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Prospects for FDI Flows, TNC Strategies and Policy Developments, 2004-2007

- Global Investment Prospects Assessment (GIPA) Research Note No. 2: UNCTAD's findings of the second worldwide survey of investment promotion agencies -

Executive Summary

Investment Promotion Agencies (IPAs) worldwide are becoming increasingly optimistic regarding prospects for an increase in foreign direct investment (FDI) in the near term (2004–2005) as well as in the medium term (2006-2007). The likely recovery of FDI in 2004 is a key finding of UNCTAD's second annual survey of IPAs carried out in 2004. This result confirms the findings of a related survey of locational experts which UNCTAD carried out in cooperation with Corporate Location magazine the results of which were published in April this year. This year's IPA survey is the second of its kind following the first edition in 2003 and yielded a great many interesting findings. IPAs, for example, are optimistic about FDI prospects in the medium term (2006-2007), with 91 per cent of the respondents believing that these will improve. Prospects are considered positive for almost all industries. Globally, the top ranked industries in terms of prospects for FDI are hotels and restaurants, tourism, computers/information and communication technologies (ICT), and retail and wholesale – all in the services sector. The United States, Germany, the United Kingdom and France are viewed as the leading sources of FDI, followed by China and Japan. Production, logistics and other support services, as well as distribution and sales, are the foremost types of activities that IPAs expect TNCs to relocate abroad. Half of the responding IPAs expect FDI to enter through greenfield investments, while 27% expect mergers and acquisitions (M&As) to be the preferred mode of entry. On the policy side, IPAs are intensifying their efforts to attract FDI using targeting, in particular, and are not shying away from offering additional incentives.

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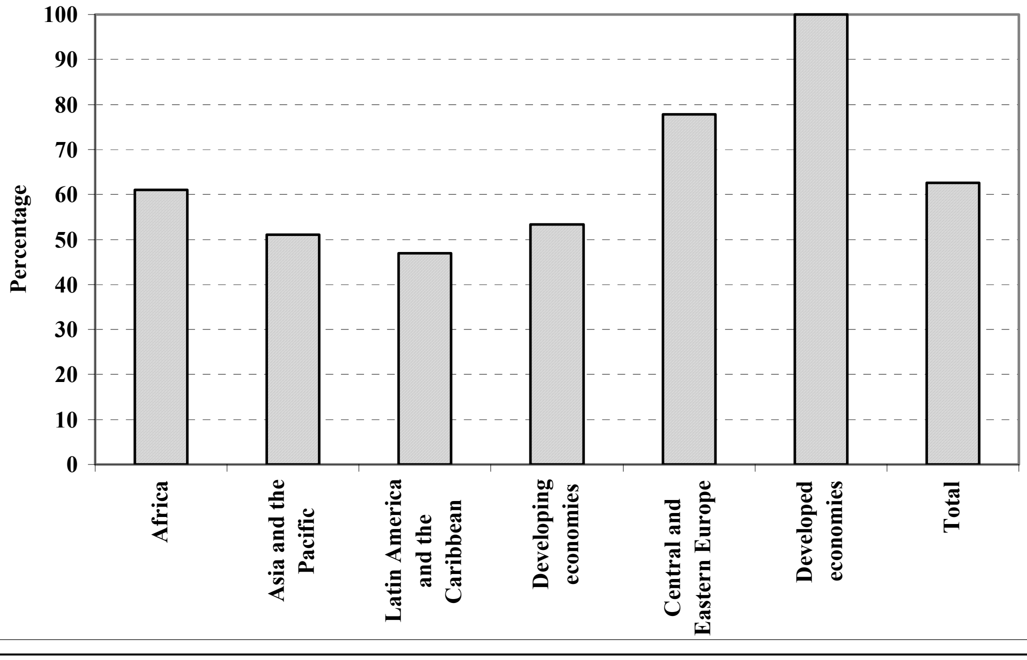
DITE-GIPA-2004-2

I. Introduction

Global flows of FDI remained stagnant in 2003 at $653 billion after two consecutive declines: from $1.4 trillion in 2000 to $824 billion in 2001 and $651 billion in 2002.[2] This sharp decline and ensuing stagnation raised several questions about FDI prospects in the short and medium term, as well as about the expected patterns by industry and region. The decline also prompted a number of policy responses by governments seeking to counterbalance the global trend.

To address some of the questions and improve an understanding of FDI prospects and related issues, UNCTAD conducted its second worldwide survey of 158 national IPAs during January-March 2004.[3] The overall response rate of the second survey was 63 per cent. The response rate for developed countries with IPAs was 100 per cent, while that for developing countries was 54 per cent (figure 1). IPAs can provide insights and a unique perspective on FDI trends and prospects, being at the forefront of countries' efforts to attract and facilitate such investments. As they respond in their day-to-day operations to foreign investors' inquiries and facilitate investors' locational exploratory missions and feasibility studies, they serve as important antennae for receiving signals relating to FDI flows and TNCs' location strategies.

Figure 1. UNCTAD IPA survey: response rate by region



Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004*.

[2] For a comprehensive analysis of FDI trends, see UNCTAD. *World Investment Report 2003: FDI Policies for Development – National and International Perspectives*. Geneva and New York, United Nations, Sales no.: E.03.II.D.8. For an account of the most recent FDI developments, see UNCTAD press release, Global FDI Decline Bottoms Out In 2003, UNCTAD/PRESS/PR/2004/001, 12/01/04

[3] Some countries do not have national IPAs. They are, therefore, not covered by the survey.

