Metal	- Tourism, hotels and restaurants - Construction - Computing and ICT - Food and beverages - Electricity, gas and water - Mining and petroleum	- Construction - Computing and ICT - Food and beverages - Transport - Chemicals - Electrical and electronic products

Table 1. Summary of survey results (concluded)

	Global prospects	Regional prospects: Developed countries	Africa	Asia and the Pacific	Latin America and the Caribbean	Southeast Europe and CIS
Corporate functions in 2005-2006 (IPA responses)	-Production (84%) -Distribution and sales (64%)	-R&D (84%) -Production, logistics and supporting services(76%)	-Production (92%) -Distribution and sales (79%)	-Production (91%) -Logistics and supporting services (87%)	-Production (71%) -Regional headquarters, logistics and supporting services (50%)	-Production (100%) -Distribution and sales (64%)
Expected modes of FDI in 2005-2006 (TNC responses)	M&A	M&A	Greenfield	Greenfield	Greenfield	Greenfield
Plans for new investment policy measures in 2005-2006 (IPA responses)	1. Greater targeting 2. Other promotion measures 3. Additional incentives	1. Greater targeting 2. Additional incentives 3. Further liberalisation	1. Greater targeting 2. Additional incentives 3. Further liberalisation	1. Greater targeting 2. Further liberalisation 3.Additional incentives	1. Greater targeting 2. Other promotion measures 3. Additional incentives	1. Greater targeting 2. Additional incentives 3. Further liberalisation
Major threats to global FDI flows in 2005-2006 (% of total expert, IPA and TNC responses)	**Experts** 1.Protectionism (89%) 2. Global terrorism threat (81%) 3. Slow growth in industrialised countries (80%)		**IPAs** 1. Financial instability of major economies (92%) 2. Price volatility of petroleum and other raw materials (81%) 3. Political instability and civil wars (78%)		**TNCs** 1. Protectionism (100%) 2. Slow growth in industrialised countries (89%) 3. Financial instability of major economies (84%)	

Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

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I. Introduction

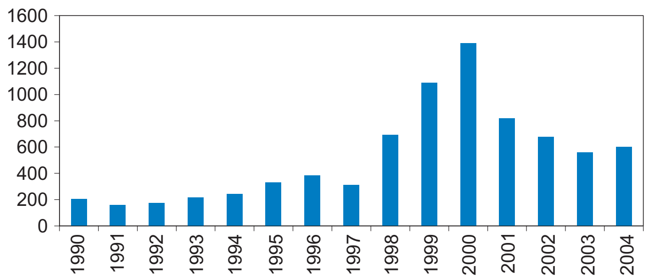
The Global Investment Prospects Assessment (GIPA) is designed to present short- and medium-term prospects for foreign direct investment (FDI) at the global, regional and industry levels. It also analyses the evolving trends in the strategies of transnational corporations (TNCs), as well as national FDI policies.

GIPA is designed to equip governments and business alike with an instrument for proactive development of policies and strategies, as opposed to a *post facto* assessment of foreign investment facts.

This study, the third in the GIPA series, assesses the 2005-2008 prospects for FDI trends, TNC activities and policy developments using a methodology similar to last year's report. GIPA is a comprehensive analysis based on the findings of three parallel global surveys of TNCs, FDI experts and IPAs, as well as on relevant macroeconomic and microeconomic indicators and policy initiatives that shape the future global FDI.

The GIPA 2005 survey was conducted against the backdrop of the end of a three-year downturn in global FDI, with the recovery, which began in 2004, being led by a rise in FDI to developing countries as flows to developed countries remained modest (figure I.1).[1]

Figure I.1. Trends in global FDI flows, 1990-2004
(US$billion per year)



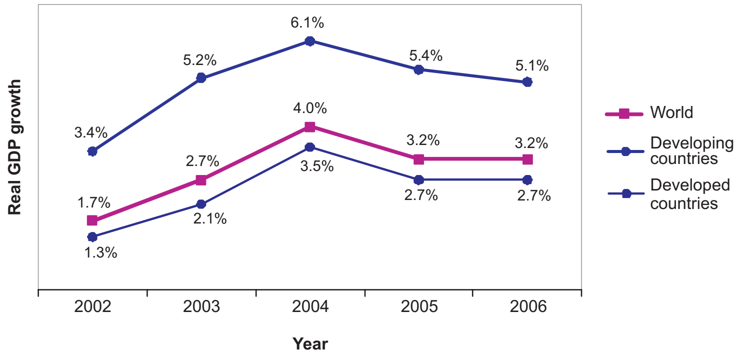
Source: UNCTAD, www.unctad.org/fdistatistics.

II. Investment environment for future FDI

A. Economic determinants for future FDI

Recent growth forecasts suggest that the global macroeconomic climate will be largely favourable to FDI in the short and medium term (figure II.A.1). Most regions are expected to maintain robust gross domestic product (GDP) growth, with Asia at the forefront. Important threats to growth and FDI in turn are ongoing increases in interest rates and spiralling petroleum and commodity prices.

Figure.II.A.1. Global GDP growth rates, 2002-2006



Source: World Bank, Global Economic Prospects 2005.

Note: The figures for the years 2005 and 2006 are estimates.

Global growth rates are expected to fall slightly from a peak of 4% in 2004, to an average of 3.2% in 2005 and 2006. The figures, at least for the world as a whole, are still higher than in 2002 and 2003 (World Bank 2005a). As in previous years, growth in developing countries is expected to outstrip that of the developed world. While the former are expected to see a growth rate of over 5% in 2005 and 2006, the latter are likely to average a rate of 2.7%. There is, however, significant variability in growth among countries in each of the groups.

The United States economy is expected to grow by slightly more than 3% in both 2005 and 2006, while Western Europe and Japan are expected to be less dynamic. Growth in the euro area is forecast at 2.6% per year, dragged down by the sluggishness of its three largest economies, France, Germany and Italy. These three are all expected to see annual growth of just 1-2% over the next two years (Eurostat 2005). On the other hand, most of the smaller European Union (EU) countries, particularly the new Central and Eastern European members, are expected to record healthy growth of at least 4%. Japan's economy is likely to grow by only 1.8% in 2005 and 1.6% in 2006.

South Asia, East Asia, and Eastern Europe and Central Asia are all expected to experience growth of over 5.5% in 2005 and 2006 (World Bank 2005a). Every other developing region is expected to expand by between 3.5% and 5% per year. Developing countries are, therefore, becoming increasingly the primary engine of global economic growth.

Since there is generally a stable and positive relationship between GDP growth and global FDI flows, this positive macroeconomic performance bodes well for national FDI prospects. On the supply side, FDI is affected by the availability of investment capital, generated by corporate profits or loans, which in turn are affected by domestic economic conditions, including growth. On the demand side, growing overseas markets lead TNCs to invest more, while depressed markets inhibit them.

Over the past two decades, booms in global FDI have followed periods of high economic growth, while declines have followed recessions or periods of slow growth. The decline in FDI flows in 2001 and 2002 followed rapid increases in FDI growth during the late 1990s. There was a similar pattern during the late 1980s and early 1990s, as well as in 1982-1983. The positive recent economic trends suggest that an FDI upturn is in the works following the recent investment recession.

While short-term growth forecasts are largely positive, the macroeconomic outlook is not entirely rosy. Firstly, gross fixed capital formation (GFCF) figures for the period 2005-2006 point to a slowdown in overall investment in member countries of the Organisation for Economic Co-operation and Development

(OECD). The OECD average is expected to drop from 5.9% in 2004 to 2.65% in 2005 and 0.8% in 2006. Secondly, while inflation is expected to remain under control in most regions, interest rates are expected to increase. This is particularly true in the United States, where rates for 6-month dollar denominated loans are expected to increase from 1.6% in 2004 to 3.5% in 2005 and 4.6% in 2006 (World Bank 2005a). Such a surge may dampen FDI expectations over the next two years. Thirdly, there are no indications of an imminent drop in petroleum prices. Forecasts for 2005-2006 suggest the price of crude oil will be high (United States Energy Information Administration 2005). The latter is bound to have an adverse effect on a variety of manufacturing and services industries, although the higher prices are likely to generate additional FDI in natural resources.

Another issue that has to be considered in the macroeconomic framework is the fluctuation in the value of the dollar vis-à-vis other currencies, which is likely to have an effect on cross-border investment flows between the United States and the rest of the world, be it in the form of equity, earnings or inter-company. For foreign-based TNCs, United States assets have been cheaper in recent years. For foreign affiliates of TNCs based in the United States, it also means that this is a good time to repatriate intra-firm dollar denominated debt or foreign earnings. The net impact on FDI flows will depend of course on the magnitudes of these two effects.

Firm-level indicators suggest the microeconomic environment will be largely favourable to FDI expansion over the next few years. Firstly, robust economic growth and strong demand has raised corporate profits in a range of industries. This has helped to increase the volume of capital available for investment. The growth in profits may not remain at an exceptional level as was the case in 2003-2004, but the profitability of the largest TNCs remains healthy in the short term. According to UNCTAD's calculations, profits in the world's largest TNCs[2] are likely to continue to increase over the next three years, but at a slower pace.

The average net profits of the top five hundred companies in the United States continue their ascent, charting a record-breaking $8.2 trillion in revenues and $513.5 billion in profits in 2004, according to Fortune Magazine. Of the forty-two industries analyzed by Fortune, thirty-eight registered profit growth in 2004 (Fortune Magazine, April 2005). The average net profits of the thousand largest Asian companies (mainly TNCs from Japan, China, Hong Kong (China), Malaysia, the Republic of Korea and Taiwan, Province of China), also rose, at a high rate of 52% (Asia Week 2005).

The positive profit outlook is also reflected in another set of microeconomic indicators business confidence levels. Several surveys of CEOs and investment experts from various regions have portrayed cautious optimism about future investment. The *McKinsey Global Survey of Business Executives Confidence Index* (McKinsey 2005), for example, revealed a positive attitude among the 9,300 business executives surveyed, though their forecasts were generally less upbeat than a year ago. The *PriceWaterhouseCoopers 8th Annual Global CEO Survey* (PwC 2005) found rising confidence in future levels of revenue growth over the next twelve months. The proportion of CEOs who were “very confident” or “somewhat confident” rose from 72% in 2002 to 84% in 2003 and 91% in 2004. In response to growing competition, nearly 40% of the CEOs are engaging in offshoring or planning to do so.

B. Policy determinants for future FDI

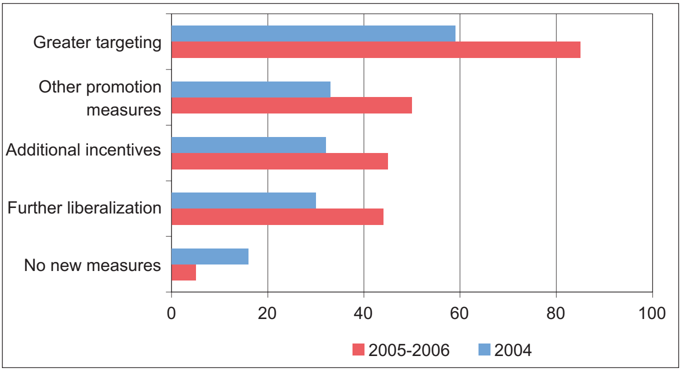
Investment liberalisation continues apace, and has in fact intensified at both national and international levels. This is likely to contribute to increased FDI flows in years to come. Competition to attract FDI through various promotion and facilitation measures has also escalated further.

National level

Generally, countries are responding to increased global competition for FDI by becoming more proactive in their investment promotion efforts. The number of countries implementing investment-related policies, and the range of measures they used, both grew in 2004. Measures included further liberalisation, additional incentives and often investor targeting (figure II.B.1). Only 16% of the IPAs surveyed indicated that their countries did not introduce any additional investment promotion measures over the past year.

A total of 269 FDI-related regulatory changes were introduced in 102 countries in 2004. The vast majority (87%) were designed to make host countries more attractive to foreign companies (UNCTAD 2005a). A clear example of this was a reduction in corporate tax rates, which fell on average in the OECD from 29.7% to 26.5% (UNCTAD 2005a). The largest reduction was made by Romania, from 26% to 16%, followed by Uruguay and Bulgaria.

