

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

CHAPTER 3



UNITED NATIONS
New York and Geneva, 2005

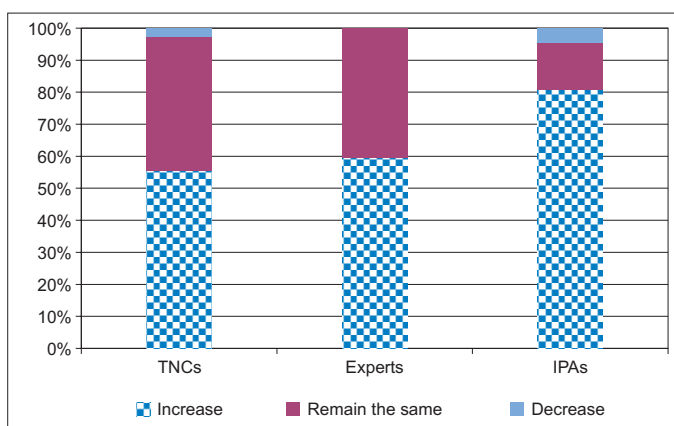
III. Global FDI prospects and TNC strategies

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.

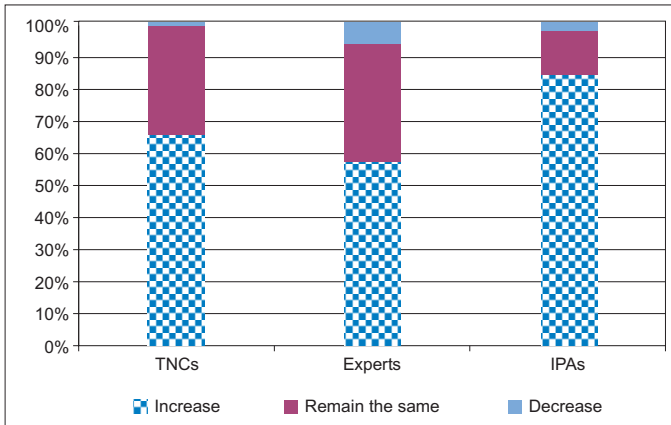
Figure III.A.1a. Global prospects for FDI, 2005-2006
(Per cent of responses)



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/fdiprosppects.

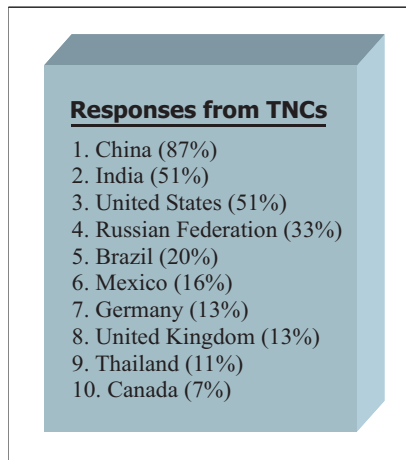
These results are broadly in line with those of the GIPA 2004 survey, though a greater proportion, but still a minority, of this year's respondents predict that FDI will remain stable rather than grow. This caution is due in part to the slowdown in economic growth in some major developed economies and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



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

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.

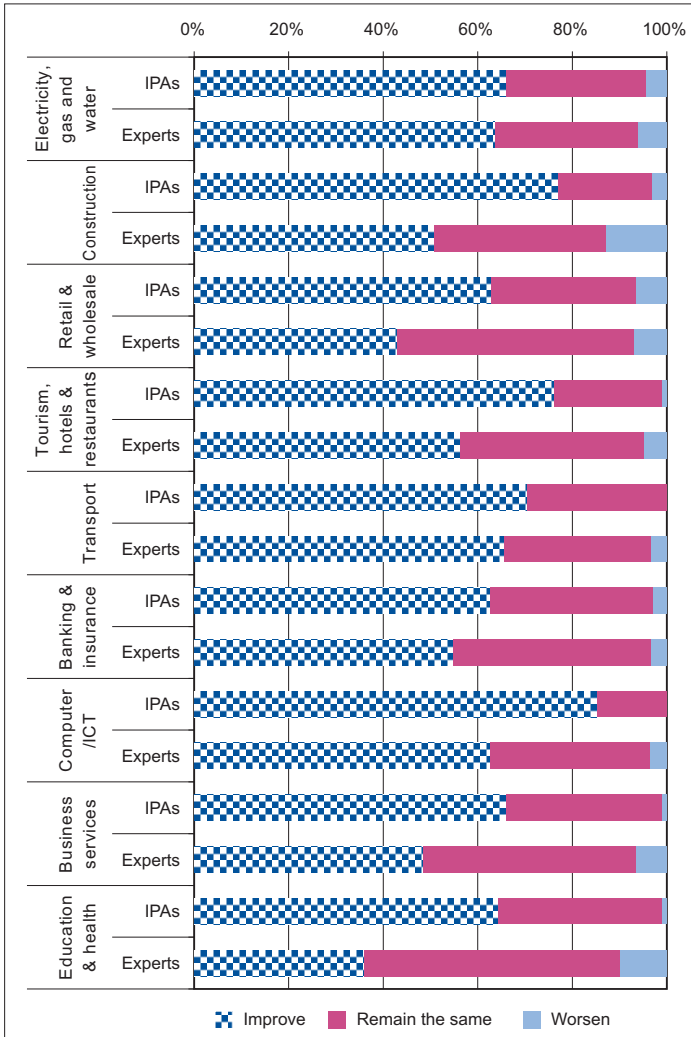
FDI growth is expected to be led by services in computing and ICT, public utilities (such as the generation and distribution of electricity, water and gas), transportation, followed by tourism, hotels and restaurants, construction, banking and insurance, retail and wholesale and business services, all 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.