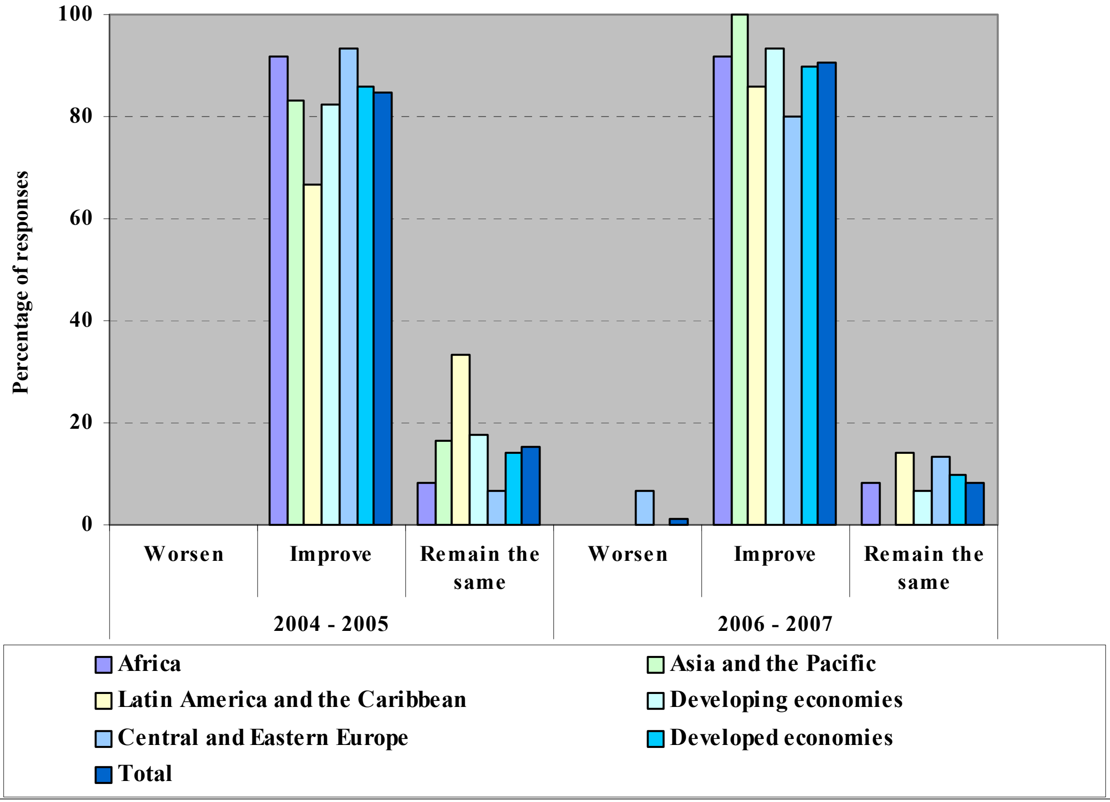
For the first time, the findings of the 2004 survey of IPAs are complemented by and cross-checked against those of two other UNCTAD surveys carried out at the same time: a survey of the largest TNCs from developed, developing and the transition economies of Central and Eastern Europe (CEE); and a survey of international investment experts, who typically assist TNCs in their overseas location decisions. However, this note presents only the findings of the second annual survey of IPAs.

II. Global prospects

Optimism prevails for short- and medium-term prospects for FDI, indicating a revival of future investment flows.

Bearing in mind the severity of the recent downturn in FDI, the extent of optimism surrounding prospects for increased FDI in the short (2004-2005) and medium term (2006-2007) is striking (figure 2). A few survey findings stand out. In the short term, no IPA expects prospects to worsen, but in the medium term, 7 per cent of the Central and Eastern European respondents do. Latin American and Caribbean IPAs are relatively less optimistic, with 67 per cent of the respondents expecting an improvement in FDI in the short run, and 86 per cent in the medium term. Developed countries are slightly more optimistic about the medium term than the short term. Overall, respondents from developing economies are as optimistic as those from developed ones regarding FDI prospects in the medium term.

Figure 2. Prospects for FDI inflows in 2004-2005 and 2006-2007 as compared to the period 2002-2003, in %

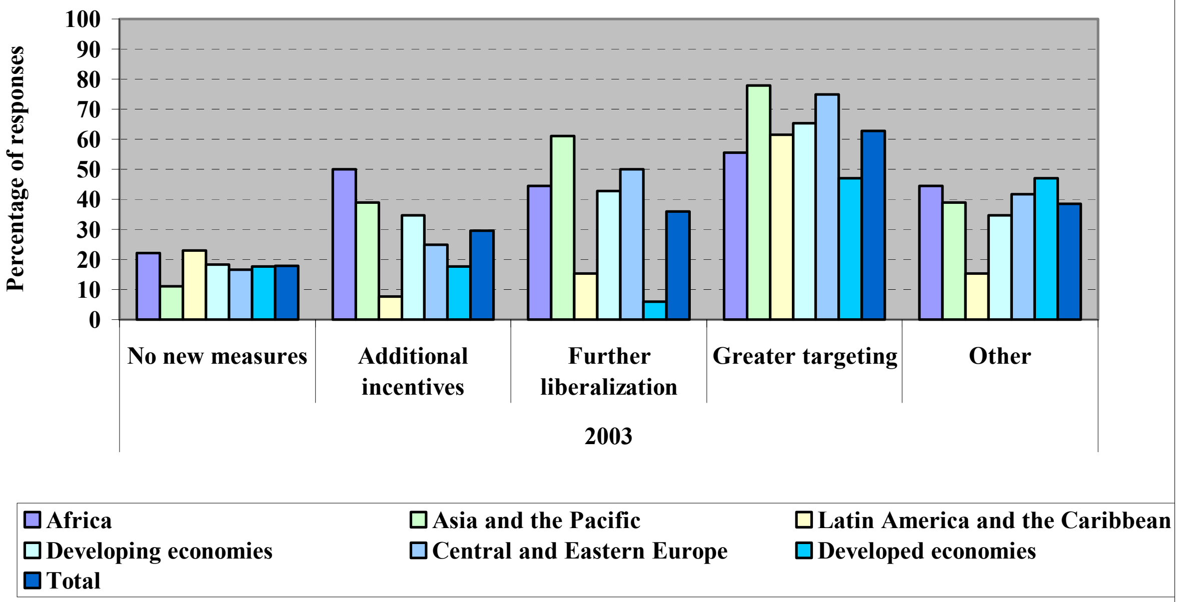


Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

Competition for attracting FDI is becoming more intense, including through greater use of incentives and ongoing liberalization, as well as the use of targeting as an investment promotion instrument.