Figure II.B.1. Policy measures to attract FDI, 2004-2006
(Per cent of response by IPAs)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

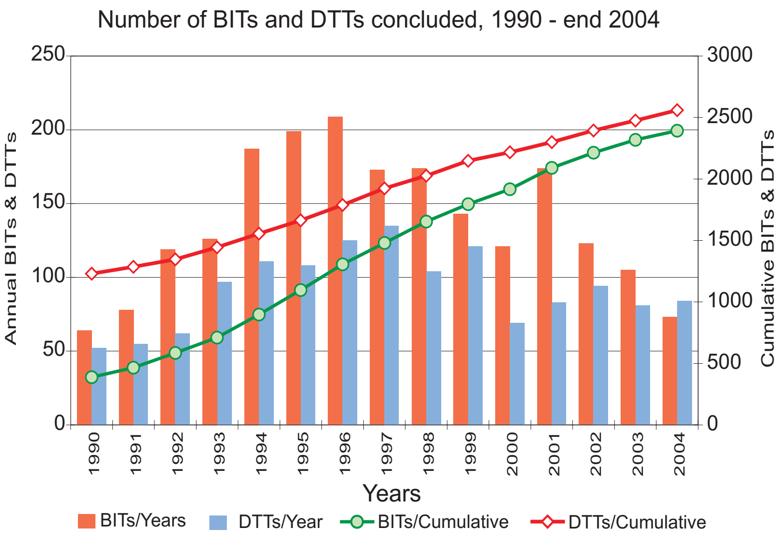
According to the GIPA 2005 survey, more than 50% of the responding countries planned to intensify their investment promotion efforts for 2005-2006. Furthermore, given the limited resources at their disposal, most countries intend to use more targeted policies that are also viewed as yielding better results and being more cost-effective. These findings suggest that global and regional competition for FDI is increasing, and will continue to do so in the future.

International level

International investment agreements continue to proliferate at the bilateral, regional and interregional levels. Through their liberalisation, protection and promotion provisions, these constitute an international enabling framework for investment. On average, in 2004, more than three agreements were signed each week.

As part of this trend, the number of bilateral investment treaties (BITs) continued to expand. During 2004, 73 new BITs were concluded, bringing the total number in force to 2,392 (figure II.B.2). Several countries, including Germany, China, Switzerland and the United Kingdom, have now signed over 100 such agreements. 84 double taxation treaties (DTTs) involving 80 countries were also concluded in 2004, bringing the total number in existence to 2,559.

Figure II.B.2. Number of BITs and DTTs concluded, 1990- 2004
(Cumulative and year by year)



Source: UNCTAD (www.unctad.org/iia).

Investment rules are also increasingly being incorporated into free trade agreements (FTAs), regional integration agreements (RIAs) and economic partnership agreements (EPAs). They usually contain commitments to liberalise, protect and/or promote cross-boarder investment flows in addition to a range of trade liberalisation and promotion provisions.[3] The number of agreements with investment components has been growing steadily and, by June 2005, more than 215 had been concluded.

A number of other agreements are likely to help facilitate FDI, especially to developing countries. Preferential trade arrangements, for example, can encourage trade-related, or “barrier-hopping” investment. Market access measures for African countries, such as the African Growth and Opportunity Act (AGOA), the Everything But Arms initiative (EBA) and Japan’s so-called 99% rule[4] can help attract foreign investors seeking to gain access to markets in the United States, EU and Japan. Equally, the Kyoto Protocol’s Clean Development Mechanism (CDM) could result in increased FDI to developing countries. It creates an incentive for firms to make environmentally friendly investments in developing countries. The CDM covers a wide range of industries and the first projects have already come to fruition.

In summary, developments at both national and international level point towards continued long-term growth in FDI. The expanding body of agreements will increasingly facilitate international investment and present new opportunities for developing countries. At the same time, competition for FDI is growing as countries are introducing more policy measures to attract FDI.

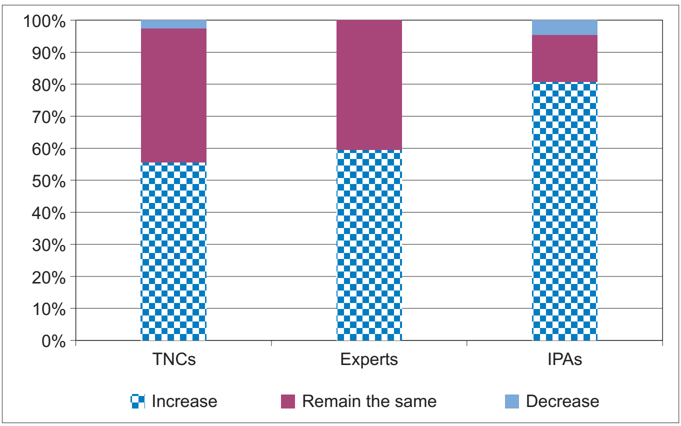
III. Global FDI prospects and TNC strategies

A. Global FDI prospects

The principal findings of the GIPA 2005 survey augur well for FDI prospects. After its rebound in 2004, global FDI is likely to continue rising in the coming years. Indeed, the majority of the FDI experts, TNCs, and IPAs surveyed predicted that FDI would continue to grow in both the short and medium term. While forecasts remain positive, however, they are not as optimistic as those in the GIPA 2004 survey.

More than half of the TNCs and expert respondents, and four-fifths of IPAs, expected short-term (2005-2006) growth in FDI flows, while almost all remaining respondents expected levels to remain steady (figure III.A.1a). Only a small fraction of respondents thought that FDI would decrease in the immediate future. The survey results represent a vote of confidence in the prospects for short-term FDI flows.

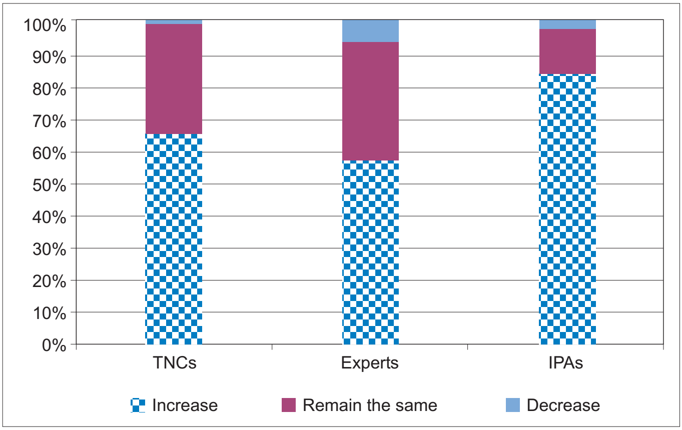
Figure III.A.1a. Global prospects for FDI, 2005-2006
(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Opinions on medium-term (2007-2008) FDI prospects are even more optimistic (figure III.A.1b). Some 57% of experts, 65% of TNCs and 83% of IPAs expected FDI to increase through 2007-2008. Again, most of the remaining respondents expected FDI levels to remain the same, and only a few foresaw a decline.

Figure III.A.1b. Global prospects for FDI, 2007-2008
(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

These results are broadly in line with those of the GIPA 2004 survey, though a greater proportion, but still a minority, of this year's respondents predict that FDI will remain stable rather than grow. This caution is due in part to the slowdown in economic growth in some major developed economies and structural weakness in some regions.

B. Most attractive global FDI locations

There were a number of surprises in the investment locations that were selected as "most attractive". Four of the top five countries, as ranked by TNCs, are not from the developed world (figure III.B.1). China is considered an attractive location by 87% of TNCs, by a margin of 36 from the next country in line. This is impressive, even for a country which has been one of the world's largest FDI recipients for quite some time. India's high ranking is even more remarkable, given that FDI flows to that country have been modest until recently. The United States is the only developed country in the top five locations. Germany, Canada and the United Kingdom made it into the top ten, but traditionally important FDI destinations, such as France, the Netherlands and Italy, were not included. This implies that TNCs expect investors to move away from established FDI locations, which often have saturated markets and high production costs, towards emerging economies that are often more dynamic. This finding is also supported by overall trends in FDI flows in 2004, which saw developing countries taking the lead in the global FDI recovery (UNCTAD 2005a).

Figure III.B.1. Most attractive global business locations, 2005-2006
(Per cent of responses)

Responses from TNCs

1. China (87%)
2. India (51%)
3. United States (51%)
4. Russian Federation (33%)
5. Brazil (20%)
6. Mexico (16%)
7. Germany (13%)
8. United Kingdom (13%)
9. Thailand (11%)
10. Canada (7%)

Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

C. FDI prospects by industry

Prospects for FDI vary significantly by industry, according to the 2005 survey.[5] The outlook for the services sector is more positive than that for the manufacturing or primary sectors. IPAs and experts shared *gross modo* the views in regard to the prospects of specific industries. IPAs were at times more optimistic than experts in their assessment across sectors.

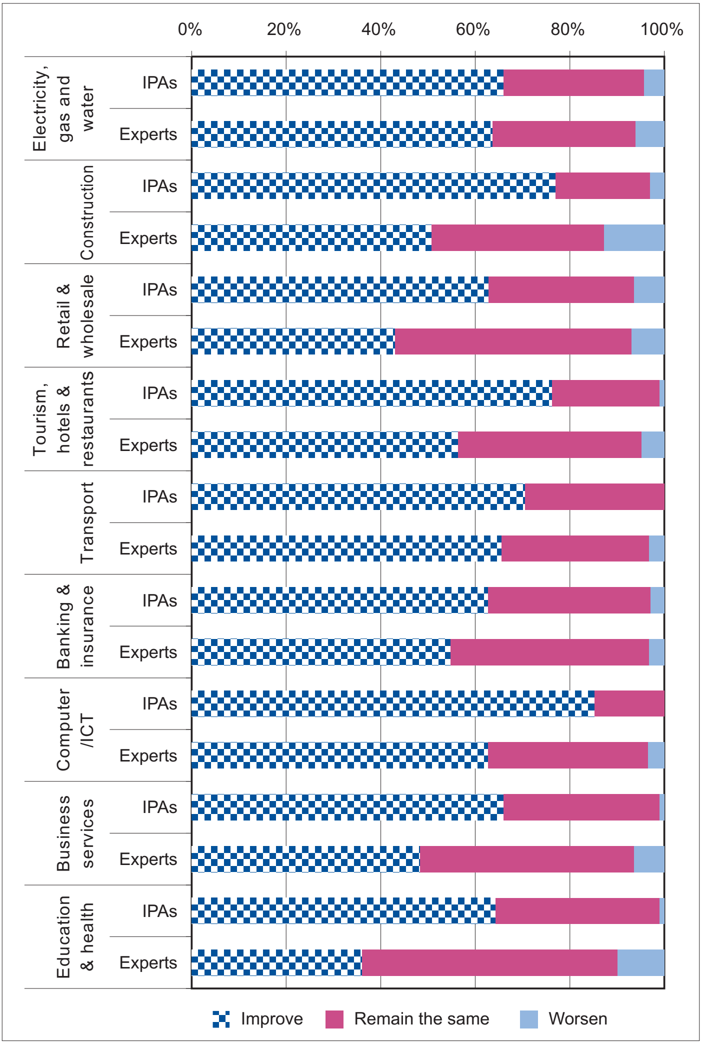
FDI growth is expected to be led by services in computing and ICT, public utilities (such as the generation and distribution of electricity, water and gas), transportation, followed by tourism, hotels and restaurants, construction, banking and insurance, retail and wholesale and business services, all of which were noted by more than 40% of both IPAs and experts (figure III.C.1).

In manufacturing, the greatest FDI growth is expected in electrical and electronic products, machinery and equipment, and metals and metal products (figure III.C.2). There is less optimism regarding FDI in textiles and clothing, rubber and plastic products, non-metallic minerals and media and publishing. It is interesting to note that in contrast to the 2004 survey, the optimism is quite concentrated in a few industries in the manufacturing sector.

In the primary sector, FDI in mining and petroleum is expected to increase in response to higher prices and strong demand for natural resources (figure III.C.3). Higher oil and commodity prices induce TNCs to take up new exploration projects, or to step up production in existing ones. Downbeat predictions for the agriculture industry might be due to ongoing trade disputes and slow liberalisation in this area.

In sum, the findings of the GIPA 2005 survey are broadly in line with those of the 2004 survey. One major difference is that this year’s respondents expect a greater divergence in the prospects for individual sectors compared with the 2004 survey. As well, the gap between the prospects for FDI in the services sector and those for FDI in other sectors has widened, as compared with the 2004 survey.