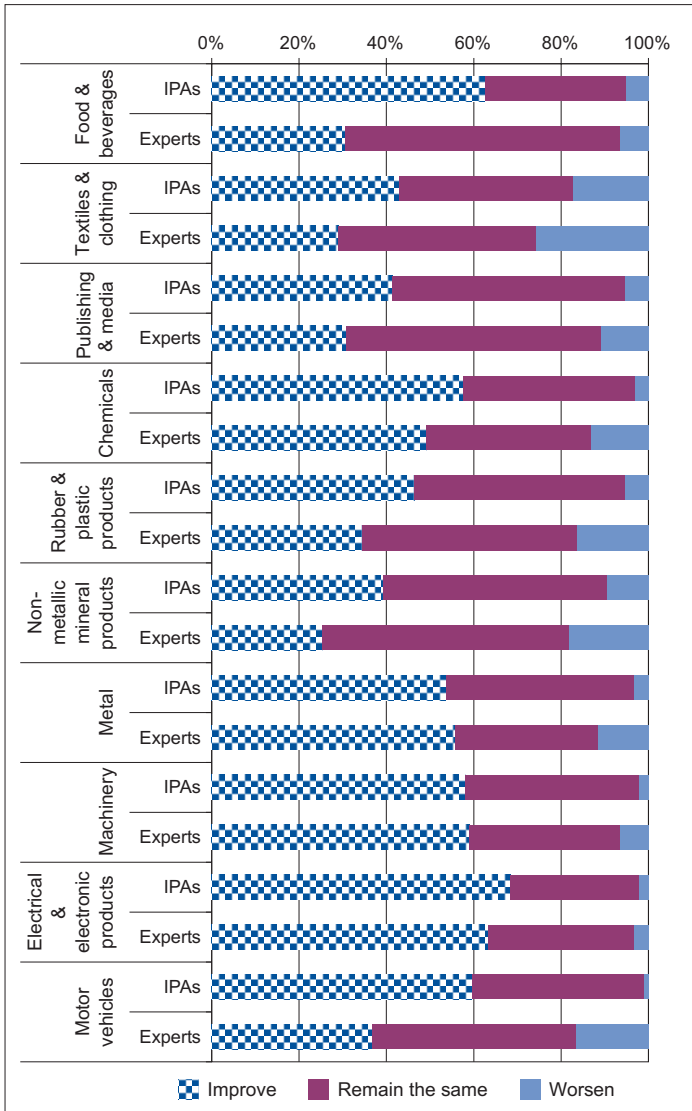
In sum, the findings of the GIPA 2005 survey are broadly in line with those of the 2004 survey. One major difference is that this year's respondents expect a greater divergence in the prospects for individual sectors compared with the 2004 survey. As well, the gap between the prospects for FDI in the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



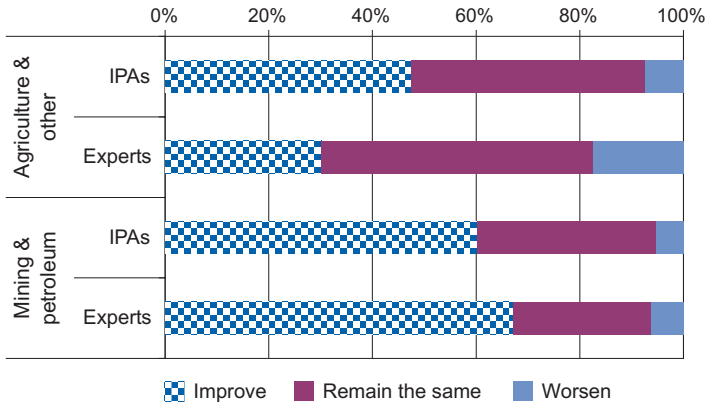
Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

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)