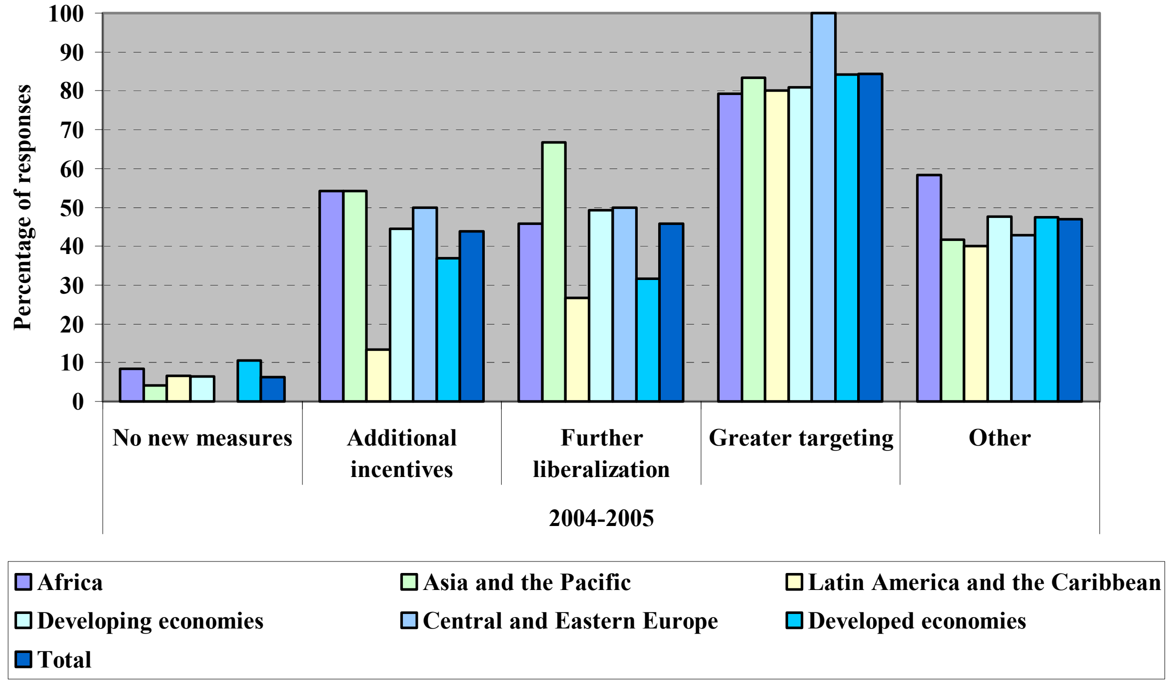
Despite expectations of improved FDI prospects in the short and medium term, competition among countries for FDI does not show signs of subsiding. If anything, it is becoming more intense, including through the greater use of incentives and liberalization. This was evident in 2003, especially by IPAs in Africa, Asia and the Pacific and Central and Eastern Europe. However, for most Latin American and Caribbean IPAs this trend is less evident; they used to a lesser degree than other regions further liberalization and incentives to attract FDI. Developed countries also have low rates of response concerning the use of policy instruments such as incentives and further liberalization. Investment targeting, on the other hand, has become one of the most important tools for attracting FDI throughout the world, especially by IPAs in Asia and the Pacific, Central and Eastern Europe and Latin America and the Caribbean (figure 3). The use of targeting overall is expected to increase during the period 2004-2005 (figure 4).

Figure 3. Preferred policy measures to attract FDI in 2003 by region, in %



Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004*

Figure 4. Preferred policy measures to attract FDI in 2004-2005 by region, in %



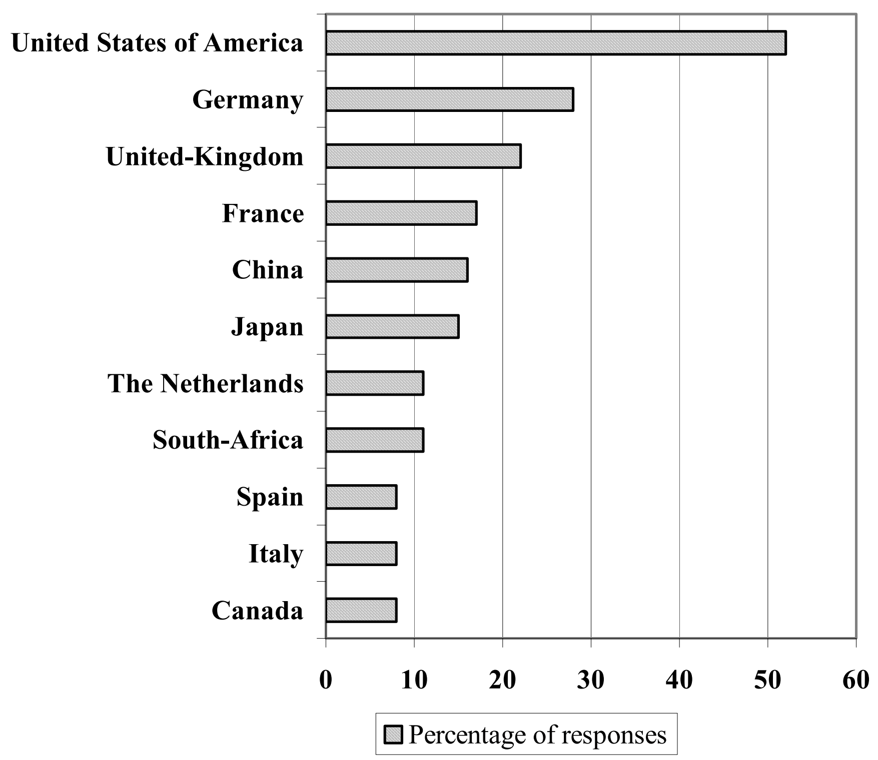
Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004*.

China is now among the top five investing countries for the first time, but the United States is still expected to be the largest source country.

For the first time, a developing country, China, has made the list of the expected top five investing countries worldwide during 2004-2005, replacing Japan, which traditionally has been a significant source country for FDI (figure 5).[4] Many developing countries rank China second after the United States as an expected country of origin for FDI during that period. This is possibly because Chinese TNC ventures abroad so far may have raised expectations on the part of developing country IPAs as to the likelihood of attracting additional Chinese investment. It is particularly significant because it underscores China's growing importance as regards FDI, not only as a host but also as a source country. However, in terms of value of individual FDI projects, Chinese investment tends to be still smaller than that of traditional home countries for FDI.

[4] For a comprehensive analysis of China's outward FDI, see UNCTAD's e-brief: China: an emerging outward investor, 4 December 2003, available at: http://r0.unctad.org/en/subsites/dite/fdistats_files/pdfs/China_ebrief.pdf

Figure 5. Leading sources of FDI



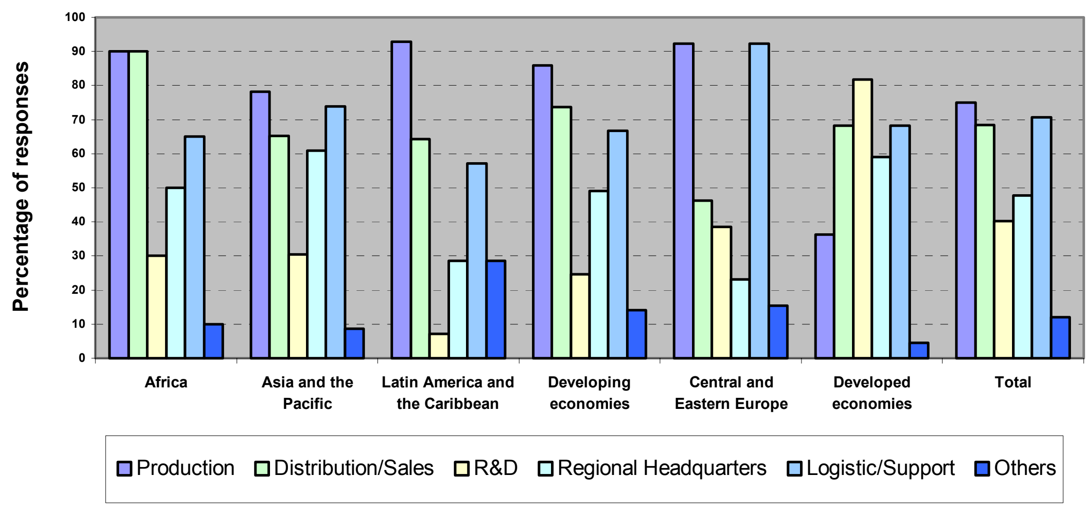
Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

Despite China's ascendancy, the United States remains in top place as the largest expected source country worldwide, both for developing and developed economies as distinct groups. In Central and Eastern Europe it ranks in second place after Germany. Interestingly, a few smaller countries, such as South Africa and Spain, not typically identified as large foreign investors, have made the list of expected top 10 source countries, principally because of their significance as home countries for specific regions.