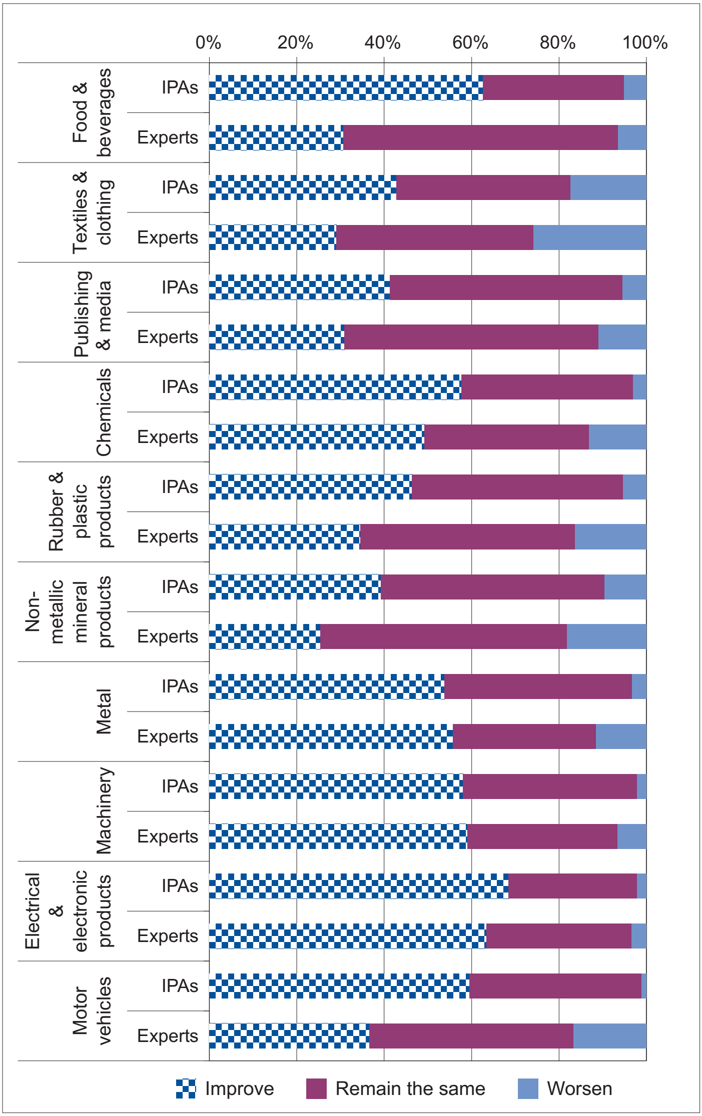
Figure III.C.1. Global FDI prospects in services sector, 2005-2006
(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

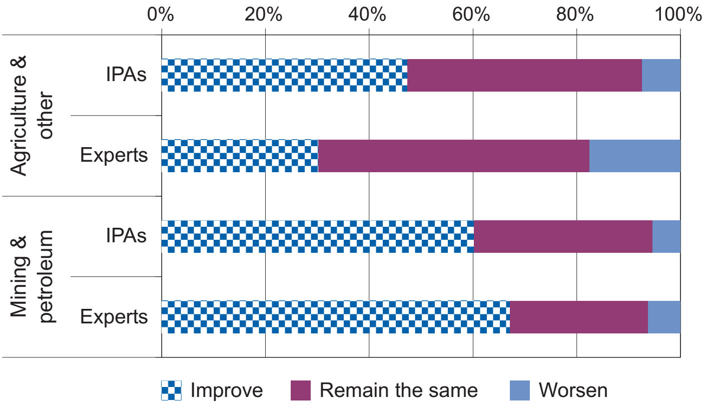
Figure III.C.2. Global FDI prospects in manufacturing sector, 2005-2006

(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Figure III.C.3. Global FDI prospects in primary sector, 2005-2006
(Per cent of responses)

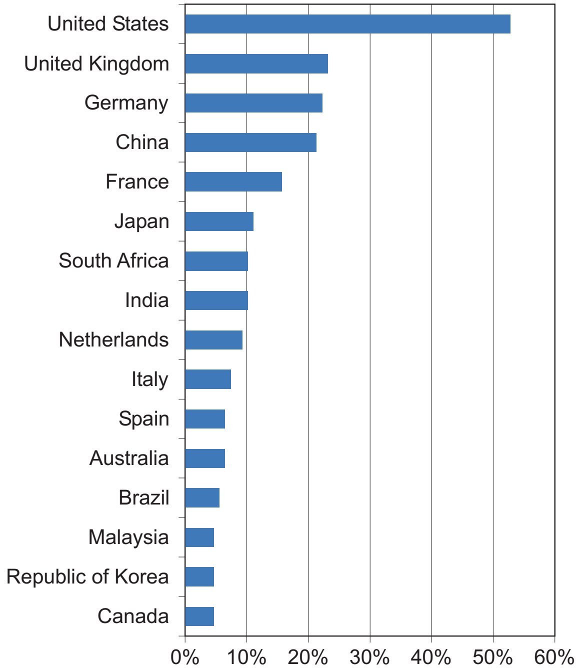


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

D. Predicted sources of FDI

In the short term, the IPAs surveyed expect the United States to be by far the most important source of global FDI flows, followed by the United Kingdom, Germany and China. The overall ranking is interesting because along with China, several other developing countries feature in the top 15 (figure III.D.1). These include South Africa, India, Brazil, Malaysia and the Republic of Korea. It is important to note that this is not a ranking of the magnitude of FDI outflows. Instead, the survey asks IPAs from which three countries they expect to receive the largest investment in 2005-2006. This finding confirms the current trend of TNCs from developing countries increasingly becoming global players and investing abroad.

Figure III.D.1. Expected leading sources of FDI, 2005-2006
(Per cent of responses)



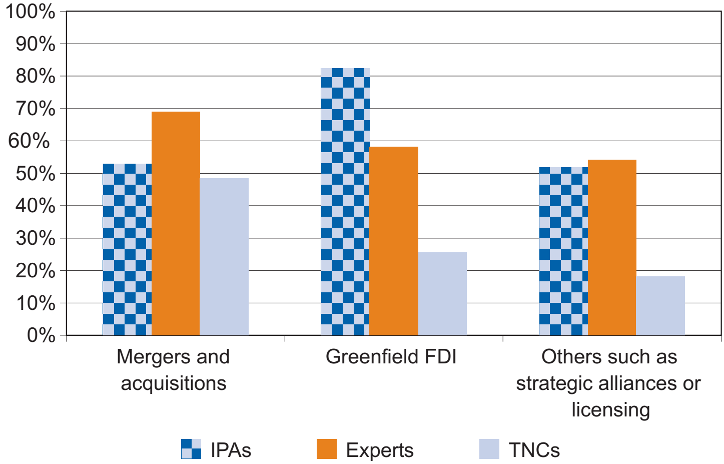
Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

E. Prospects for TNC strategies: mode of entry

More than 50% of the three groups of respondents combined expected mergers and acquisitions (M&As) to be the primary vehicle for FDI in 2005-2006. In contrast, most IPAs expected greenfield investment to be the most important (figure III.E.1). This reflects the fact that most IPA respondents were from developing countries in which greenfield FDI tends to dominate. Non-equity investment, such as investment through strategic alliances or licensing, is also expected to remain important, although TNCs seem less convinced of this. The emphasis of TNCs on M&A

activity contrasts with the GIPA 2004 findings, according to which TNCs expected equal use of each mode of investment.

Figure III.E.1. Expected modes of global investment, 2005-2006
(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

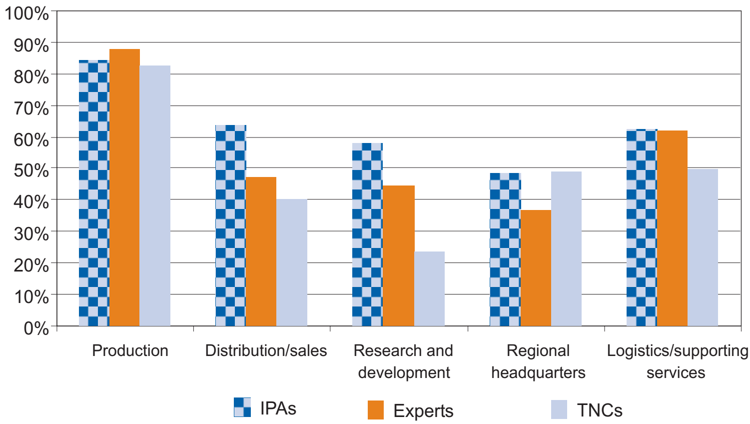
F. Prospects for TNC strategies: relocation of corporate functions

There was a broad consensus among IPAs, TNCs and experts that production would be the corporate function most likely to be relocated. Well over 80% of those surveyed expected production-related activities to be transferred overseas (figure III.F.1)

After production, logistics and support services are the next most frequently expected functions to be relocated abroad. This is followed by distribution and sales. Regional headquarters and research and development are the least likely corporate functions to be relocated abroad.

TNCs expected to see less relocation of R&D activities than IPAs and experts. Only 20% of TNC respondents expected R&D to be relocated, in contrast with more than 40% of experts and almost 60% of IPAs. This finding is particularly interesting given the recent trend towards the globalization of R&D, and reinforces the notion that since R&D involves knowledge vital to a firm's competitiveness, it is in need of maximum protection, and it is therefore less likely to be transferred overseas. A separate UNCTAD survey of the world's largest R&D spenders shows that the share of R&D funded by foreign companies will increase by 2009, with China, the United States and India as the top three recipients of FDI in R&D (UNCTAD 2005a).

Figure III.F.1. Most expected corporate functions to be relocated, 2005-2006
(Per cent of responses)

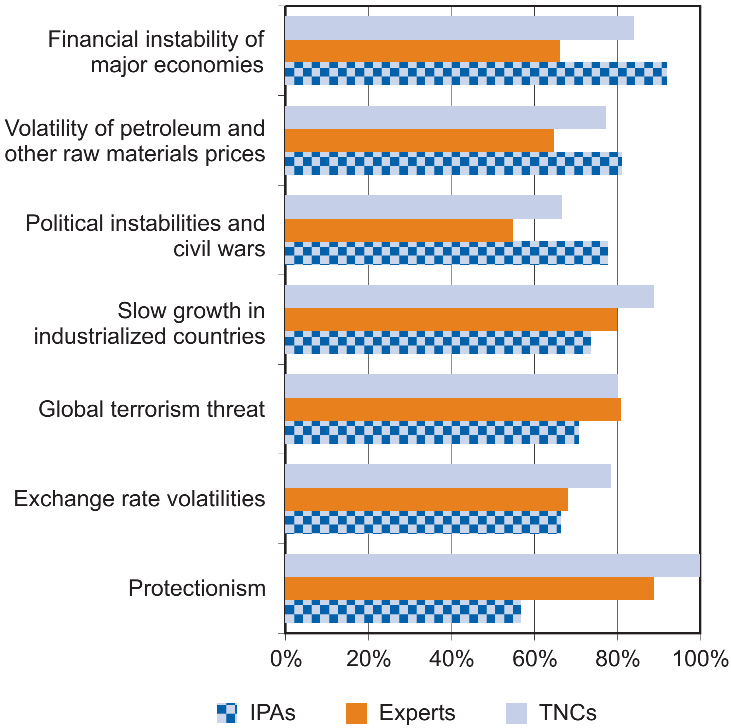


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

G. Risks to global FDI flows

Interestingly, views on what constitutes major threats to global FDI prospects differ among the three survey groups. Protectionism and slow growth in industrialised countries were the issues TNCs and experts felt were the most threatening to FDI growth (figure III.G.1). Indeed, every TNC respondent felt that trade wars had the potential to undermine FDI growth in 2005-2006.

Figure III.G.1. Major risks to FDI flows, 2005-2006
(Per cent of respones)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Note: Percentage of respondents that considered each factor as "important" or "very important."

For IPAs the biggest concern was the financial instability of major economies and the volatility of raw material prices. This difference in views underlines the fact that IPAs are more in tune with host country domestic political and economic issues and less focused on broader global issues. This might also explain why political instability and civil war is the third greatest concern of IPAs, while the other two survey groups of respondents ranked it as the least important.

IV. Regional prospects

The focus of investors' attention appears to be shifting away from traditionally important investment locations in the developed world towards a handful of emerging markets. This underlies the fact that developing countries were at the forefront of the global FDI recovery in 2004 (UNCTAD 2005a).

Overall, developed countries are expected to see some recovery in FDI, but this will be relatively modest in the short run. The United States is expected to remain the most attractive destination for FDI in the developed world. Of the major European economies, only the United Kingdom and Germany feature among the ten most attractive investment locations. Prospects for FDI in new European Union (EU) member countries are generally positive.

Asia and Eastern Europe are the two regions with the most positive FDI prospects. China, India and the Russian Federation are likely to be the main beneficiaries, while Thailand, the Republic of Korea, Ukraine and Romania are also expected to perform well. FDI flows to Africa are generally expected to remain stable. South Africa is considered to be by far the most attractive investment location on the continent, although Egypt, Nigeria and Morocco are also expected to see healthy FDI growth. Latin America should maintain its recent FDI recovery, with Brazil at the forefront, followed by Mexico, Argentina and Chile.