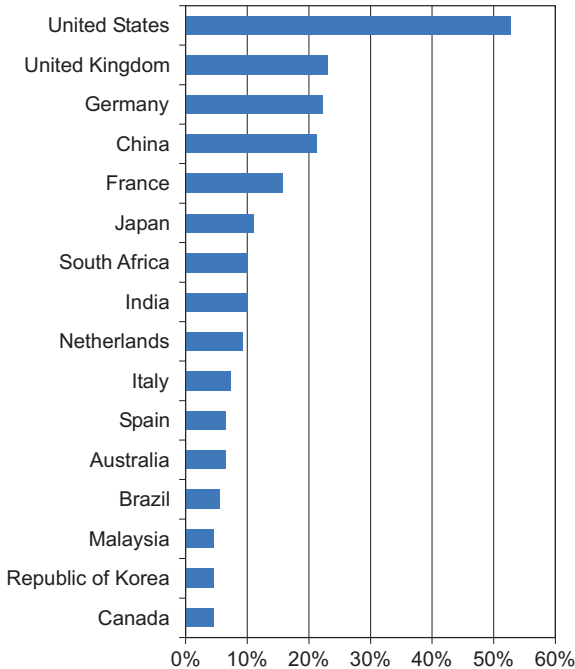


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

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)



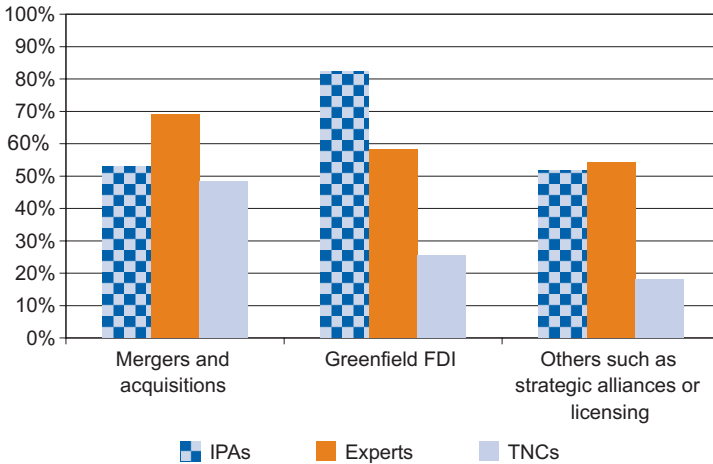
Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

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/fdiprosppects.

F. Prospects for TNC strategies: relocation of corporate functions

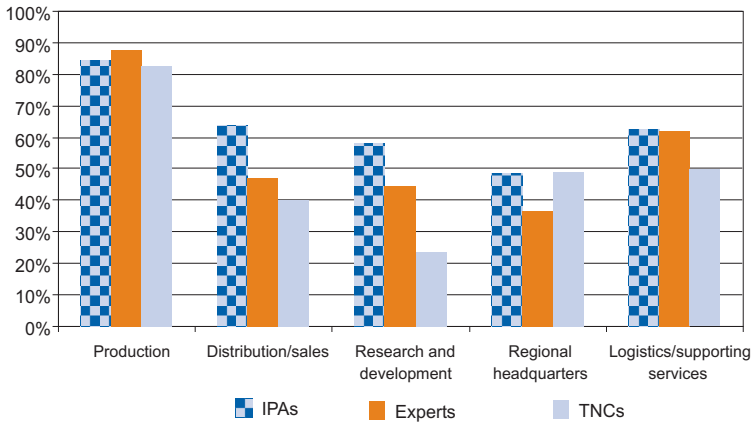
There was a broad consensus among IPAs, TNCs and experts that production would be the corporate function most likely to be relocated. Well over 80% of those surveyed expected production-related activities to be transferred overseas (figure III.F.1)

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)

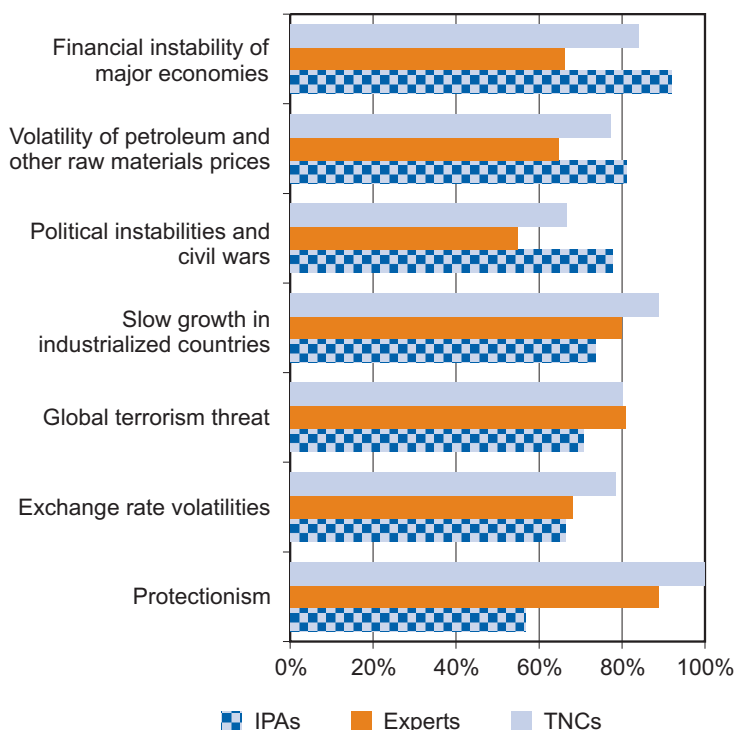


Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

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 responses)



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.