Logistics-related functions have gained ground globally, but production functions dominate the corporate activities located in developing countries. Activities related to research and development (R&D) are expected to remain highly concentrated in developed countries.

Three out of four of the responding IPAs expect more production activities to be located in developing countries during the period 2004–2005, thus underlining the importance of this more traditional type of functional concentration for developing countries (figure 6). However, this finding should not divert attention from the changes in the nature of production functions located abroad; increasingly, spatial specialization of international production is taking place, both regionally and globally. Latin America and the Caribbean stands out as the developing region where most countries expect an influx of production activities, according to 93 per cent of the respondents, followed by Africa (with 90 per cent of the respondents) and Asia and the Pacific (with 78 per cent of the respondents). The majority of respondents from developing countries also expected to benefit from the relocation of distribution and sales- related activities (74%) as well as logistics and other support services (67%). These results are in line with those of other studies that show an increase in off-shoring of certain white-collar jobs from developed to selected developing countries.

Figure 6. Corporate functions expected to be relocated in 2004-2005 by region, in %



Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

Developed countries have clearly shifted away from attracting production or manufacturing activity per se; instead, the majority of respondents from those countries expect logistics and other support services, distribution and sales, R&D and headquarters to be the principal functions located there.

Central and Eastern Europe stands out in the survey findings with regard to the location of international production by function, in that an exceptionally high percentage of respondents from the region (92 per cent) singled out production as well as logistics and other support services as activities they expect will be relocated there during 2004–2005.These figures suggest that the trend of relocation of production particularly from Western Europe towards CEE countries is continuing as many of these are joining the European Union. Accession to the EU of many Central and Eastern European countries has also increased the prospects for greater rationalization in functions other than production; hence the high scores not only for logistics and other support services, but also for distribution and sales. It is also noteworthy that 38 per cent of the respondents mentioned Central and Eastern Europe as a location for R&D functions, compared with only 25 per cent for developing countries, a reflection of the region’s technical expertise and level of education.

The Asia-Pacific region dominates the developing but also the developed world as an expected location for regional headquarters of TNCs during 2004-2005, with 61% of the respondents expecting headquarters functions being located there. Thus the well-established reputation of a handful of countries in Asia and the Pacific for offering environments friendly to headquarters-related services continues to pay off.

IPAs are much more optimistic about FDI prospects in services than in manufacturing or mining.

There is across-the-board optimism regarding FDI prospects in services compared with both manufacturing and the primary sector. For most service industries, more than 70 per cent of all respondents expected better prospects for FDI compared with the situation in 2002 and 2003 (figure 7).

Figure 7. Prospects for FDI flows by industries in 2004-2005, ranked by the share of respondents expecting an increase in FDI

Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

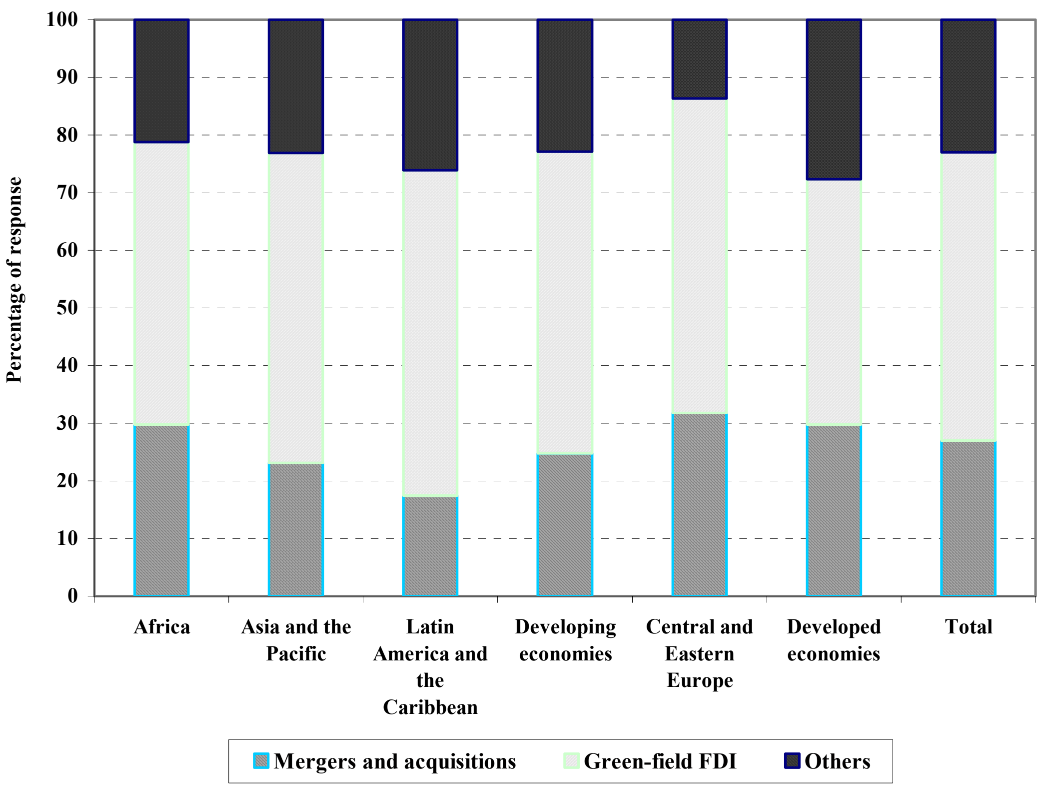
For many service industries (energy services, retail and wholesale, hotel and restaurant, transport, computer/ICT, business services and tourism), no IPA expected a worsening of FDI prospects during the period 2004–2005. For all service industries, except banking and insurance, business services and other services, respondents from developing countries were more optimistic regarding FDI prospects than those from developed countries.

The picture emerging from the survey for FDI prospects in the manufacturing sector was more mixed. No IPAs expected a worsening of FDI prospects in any industry, except rubber and plastic products and “other” manufacturing. Overall, IPAs expressed significant optimism for FDI in electrical and electronic equipment, but in several industries (e.g. non-metallic products and metals, textiles and clothing, publishing and media) their optimism was more subdued than that for most service industries.

Modes of investment are again expected to follow traditional lines, greenfield FDI being dominant in the developing countries and M&As in the developed countries, but greenfield FDI is not far behind in the latter.