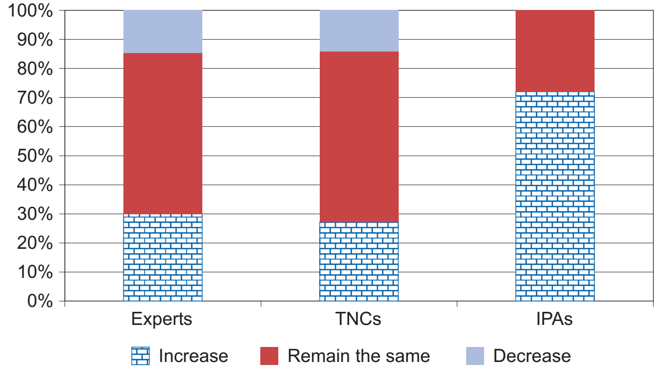
A. Developed countries

Between 2003 and 2004, developed countries' share of global FDI inflows dropped from 70% to 59%. Looking ahead, most of the experts and TNCs surveyed expect FDI flows to developed countries to remain steady in the short term (figure IV.A.1). Much of the caution over the FDI prospects of developed countries is due to ongoing uncertainty about the health of their economies, as well as concerns over protectionism and trade wars (see the policy section, chapter II, section B). IPA respondents[6] are much more optimistic, however. This reflects the positive outlook of

IPAs from EU accession countries, which are currently enjoying high growth and offer access to EU markets, low labour costs and low corporate tax rates (UNCTAD 2005a).

Figure IV.A.1. Developed countries: prospects for FDI flows, 2005-2006

(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

The United States remains the most attractive destination, and largest source, for FDI among developed countries (figure IV.A.2). Other top FDI destinations include the United Kingdom, Canada, Germany and France.

Figure IV.A.2. Developed countries: most attractive business locations, 2005-2006

(Per cent of responses)

Responses from experts

1. United States (75%)
2. United Kingdom (59%)
3. Canada (44%)
4. Germany (41%)
5. France (31%)
6. Japan (28%)
7. Spain (28%)
8. Belgium (13%)
9. Ireland (13%)
10. Italy (13%)

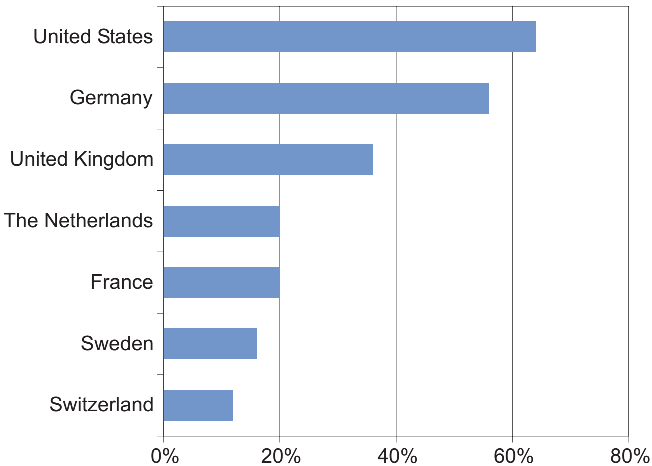
Responses from TNCs

1. United States (74%)
2. Canada (44%)
3. United Kingdom (37%)
4. Germany (35%)
5. France (26%)
6. Spain (20%)
7. Ireland (17%)
8. Japan (17%)
9. Australia (13%)
10. Italy (11%)

Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Most FDI flows are likely to take place between developed countries. The expected leading sources of FDI to the group of developed countries are the United States, followed by Germany and the United Kingdom (figure IV.A.3). Indeed, significant variation in FDI flows between developed countries was recorded in 2004 (UNCTAD 2005a), due to, among other things, varying levels of economic growth, business confidence, and cross-border M&As. On the other hand, EU-15 countries, Norway and Switzerland generally performed worse owing to lower economic growth rates and corporate restructuring. Meanwhile, FDI flows to those new EU accession countries are expected to continue growing.

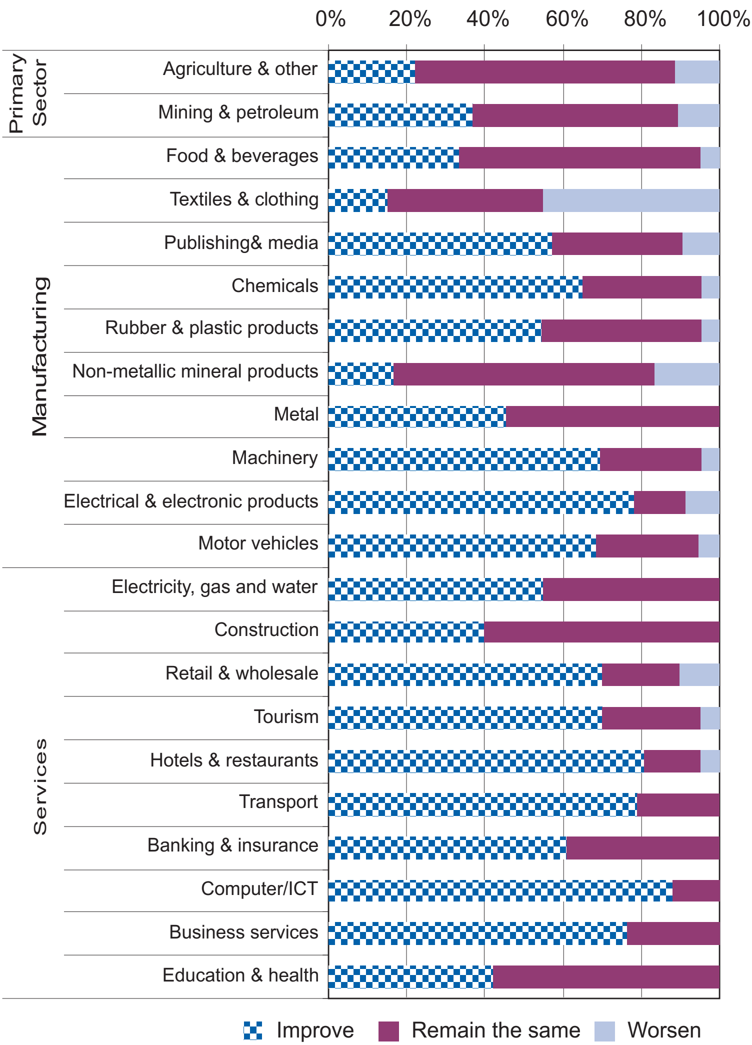
Figure IV.A.3. Developed countries: expected leading sources of FDI, 2005-2006
(Per cent of responses from IPAs)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Overall, IPAs from developed countries were generally most optimistic about the prospects for attracting FDI in services (figure IV.A.4). The sectors expected to attract most investment are computing and ICT, hotels and restaurants, transport and business services industries. FDI in tourism, and in the retail and wholesale sector, is also expected to grow, though more modestly.

Figure IV.A.4. Developed countries: FDI prospects by industry, 2005-2006
(Per cent of responses from IPAs)



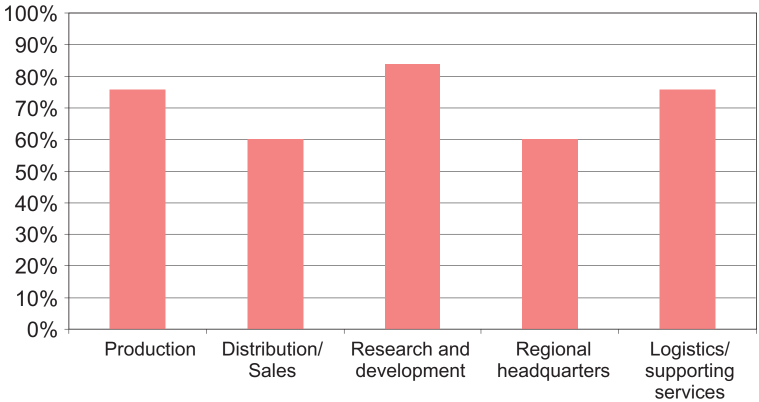
Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

The largest growth areas for foreign investment in the manufacturing sector are likely to be electrical and electronic equipment, motor vehicles and other transport equipment, machinery and chemicals. Investment in textiles and clothing is expected to fall because of competition from developing countries, particularly those from Asia.

The corporate functions that IPAs from developed countries most expect to see relocated include R&D, logistics and supporting services, and production (figure IV.A.5). Most of the FDI in R&D by firms from developed countries continues to be directed at other developed countries.

Figure IV.A.5. Developed countries: expected relocation of corporate functions, 2005-2006

(Per cent of responses from IPAs)

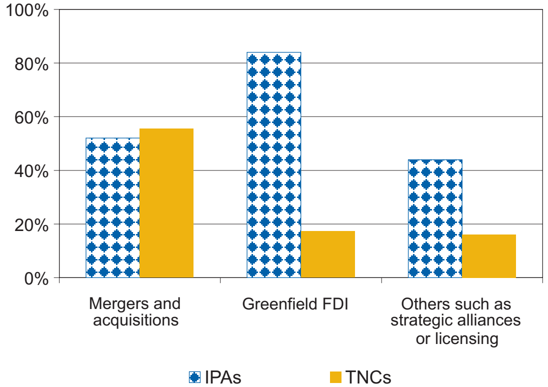


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

TNCs believe that M&As will remain the most frequent means of investment in developed countries. On the other hand, IPAs believe that the majority of the FDI they will receive in 2005-2006 will take the form of greenfield investment (figure. IV.A.6). This is largely a reflection of the shift taking place within the EU, with firms looking to move their operations to new accession countries to take advantage of the lower cost structures available. This could also reflect the fact that IPAs are geared more towards new, greenfield investors.

Figure IV.A.6. Developed countries: expected modes of investment, 2005-2006

(Response by TNCs and IPAs from developed countries)

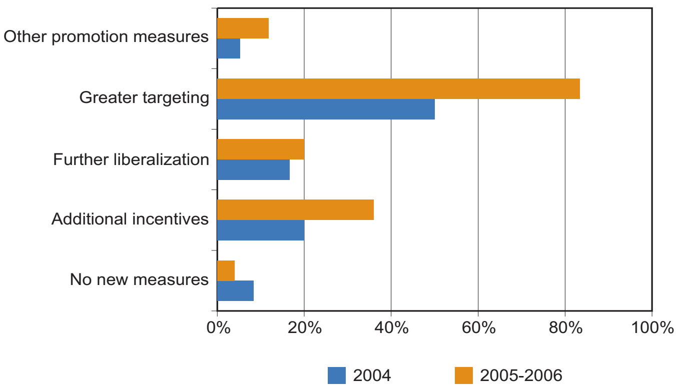


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

In 2004, around half of developed countries boosted their investment promotion efforts by introducing more sophisticated targeting techniques. In addition, 20% offered extra investment incentives, and 17% further liberalised their investment regimes (figure IV.A.7).

Figure IV.A.7. Developed countries: trends in policy measures to attract FDI, 2004-2006

(Per cent of responses)



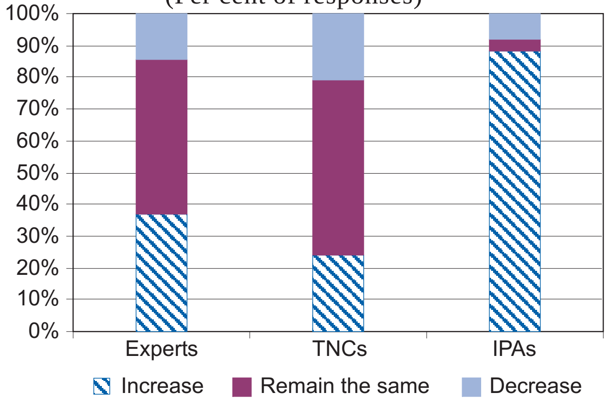
Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

In 2005-2006, developed countries will continue to intensify their investment promotion efforts, particularly through greater targeting and additional incentives. However, they plan to introduce fewer new liberalization measures than countries from other regions. This is not surprising given that most developed countries already have highly liberalised markets and relatively hospitable investment environments.

