

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

EXECUTIVE SUMMARY



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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.