After the M&A boom of the 1990s, the preferred mode of expansion by TNCs is expected to continue reverting back to being predominantly greenfield in 2004-2005 (figure 8). This reflects the decline in M&As worldwide over the past few years following the M&A bust which started in 2001 and dampened prospects for a new wave of M&As of similar magnitude.

Figure 8. The preferred modes of foreign direct investment (FDI) and the business internationalisation



Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

In developing countries, as well as in Central and Eastern Europe, there is a pronounced expectation of greenfield investment projects being dominant, with 52 per cent and 55 per cent of the respondents, respectively, expecting such investment. Expectations of M&As are much lower at 32 per cent or less. In contrast, however, in the developed world the difference in expectations between greenfield investment and M&As is smaller, the respective shares of respondents being 43 per cent and 30 per cent; the remaining 27 per cent envisage other modes of international expansion, including licensing.

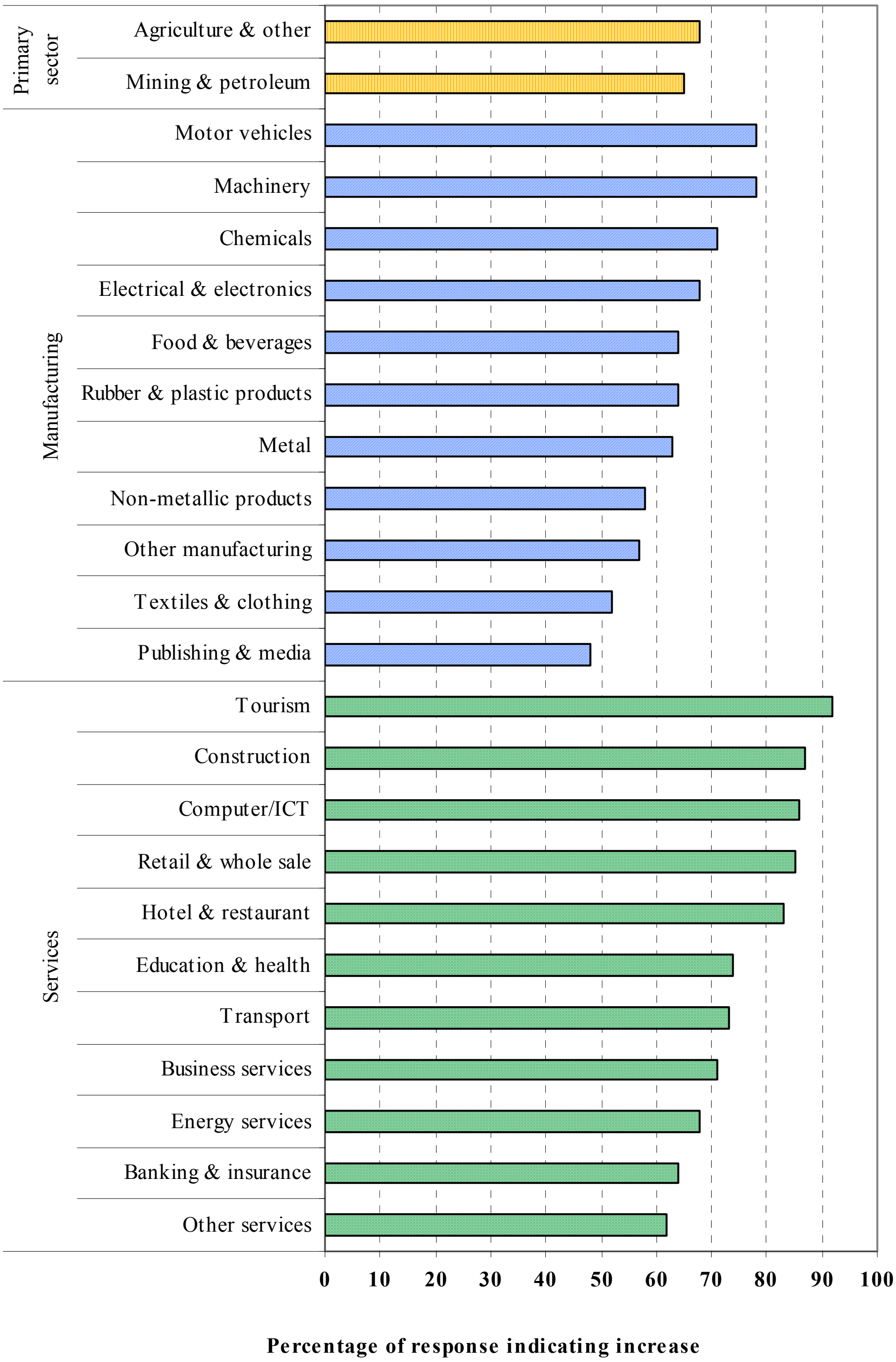
III. Regional prospects

Some of the findings of the second IPA survey are of particular importance for individual regions or groups of countries. These are highlighted below.

Asia and the Pacific

In contrast to the somewhat uncertain short-term FDI picture that emerged for Asia and the Pacific in last year's survey, the region now appears to have moved beyond the stagnating FDI flows that characterized 2003. Prospects for 2004–2005 are perceived to be bright, with further improvement anticipated in the medium term (2006–2007) (figure 2). machinery and equipment along with motor vehicles are the two manufacturing industries for which FDI prospects are particularly positive in the short term. At the same time, in the services sector there is considerable optimism for FDI in tourism, construction, and computers/ICT (figure 9). IPAs' response rate concerning expectations for location of regional headquarters, R&D and logistic/support services were the highest in Asia and the Pacific among all developing regions (figure 6). The United States and Japan were most frequently cited as the most important investors in the region. Finally, greenfield investment remains the preferred mode of entry for TNCs in the years to come.

Figure 9. Asia and the Pacific: all sectors should profit from an increase in FDI



Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

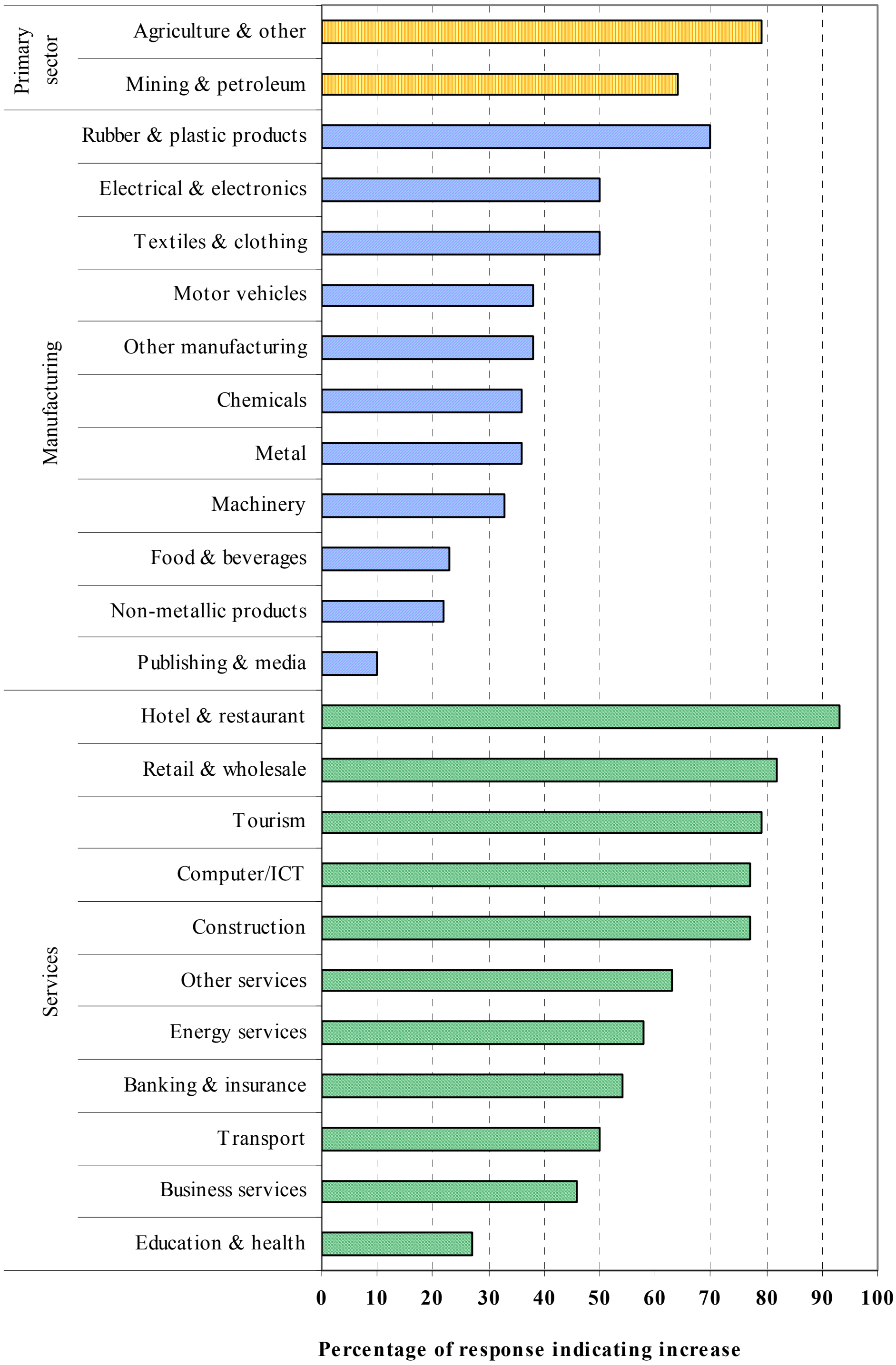
Over 78 per cent of the IPA respondents from Asia and the Pacific indicated that they have intensified their investment promotion efforts by using targeting strategies, while 39 per cent resorted to additional incentives and 61 per cent used increasing liberalization to attract FDI (figure 3). Even more distinct than in any other developing region, greater FDI liberalization and targeting are reported to be the Asia-Pacific region's preferred instruments for attracting FDI in the medium term (figure 4).

Latin America and the Caribbean

Prospects for FDI in Latin America and the Caribbean are also improving, according to respondents from this region, who expressed considerable optimism for increased FDI (86 per cent of respondents) in the medium term. However, it is noteworthy that these respondents were the least optimistic compared to those from other regions of the world – developed and developing – in the short term as regards improved FDI prospects. One third of the respondents expect prospects to remain unchanged in 2004 and 2005. As mentioned earlier, expectations for the medium term are significantly better, but still lag behind most other developing regions' expectations (figure 2). This picture reflects the economic difficulties that individual countries in the region continue to face, their disappointing FDI performance in 2002 and 2003, as well as the termination or lull in many privatization programmes that have attracted FDI in the past. Again, the United States is expected to dominate the FDI picture in the region as the top source country, followed by Spain.

For the primary sector, agriculture is seen as the industry holding the brightest prospects for FDI. As for the secondary sector, no manufacturing industry stands out as having exceptionally bright prospects for FDI in 2004 and 2005, apart from rubber products. The percentage of respondents expecting prospects to remain unchanged or worsen generally exceeds that of respondents expecting an increase in FDI. There is typically greater optimism for FDI in the services sector, particularly for hotels and restaurants, retail and wholesale trade as well as tourism followed by computer/ICT and construction (figure 10). More than in any other region of the world, prospects for greenfield investment seem the brightest, with 56 per cent of the respondents expecting this to continue in 2004 and 2005 (figure 8). Provision of additional incentives is the least preferred instrument for attracting FDI compared to other developing regions, while a considerable increase in the use of investor targeting is expected during these two years (62 per cent of respondents used greater targeting in 2003 to attract FDI, but 80 per cent said they expect to do so during the period 2004–2005) (figures 3 and 4).

Figure 10. Latin America and the Caribbean: FDI growth will be in the services and primary sector