B. Africa

After a downturn in 2002, FDI flows to Africa recovered in 2003 and remained relatively stable in 2004. In the short run, FDI expectations for the continent remain fairly positive, though the three survey groups gave widely differing assessments (figure IV.B.1). The consensus among TNCs is that FDI flows to Africa will remain stable, with the same proportion of respondents predicting an increase in FDI as predicting a fall. In contrast, experts and, especially, IPAs[7] are more optimistic: a third of the former and 90% of the latter believe that FDI inflows will continue to increase. Both experts and TNCs believe that North African countries have greater FDI potential than those from sub-Saharan

Figure IV.B.1. Africa: prospects for FDI flows, 2005-2006
(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Africa. The overall mood of optimism is due in large part to high petroleum and commodity prices. In the case of the IPAs and their high level of confidence, it should be noted that their optimism is partly rooted in their professional role.

In the short term, South Africa appears to be by far the most attractive business location in Africa (figure IV.B.2). Nine out of ten experts and TNCs believed it will be among the continent's top five business locations in 2005-2006. Around half of each group also placed Egypt in their top five most attractive business locations, while North African countries in general featured prominently in the top ten.

Figure IV.B.2. Africa: most attractive business locations, 2005-2006
(Per cent of responses)

Responses from experts

1. South Africa (92%)
2. Egypt (44%)
3. Nigeria (33%)
4. Morocco (28%)
5. Libya (23%)
6. Algeria (21%)
7. Botswana (21%)
8. Tunisia (18%)
9. Ghana (15%)
10. Kenya (15%)

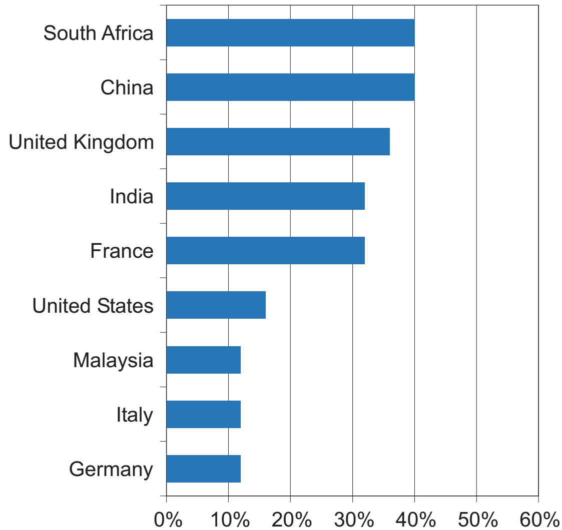
Responses from TNCs

1. South Africa (87%)
2. Egypt (53%)
3. Morocco (40%)
4. Nigeria (38%)
5. Tunisia (35%)
6. Algeria (29%)
7. Libya (16%)
8. Botswana (11%)
9. Ghana (7%)
10. Angola (7%)

Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

South Africa and China were the most frequently cited as potential sources of FDI for Africa (figure IV.B.3). 40% of African IPAs believe that corporations from these countries will be among their three largest investors. Europe is also seen as a major source of investment, with the four largest EU economies all in the top ten. Many IPAs also expect significant investment from Asia. In recent years, Chinese TNCs have expanded their resource-seeking and manufacturing activities on the continent, and Indian firms have begun to invest in IT-related services. Both China and India featured in the top five expected leading sources of FDI in the 2004 edition of the GIPA survey.

Figure IV.B.3. Africa: expected leading sources of FDI, 2005-2006
(Per cent of responses from IPAs)

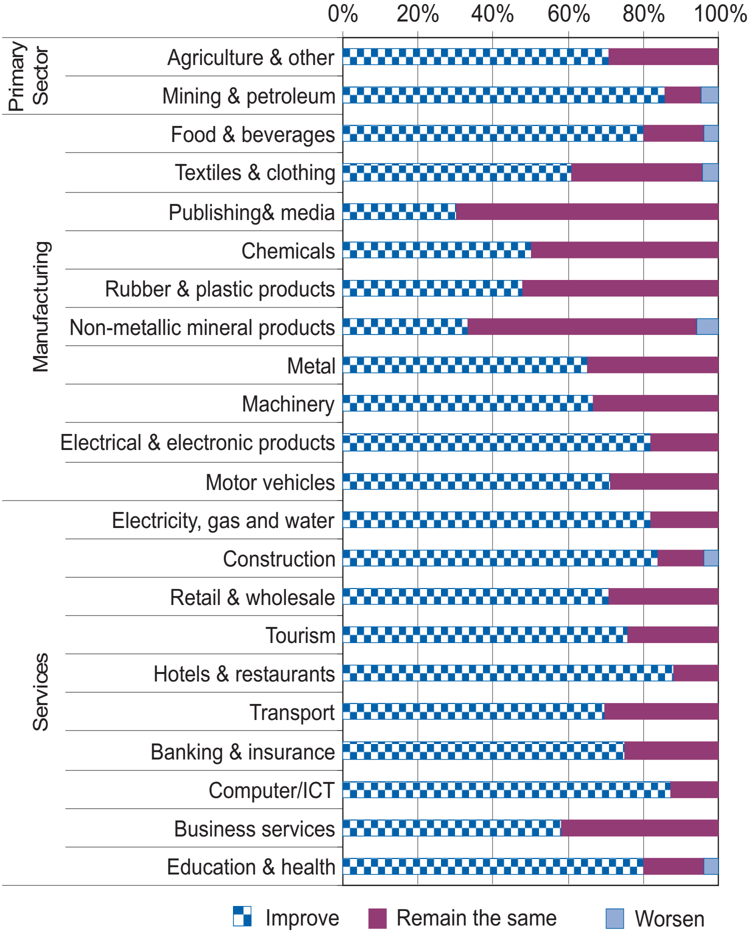


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

The majority of African IPAs continue to expect FDI growth in the services sector to remain strong (figure IV.B.4). They are particularly positive about prospects for computing and ICT services, the hotel and restaurant sector and construction and real estate. This is in line with most other developing countries. There is less optimism about FDI in the manufacturing sector, although some exceptions, such as electrical and electronic products, food, beverages and tobacco, are expected to perform relatively well. In the primary sector, predictions for FDI in agriculture, forestry and fishing are less upbeat than last year. In contrast, 85% of IPAs believe that mining, quarrying and petroleum will see substantial investment growth, largely as a result of rising commodity prices.

Most African IPAs believe that production and distribution are the corporate functions that are the most likely to be relocated to their countries (figure IV.B.5), with 80% expecting to benefit from investment in these areas. Around half are also optimistic about the prospect of attracting FDI in logistics and supporting

Figure IV.B.4. Africa: FDI prospects by industry, 2005-2006
(Per cent of responses from IPAs)

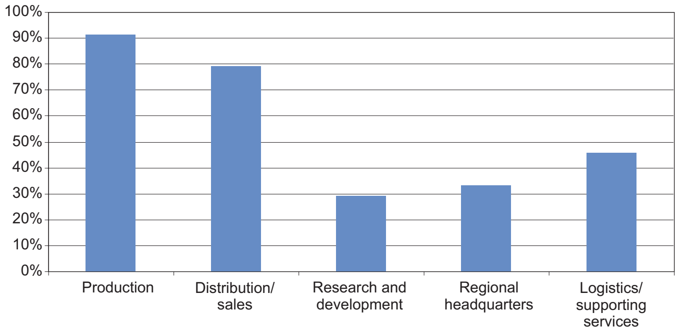


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

services. Few believe that they will attract FDI for R&D or regional headquarters.

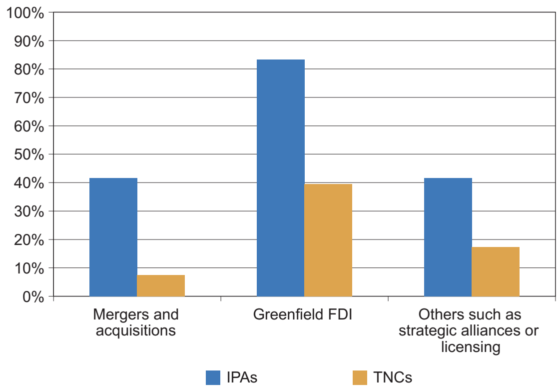
Both TNCs and IPAs believe that greenfield investment will dominate FDI to Africa in the short term (figure. IV.B.6). 80% of IPAs expect to see new greenfield investment in their country by the end of 2006. The low expectation for other modes of investment is largely a result of the under-developed nature of African economies and companies, which makes it difficult for TNCs to find appropriate targets for M&As.

Figure IV.B.5. Africa: expected relocation of corporate functions, 2005-2006
(Per cent of responses from IPAs)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Figure IV.B.6. Africa: expected modes of investment, 2005-2006
(Per cent of responses)

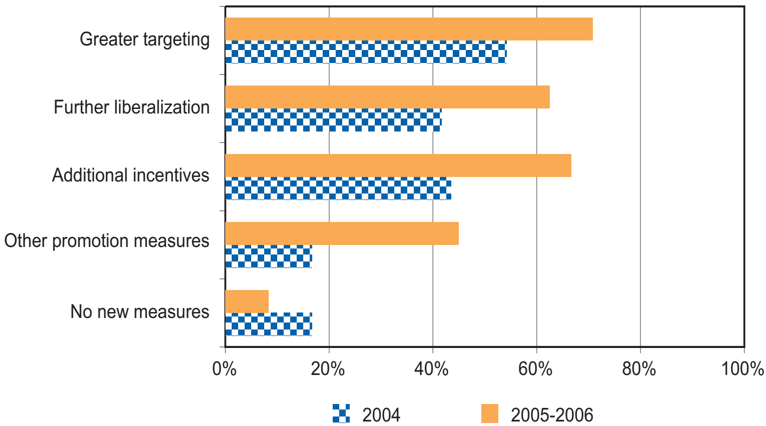


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Over two thirds of IPAs indicated that their countries will intensify investment promotion efforts through greater targeting, additional incentives and further liberalisation (figure IV.B.7). Investor targeting, which was employed by more than half of African IPAs in 2004, is expected to become even more important as promotion efforts become more focused. Investment promotion is still at its infancy for most countries, since many IPAs in the region are still young. It is not surprising, therefore, that IPAs are experimenting with different investment promotion techniques. Only one out of five African IPAs did not introduce new investment promotion methods in 2004, and just one in ten have no plans for applying new methods in 2005-2006.

Figure IV.B.7. Africa: trends in policy measures to attract FDI, 2004-2006

(Per cent of responses from IPAs)

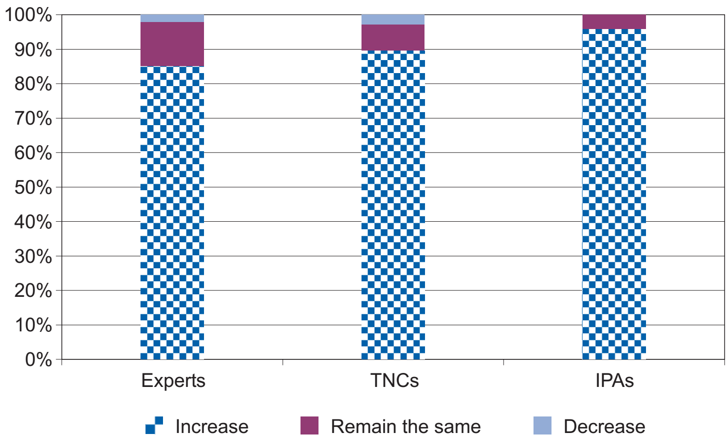


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

C. Asia and the Pacific

FDI prospects for Asia and the Pacific are resoundingly positive, with over 85% of each survey group expecting increased FDI flows to the region (figure IV.C.1). This is significantly more optimistic than in previous years. FDI inflows surged in 2004, reaching $148 billion, an increase of $46 billion on 2003 levels. Rapid economic growth, an improving policy environment and TNCs' increasing strategic commitment to the region should ensure sustained FDI growth in the years to come.

Figure IV.C.1. Asia and the Pacific: prospects for FDI flows, 2005-2006
(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

China and India are expected to be the top FDI destinations in the region. Thailand's prospects are also encouraging, while the Republic of Korea, Malaysia, Indonesia, Viet Nam and Singapore are all expected to perform well (figure IV.C.2). It should be noted that experts and TNCs came up with an identical ranking of the countries. This suggests that there is a general consensus on the region's and individual countries' prospects.

Figure IV.C.2. Asia and the Pacific: most attractive business locations, 2005-2006
(Per cent of responses)

Responses from experts

1. China (92%)
2. India (66%)
3. Thailand (50%)
4. Rep. of Korea (34%)
5. Malaysia (32%)
6. Indonesia (28%)
7. Viet Nam (22%)
8. Singapore (16%)

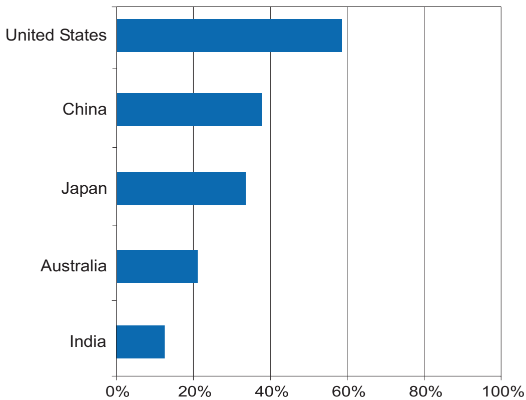
Responses from TNCs

1. China (94%)
2. India (71%)
3. Thailand (38%)
4. Rep. of Korea (38%)
5. Malaysia (32%)
6. Indonesia (29%)
7. Viet Nam (23%)
8. Singapore (16%)

Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

The United States is expected to be the most important source of FDI for more than half of Asia's economies in 2005-2006, according to IPAs in the region.[8] Other major source countries include China, Japan, Australia and India, as well as the United Kingdom (figure IV.C.3).

Figure IV.C.3. Asia and the Pacific: expected leading sources of FDI, 2005-2006
(Response rate of IPAs)

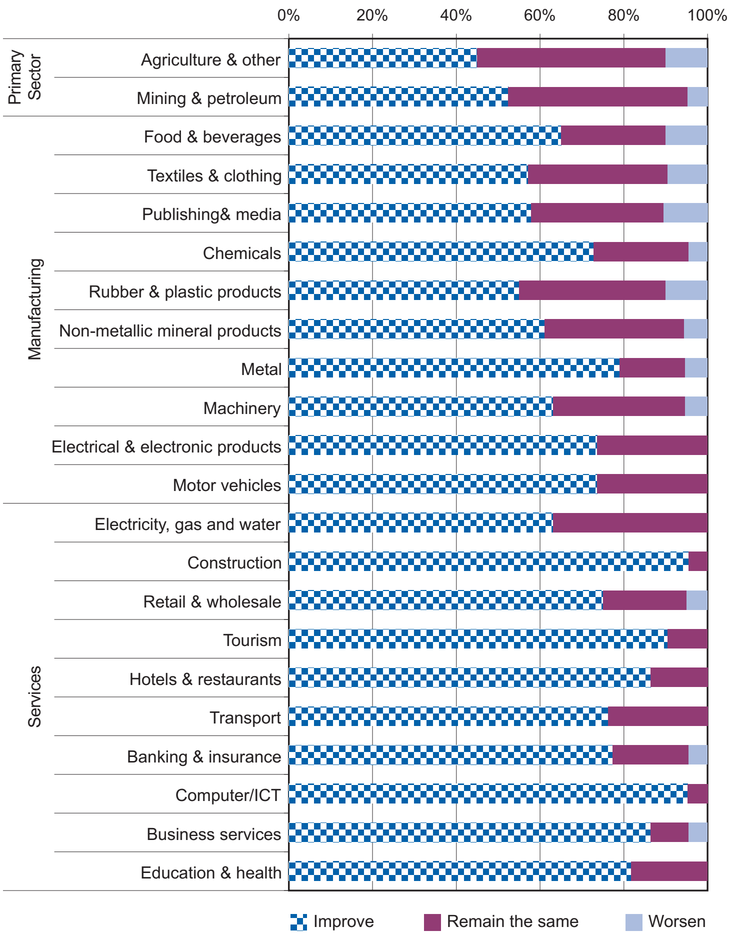


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

In the short term, FDI to Asia is expected to be concentrated in the services and manufacturing sectors as companies take advantage of low production costs and the availability of skilled labour (figure IV.C.4).

Figure IV.C.4. Asia and the Pacific: FDI prospects by industry, 2005-2006

(Per cent of responses from IPAs)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

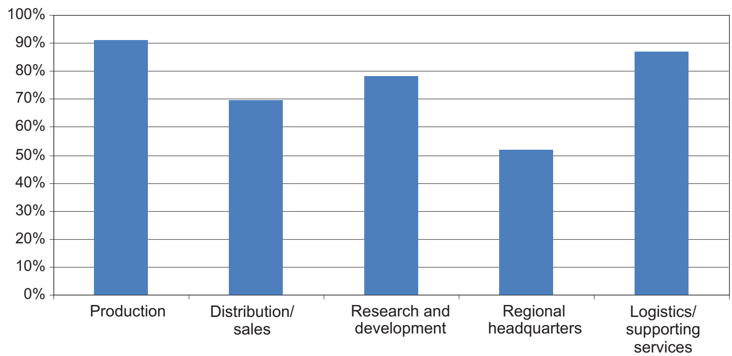
Asian IPAs expect FDI growth in the services sector to be concentrated in construction, tourism, computing and ICT, business services, and education and health. In the manufacturing sector, metal and metal products, electronics, motor vehicles and chemicals are expected to attract the most investment. The food and beverages and machinery and equipment industries are also expected to perform relatively well.

One striking aspect of these forecasts is that most of the industries predicted to attract substantial investment are human capital-intensive. This reflects an increasing effort by firms to take advantage of the abundance of skilled labour in Asia. Investment in construction, meanwhile, is driven by rapid economic growth in the region as well as post-tsunami reconstruction. Business services and computing and ICT-related activities are likely to continue to benefit from the current wave of outsourcing. In contrast, prospects for agriculture are gloomy, but this is unsurprising given that FDI in that industry is traditionally low.

Asian IPAs believed they would benefit from the relocation of numerous corporate activities in 2004-2005. 90% expect to receive investment in production, while 87% anticipated FDI in logistics and supporting services. The figures for R&D, and distribution and sales are 78% and 70% respectively (figure IV.C.5).

Figure IV.C.5. Asia and the Pacific: expected relocation of various corporate functions, 2005-2006

(Per cent of responses from IPAs)



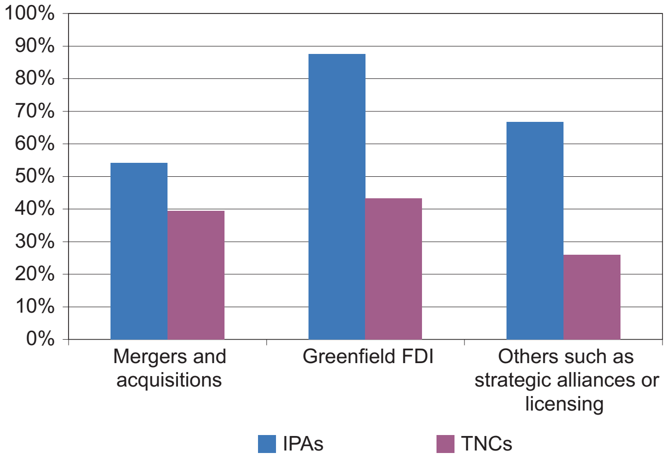
Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

The largest change from last year's results is in R&D, with positive responses more than doubling since 2004, reflecting a broader trend towards growing FDI in research (UNCTAD 2005a).

In the short term, greenfield investment is expected to be the most important form of FDI in Asia. It is interesting to note that 67% of Asian IPAs also expect to benefit from other forms of investment, up from 23% in 2004 (figure IV.C.6). This may reflect the efforts of countries in the region to upgrade the capacities of local firms, thus facilitating greater cooperation with foreign corporations through strategic alliances and contractual arrangements. TNCs continue to regard greenfield investment and M&As as equally important modes of FDI.

Figure IV.C.6. Asia and the Pacific: expected modes of investment of FDI, 2005-2006

(Per cent of responses)

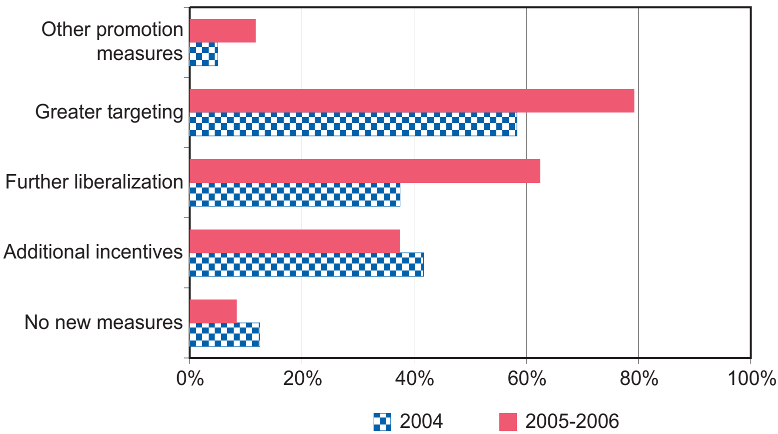


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Asian countries introduced a range of new investment promotion measures in 2004, and this is expected to continue in 2005-2006 (figure IV.C.7).

Figure IV.C.7. Asia and the Pacific: trends in policy measures to attract FDI, 2004-2006

(Per cent of responses from IPAs)

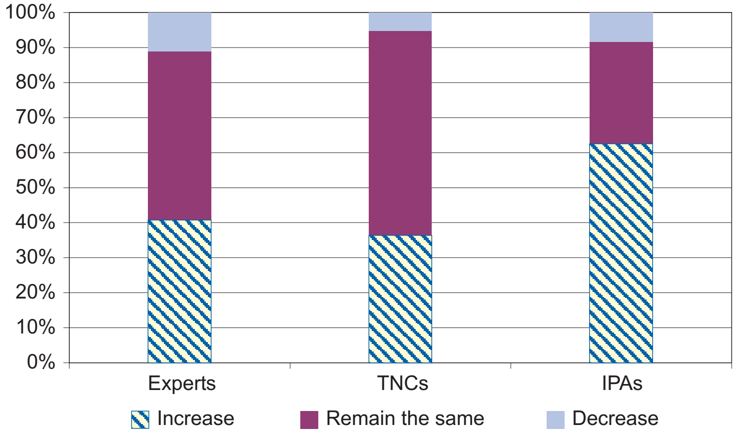


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

D. Latin America and the Caribbean

After four consecutive years of FDI decline, Latin America and the Caribbean registered a significant upsurge in inflows in 2004, albeit to a level still significantly below that recorded in 1997. The consensus among TNCs, experts and IPAs from the region[9] is that this recovery will continue, though Latin America is not expected to perform as well as other developing regions (figure IV.D.1). The majority of Latin American and Caribbean IPAs, a third of TNCs, and two out of five FDI experts expect a short-term increase in FDI to the region. The regional economic recovery, improved macroeconomic environment, high demand for commodities and increased policy support for manufacturing industries in some countries is opening up new business opportunities for foreign investors. Nonetheless, FDI experts and TNCs generally expect FDI inflows to the region to remain fairly constant.

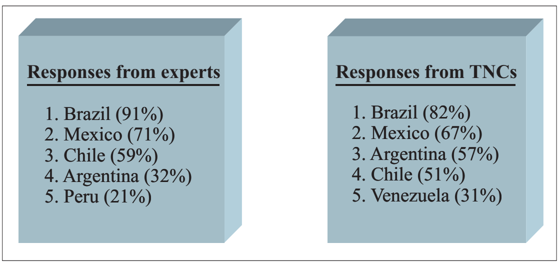
Figure IV.D.1. Latin America and the Caribbean: prospects for FDI flows, 2005-2006
(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Brazil is expected to be the most attractive location in Latin America for FDI in 2005-2006 (figure IV.D.2). More than 80% of TNCs and 90% of FDI experts believe that the country will be one of the region's five most attractive investment locations in the short term. This may be due to a recent upturn in the

Figure IV.D.2. Latin America and the Caribbean: most attractive business locations, 2005-2006
(Per cent of responses)



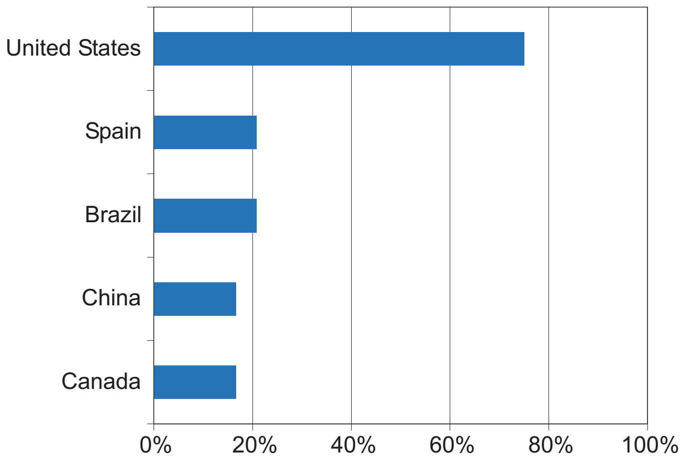
Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

economy, led by the dynamically expanding export sector. Mexico's high ranking is unsurprising given that it has been the major recipient of investment over the last four years. Argentina and Chile are also considered to have positive prospects for 2005-2006.