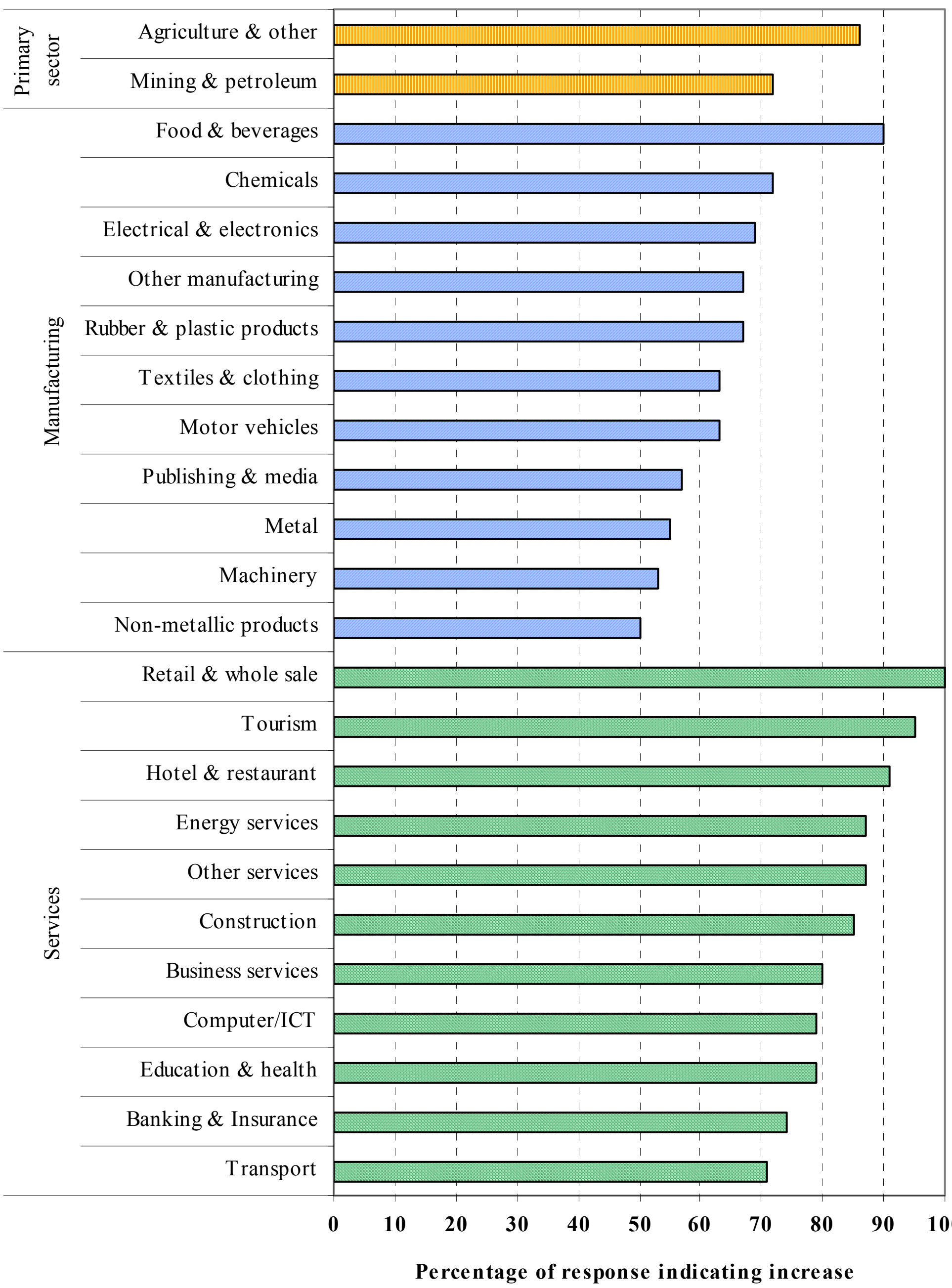


Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

Africa

The picture provided in the survey for Africa is particularly bright. There is significant optimism on the part of African IPAs both for the short and medium term (figure 2). Agriculture scored particularly high in terms of its prospects as a destination for FDI, as did food processing in the manufacturing sector. All services in Africa scored high in terms of FDI prospects, with 100 per cent of respondents expecting more FDI in the retail and wholesale sector in 2004–2005, followed by tourism and hotels and restaurants (figure 11). South Africa and China are most frequently mentioned as investors in the region for these years, surpassing countries that have been – in value terms - traditionally the most important investors (e.g. the United Kingdom and France). This implies that even if FDI from the former does not match the values of the traditional source countries, it might be more widespread, and less focused on specific countries. Almost half of the respondents (49%) expect greenfield FDI to be the preferred mode of entry (figure 8). In 2003, African IPAs utilized incentives more than in any other developing region, while they lagged behind other developing regions in their use of greater targeting. Both these trends are expected to continue in 2004–2005 although the region should catch up as far as "targeting" is concerned (figures 3 and 4).

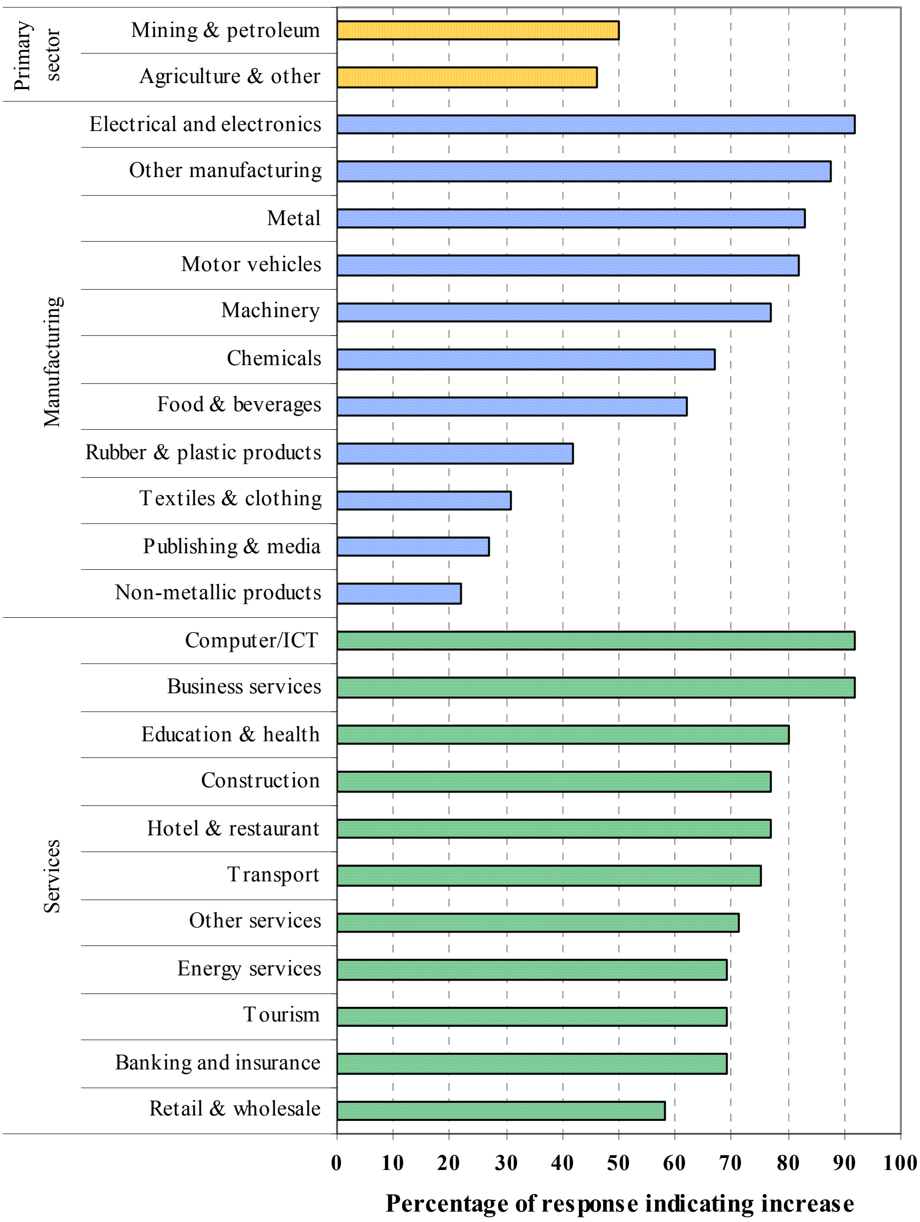
Figure 11. Africa: high scores for all services in terms of FDI prospects



Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

Central and Eastern Europe

Figure 12. Central and Eastern Europe: manufacturing and services will improve significantly