The United States is expected to remain the leading source of FDI in Latin America and the Caribbean. Spain, Brazil, China and Canada are also expected to provide investment, though on a significantly smaller scale (figure IV.D.3). Latin American and Caribbean IPAs expect growth in investment from Asian sources, such as China, the Republic of Korea and Japan.

Figure IV.D.3. Latin America and the Caribbean: expected leading sources of FDI, 2005-2006

(Per cent of responses from IPAs)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

In line with global trends, FDI growth in Latin America and the Caribbean is expected to be the highest in service industries (figure IV.D.4). This is also consistent with the results of the 2004 survey. The industries with the most positive prospects are hotels and restaurants, construction/infrastructure related and real estate, tourism and computing and ICT services.

In the manufacturing sector, the majority of Latin American IPAs expect no significant change in FDI flows. The only exception to this is the food and beverage sector, for which the outlook is more promising. This suggests that the region's manufacturing industries are still in the process of restructuring.

Figure IV.D.4. Latin America and the Caribbean: FDI prospects by industry, 2005-2006

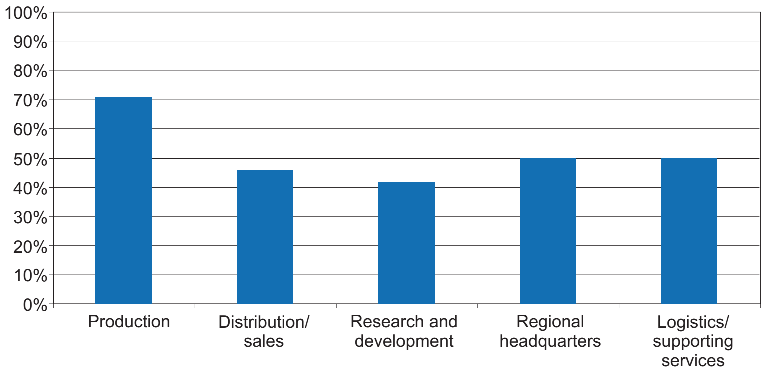
(Per cent of responses)

Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Only one in three IPAs expect FDI in agriculture to grow in 2005-2006. This is a dramatic change from last year's survey where the figure was closer to four out of five. On the other hand, prospects for the mining and petroleum industries remain positive, buoyed by high raw material prices. It is not yet clear, though, to what extent the most recent changes in the fiscal regimes covering the sector will affect FDI prospects for mining and petroleum in the region.

The IPA survey suggests that the activity most likely to receive foreign investment in Latin American and the Caribbean is production (figure IV.D.5). 71% of IPAs believe that they will see increased FDI in this area. The expectation is that other corporate functions are equally likely to be relocated to the region in 2005-2006. Less FDI is anticipated in logistics and supporting services than last year. In contrast, more investment is predicted in R&D. Remarkably, half of the respondents also expect to benefit from more regional headquarters projects.

Figure IV.D.5. Latin America and the Caribbean: expected relocation of corporate functions, 2005-2006
(Per cent of responses from IPAs)

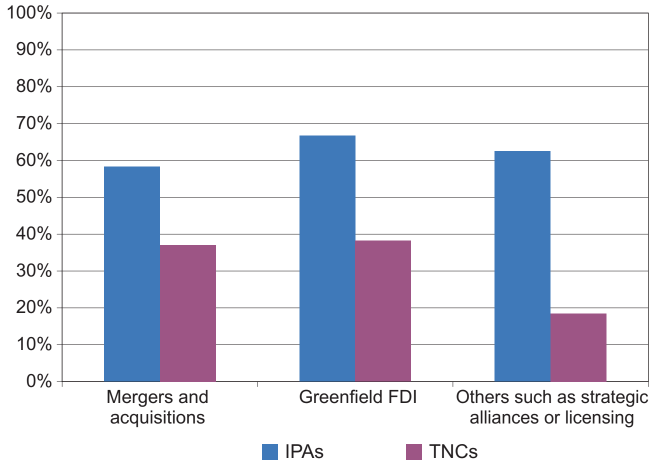


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Both TNCs and IPAs predict that greenfield investment will be an important mode of FDI delivery in Latin America and the Caribbean in 2005-2006 (figure IV.D.6). Other types of investment have also gained in importance since last year. More than half of IPAs expect M&As, strategic alliances and licensing to play an important role in the expansion of foreign companies into regional markets. FDI to the region is also expected through private-public partnerships).

Figure IV.D.6. Latin America and the Caribbean: expected modes of investment, 2005-2006

(Per cent of responses)

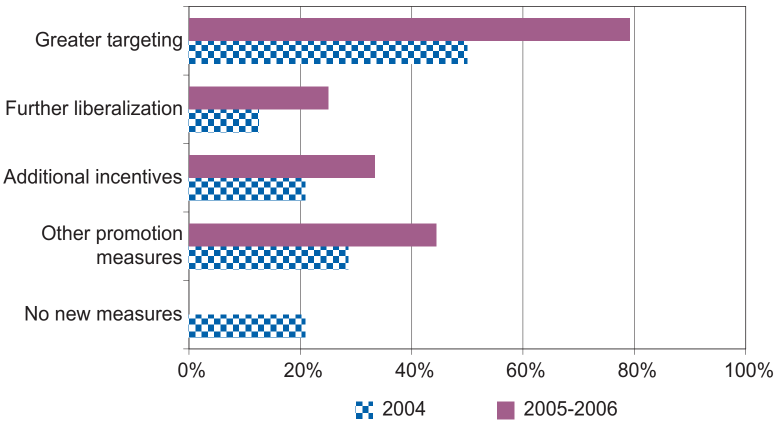


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Most Latin American and Caribbean countries plan to intensify their efforts to attract FDI in 2005-2006 (figure IV.D.7). Most importantly, they intend to use greater targeting of specific investors as an investment promotion method. These findings do not differ significantly from those for other regions, although liberalisation and additional incentives do not feature quite as prominently as elsewhere. All the Latin American and Caribbean IPAs that participated in the 2005 survey intend to use new investment promotion methods in 2005-2006.

Figure IV.D.7. Latin America and the Caribbean: trends in policy measures to attract FDI, 2004-2006

(Per cent of responses from IPAs)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

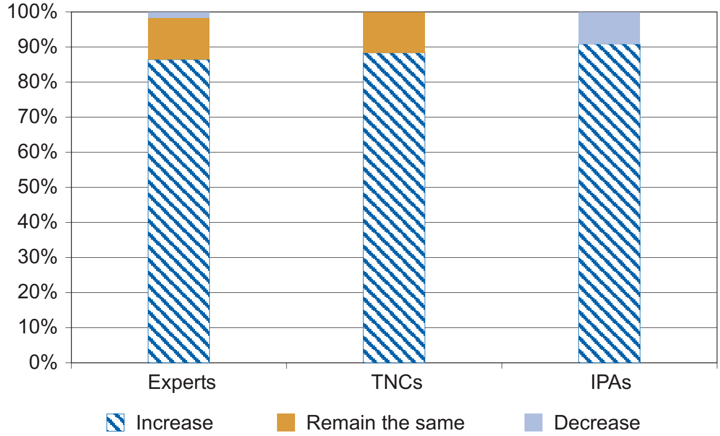
E. South-east Europe and the Commonwealth of Independent States

Short-term FDI prospects are very positive for South-east Europe and the Commonwealth of Independent States (CIS) (figure IV.E.1). Nine out of ten respondents believe that FDI will increase in 2005-2006. This makes it the second most promising investment destination after Asia. After the FDI boom in 2003 and 2004, FDI inflows to the region are expected to rise further in the near future as it attracts an increasing number of efficiency-seeking and export-orientated FDI projects. High oil and gas prices will also contribute to greater FDI inflows.

The Russian Federation is considered the most promising investment location in the region (figure IV.E.2). More than half of FDI experts and TNCs cited it among the five most attractive business locations in Southeast Europe and the CIS. It appears that even after a string of financial, macroeconomic and fraud-related crises, the country is still attracting investor interest.

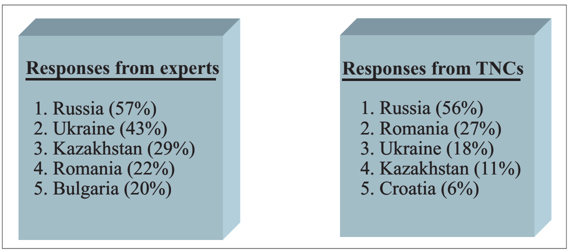
Ukraine, Kazakhstan and Romania also feature prominently in the list of top regional FDI locations .[10]

Figure IV.E.1. South-east Europe and the CIS: prospects for FDI flows, 2005-2006
(Per cent of responses)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Figure IV.E.2. South-east Europe and the CIS: most attractive business locations, 2005-2006
(Per cent of responses)



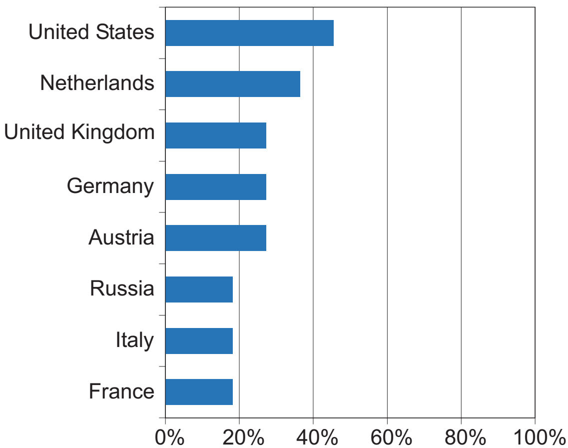
Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

The United States and EU member countries are expected to be the leading sources of FDI to South-east Europe and the CIS in the near future. Almost half of IPAs[11] mentioned the United

States as one of the countries from which they expect to receive the most investment (figure IV.E.3). One third of the region's IPAs expect investment from the Netherlands and one quarter from the United Kingdom, Germany and Austria. Despite heading the list, the United States is not anticipated to dominate investment in South-east Europe and the CIS as much as in other regions. European countries are expected to become a more important source of FDI in the short run, due in part to their geographical proximity.

Figure IV.E.3. South-east Europe and the CIS: expected leading sources of FDI, 2005-2006

(Per cent of responses from IPAs)

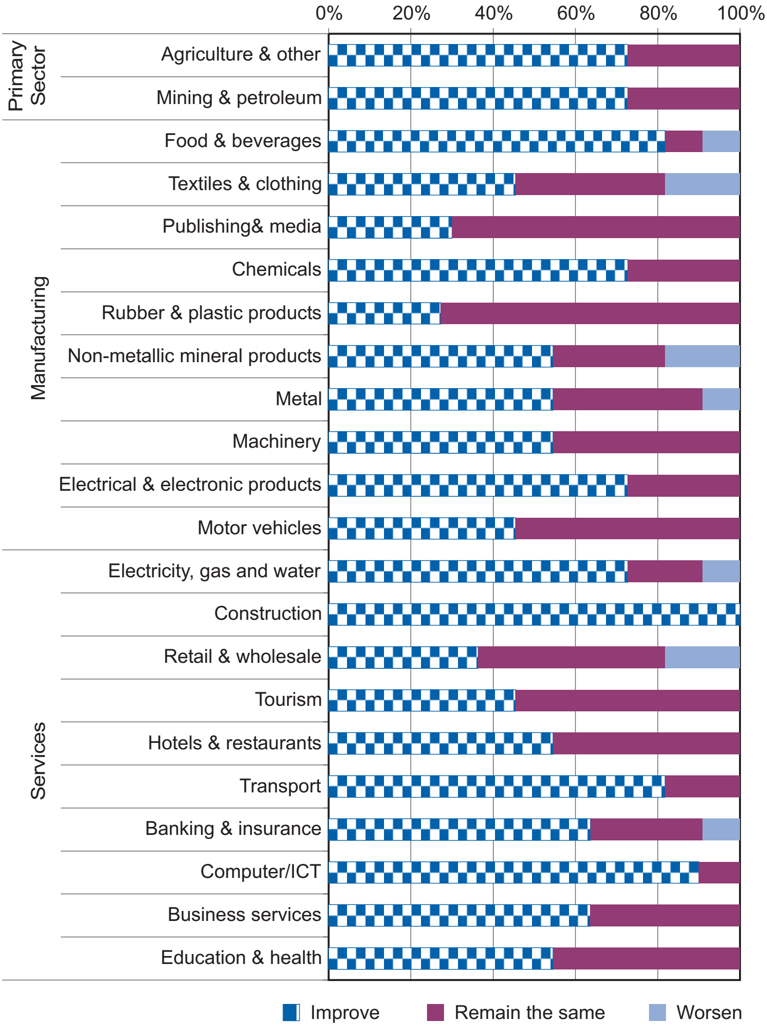


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

The services sector is widely perceived as having the greatest potential to attract foreign investors to South-east Europe and the CIS. It accounts for the industries for which 80% of IPAs agree there will be an increase in FDI inflows (figure IV.E.4). These industries are: computing and ICT, construction and real estate, and transport. The optimistic assessments for the latter two industries are largely due to the economic growth forecast in the region and the resulting need for greater infrastructure investment. High expectations for FDI in computing and ICT services are consistent with the findings for other regions.

Figure IV.E.4. South-east Europe and the CIS: FDI prospects by industry, 2005-2006

(Per cent of responses from IPAs)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

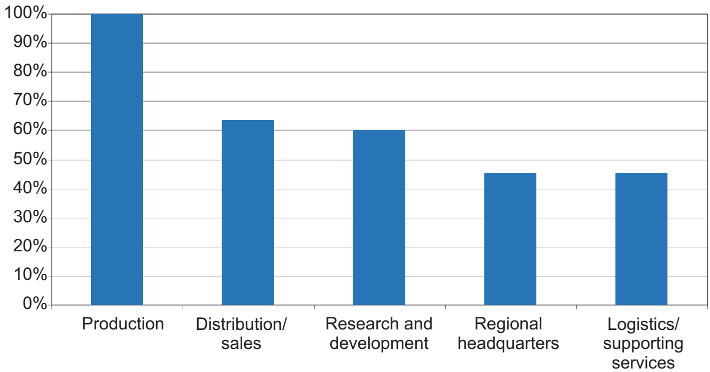
IPAs seem to believe that South-east Europe and the CIS could have a competitive advantage in the primary sector. Three out of four IPAs surveyed expect FDI growth in agriculture, forestry and fishing, as well as in the mining, quarrying and petroleum industries. This contrasts markedly with feedback from other regions, and especially the developed countries. Twice as many IPAs in South-east Europe and the CIS expect to see FDI growth in mining, quarrying and petroleum and three times more expect increased FDI in agriculture, compared to IPAs in developed countries.

In the manufacturing sector, the food and beverages industry seems to have the brightest prospects, followed by chemicals and electrical and electronic equipment. This expectation could be largely based on anticipated outsourcing of production by TNCs from the European Union.

IPAs from South-east Europe and the CIS believe that production is the corporate activity most likely to be relocated to the region. Every IPA respondent expected to see further relocation of production in 2005-2006 (figure IV.E.5). Considerably fewer IPAs expect to benefit from the relocation of other corporate functions, with three out of five anticipating investment in distribution and sales and R&D.

Figure IV.E.5. South-east Europe and the CIS: expected relocation of corporate functions, 2005-2006

(Per cent of responses from IPAs)

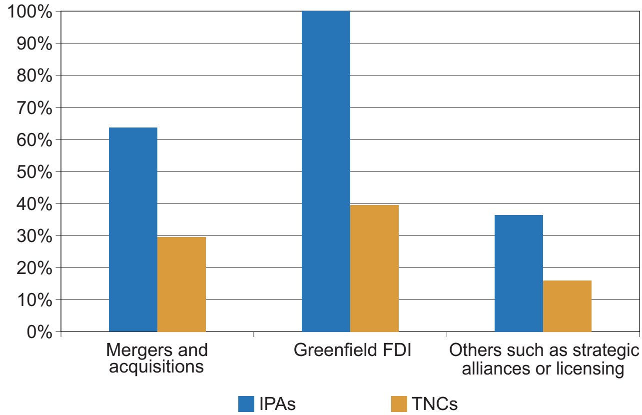


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Due to their positive investment environment, flexible labour market, and lower labour costs, South-east Europe and the CIS have benefited from the outsourcing of production by companies in the developed world, particularly Western Europe. Much of this outsourcing uses greenfield investment as its main mode of entry. It is not, therefore, surprising that all of the region's IPAs and most TNCs believe that greenfield investment will be the leading mode of entry into the region (figure IV.E.6). Three out of five IPAs also expect M&As to be a major means of investment during 2005-2006. TNCs, however, predict less use of M&As, with only 30% anticipating short-term M&A growth in the region in the near future. This is significantly lower than for other regions.

Figure IV.E.6 South-east Europe and the CIS: expected modes of investment, 2005-2006

(Per cent of responses)



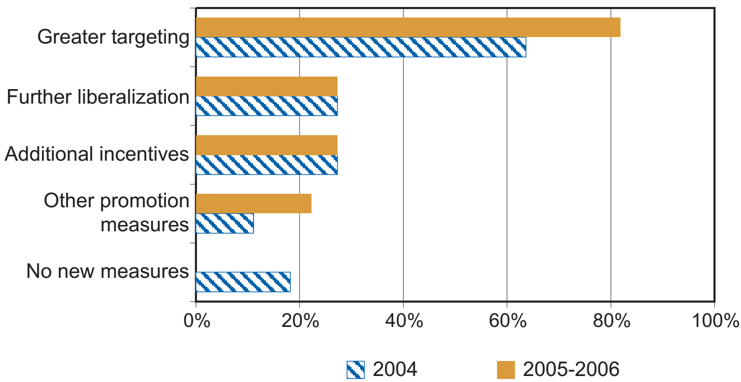
Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

Most IPAs in South-east Europe and the CIS have been established only since the fall of communism and are thus not much more than ten years old. Many are still experimenting with investment policy and promotion measures. Only one in five IPAs introduced no new investment promotion measures in 2004 (figure IV.E.7) and they all plan to apply new measures in 2005-2006.

In line with global trends, 80% of the region's IPAs believe that more focussed investor targeting is a useful tool for investment promotion. However, only one in four intends to introduce further liberalisation during 2005-2006 (less than in other regions.)

Figure IV.E.7. South-east Europe and the CIS: trends in policy measures to attract FDI, 2004-2006

(Per cent of responses from IPAs)



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

V. Concluding remarks

The GIPA survey results, global leading economic indicators and recent FDI policy developments all show that FDI flows are likely to recover further from the recession that dominated the early years of this decade. That recovery will be increasingly fuelled by FDI flows to selected developing countries and by investment in services sectors and selected manufacturing industries.

Overall, expectations for short- and medium-term FDI prospects are best described as cautiously optimistic. Much depends, as it always has, on economic growth. To the extent that growth does not falter, FDI will be strong in developing and developed countries alike, further reinforced in the latter by a resurgence of cross-border M&As.

It is clear that competition for FDI is intensifying. Countries will continue to put in place attractive investment environments through more liberal regulatory regimes and incentive structures, and through increased bilateral and regional investment agreements (Hamdani 2005). It is now common for countries to have liberal FDI entry and ownership requirements, as well as streamlined admission procedures, and to offer standard guarantees and protection to foreign investors (in such areas as national treatment, expropriation, dispute settlement, arbitration and the repatriation of funds). Investment agencies are shifting their focus away from authorisation and regulation to facilitation (one-stop operations and aftercare) and promotion (greater targeting, incentives, special economic zones and the development of industrial clusters).

The winners will not necessarily be those countries that attract the most FDI, but rather those that are able to derive the most benefits from the investment that they receive. FDI strategies are important and should be embedded in an overall national development plan or industrial development strategy. For smaller countries, a regional approach will bear dividends. For the least developed countries, the complementarity between aid and FDI will need to be realised, particularly with respect to the development of infrastructure, human resources, technological capacities and the domestic private sector. This requires greater cooperation between host and home countries on FDI issues. There is a need for innovative partnerships between public and private sectors to develop investment opportunities in infrastructure and less developed sub-regions, as well as in socially focused sectors, like education and medical services. There will also be a need for effective public-private dialogue and multi-stakeholder interaction to promote good governance and also inculcate a greater sense of corporate responsibility among resident investor communities.

Notes

1 For an analysis of these trends, see the *World Investment Reports 2000-2005*.

2 Calculations based on information from the Thomson financial database for 247 of the largest global TNCs.

3 For detailed analysis, including a definition of these agreements, see UNCTAD, *Economic Integration Investment Agreements* (http://www.unctad.org/iia).

4 Japan established duty-free and quota-free preferences for LDCs on almost all (99%) industrial and agricultural products (http://docsonline.wto.org/DDFDocuments/t/WT/COMTD/N2A10.doc).

5 The question on prospects for FDI by industry was posed to IPAs and FDI experts only, since TNCs are generally not well placed to provide forecasts for industries other than their own.

6 In this section, “IPA respondents” refers to IPAs from developed countries that took part in the survey.

7 “IPAs” in this section refers to those IPAs from Africa that took part in the survey.

8 “IPAs” in this section refers to those Asian IPAs that took part in the GIPA 2005 survey.

9 ‘IPAs’ in this section refers to those IPAs from Latin America and the Caribbean taking part in the survey.

10 The fact that Poland, last year’s number one business location, no longer features in the top five is purely due to its new country classification as a developed country (discussed earlier). As members of the EU, the United Nations has reclassified Poland and the Czech Republic as developed countries.

11 In this section, “IPAs” refer to those IPAs from South-east Europe and the CIS taking part in the survey.

Annex : Methodology

UNCTAD's *Global Investment Prospects Assessment (GIPA) 2005* is based on the results of three large-scale surveys of the largest TNCs, international FDI experts and IPAs, as well as on the analysis of various macroeconomic and microeconomic indicators and investment policy developments at the national and international level.

A. Survey of investment promotion agencies

Between January and April 2005, UNCTAD conducted its survey of investment promotion agencies (IPAs) from 154 countries. The overall response rate was 71%, with 75% of IPAs from developed countries and 70% of those from developing countries responding.

As the key agencies for disseminating information and facilitating investment in their countries, IPAs have a unique insight into investors' attitudes and activities in their countries. Through their daily contact with foreign investors and investment facilitation activities, IPAs gain a valuable knowledge of likely sources of FDI, investor strategies and key policies and risks.

B. Survey of transnational corporations

The survey of 325 of the largest TNCs was conducted in February 2005. This group represents 92% of total global FDI flows. These companies, representing the world's top 200 TNCs as well as the top 100 TNCs in developing countries and the top 25 TNCs in Central and Eastern Europe, were selected using UNCTAD's Transnationality Index. This classification is a composite based on shares of foreign assets, foreign employees and foreign sales as a ratio of total assets, total number of employees and total sales, respectively. The group of global top 200 TNCs alone, for example, accounted for US$10 trillion in sales and US$13 trillion in total assets in 2004.

The TNCs surveyed gave perspectives on their own investment outlook as well as on wider trends. In formulating their own strategies, TNCs closely track the future investment plans of other TNCs and factors affecting their industry. Their views are therefore significant, and often indicative of broader FDI trends and the investment plans of TNCs.

C. Survey of international FDI experts

UNCTAD conducted its survey of 76 international FDI experts in April 2005. Members of the GIPA expert group are professionals selected for their investment knowledge. These individuals include consultants, advisers and/or analysts dealing with FDI issues.

The respondents' mixture of expertise ensures there is no bias towards any particular industry or region. Experts were asked their opinions concerning FDI prospects, expected patterns in terms of industry and region, the expected strategies of TNCs in relocation of their corporate functions and mode of investment, as well as to give an indication of expected trends in terms of policy responses and governments.

This study uses the United Nations regional classification system. Regions were divided into two sets. The first was developing economies, which included four regions: Africa, Asia and the Pacific, Southeast Europe and the Commonwealth of Independent States, and Latin America and the Caribbean. The second group was developed economies, which consists of North America, the 25 EU Member States, and other developed economies (i.e Australia, Iceland, Israel, Japan, New Zealand, Norway and Switzerland.)

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Questionnaire

Prospects for Foreign Direct Investment and the Strategies of Transnational Corportions, 2005-2008

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The Global Investment Prospects Assesment (GIPA) is designed to present short-term and medium-term prospects for foreign direct investment (FDI) at the global, regional and industry levels. It also analyses the evolving trends in the strategies of transnational corporations (TNCs) as well as national FDI policies.

GIPA is designed to equip governments and businesses alike with an instrument for proactive development of policies and strategies, as opposed to post facto assessment of foreign investment facts.

The GIPA 2005-2008 was based on the findings of three worldwide surveys (i.e. the surveys of the world's largest TNCs, national investment promotion agencies (IPAs) and international investment experts). GIPA also analyses relevant leading economic indicators, and policy developments that would shape future FDI patterns.

For more information, please visit

http://www.unctad.org/fdiprospects; email: fdisurvey@unctad.org

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