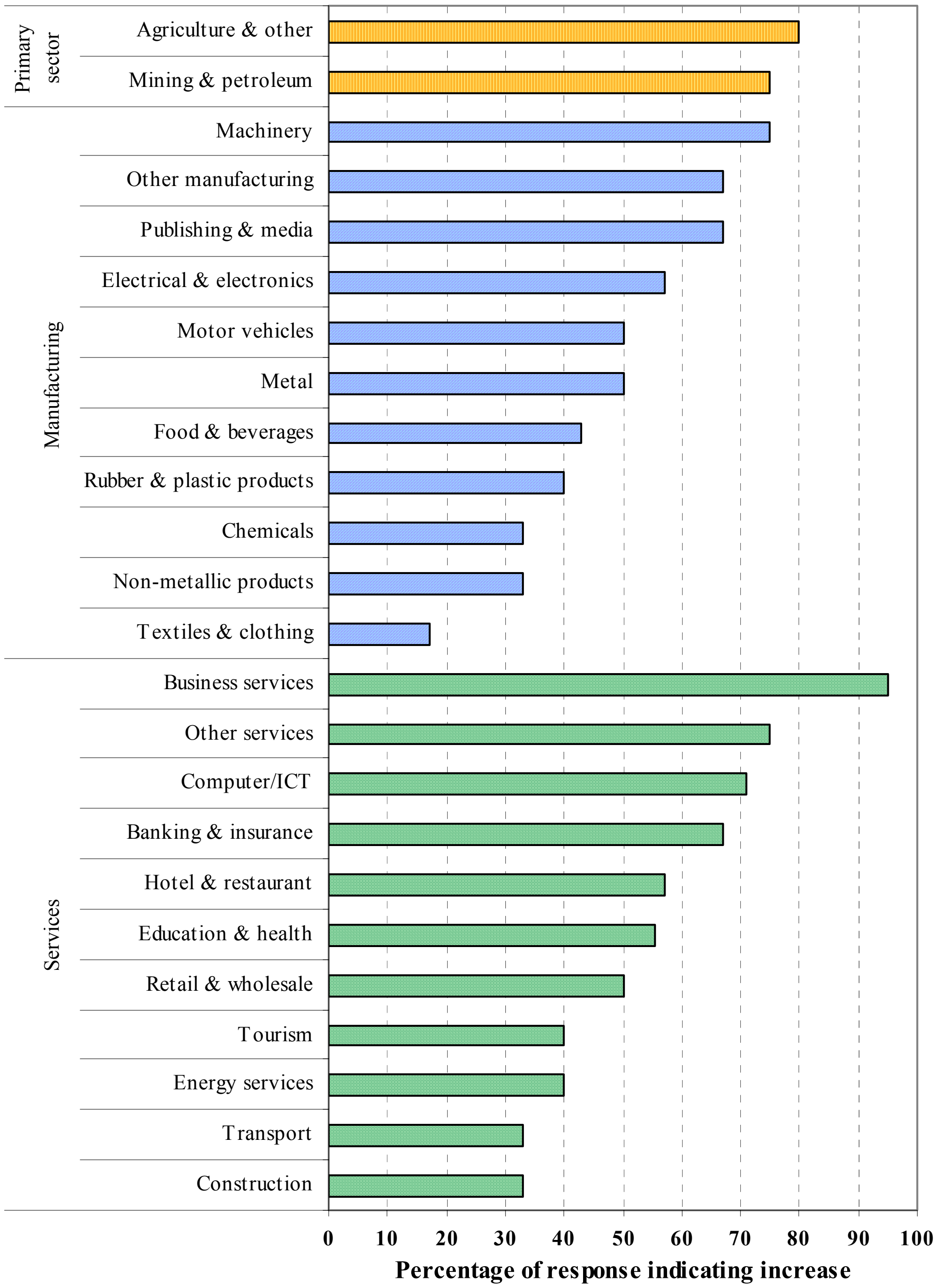


Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

Central and Eastern Europe is particularly optimistic regarding prospects for the period 2004–2005, but considerably less so for the medium term (2006–2007) (figure 2). This might stem from expectations that the accession of several CEE countries to the EU will trigger an instant wave of FDI inflows into those countries which, later, would somewhat recede. Several manufacturing industries (electrical and electronic equipment, other manufacturing, metals and mineral products, motor vehicles, machinery and equipment) stand out, with significantly improved prospects in the short term. As with other regions, service industries score higher than manufacturing, especially business services, computer/ICT, education and health, construction and transport (figure 12). Following earlier trends, Germany and the United States are most often mentioned as the largest investors in the region in the short term. Similar to the finding of the first IPA survey in 2003, greenfield investment is indicated as the dominant form of entry (figure 8). Liberalization and greater targeting were the principal instruments used in 2003 to attract FDI, and while that is expected to remain so for 2004 and 2005, greater use of incentives is also anticipated (figures 3 and 4).

Developed countries

Figure 13. Developed economies: More optimistic about FDI prospects in services



Source: UNCTAD-DITE, *Global Investment Prospects Assessment (GIPA) 2004.*

The overall picture for developed countries as a group is as optimistic as for the rest of the world. In general, while optimism is on the rise regarding medium-term prospects for FDI, it is slightly less strong than in other regions. In contrast to these findings for developed countries, the EU stands out as being particularly optimistic: all respondents from the region anticipate improved FDI prospects in 2004–2005.

The United States is expected to remain the top investor in the developed world, with Germany and the United Kingdom also ranking high. Investment promotion agencies are particularly optimistic about prospects for FDI in business services, computer/ICT, tourism, hotels and restaurants and banking and insurance in the services sector, while machinery and equipment, publishing and media as well as electrical and electronic equipment score high in the manufacturing sector (figure 13). M&As are expected to be more popular than greenfield FDI (figure 8). Greater targeting was the principal investment promotion instrument used for attracting FDI in 2003, and its importance is expected to increase considerably in 2004 and 2005 (figure 4).

IV. Concluding remarks

In all the responses to the second annual IPA survey, there are signs of optimism and confidence for buoyant FDI performance in the coming years. IPAs in the developing world are especially positive regarding improved prospects in light of renewed economic growth worldwide. This suggests that IPAs not only believe the worst is over, but have actually become upbeat about prospects. Most likely, barring unforeseen adverse events, their expectations will be met as the world enters a new cycle of growth and prosperity. IPAs are using a combination of policy and investment promotion tools as part of their strategy to compete for and attract FDI, regardless of how they view future prospects. What is obvious from the findings of this survey is that even where optimism prevails, tactics for attracting FDI continue to become more aggressive. The findings of this survey are complemented by two other UNCTAD surveys, of international investment location experts and TNCs, which provide interesting additional insights into future FDI trends.

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Acknowledgements

UNCTAD would like to express its great appreciation to the respondents for their participation in the second IPA survey. Their kind cooperation and the valuable information they provided were indispensable for the assessment of FDI prospects.

Global Investment Prospects Assessment (GIPA)
UNCTAD

The Global Investment Prospects Assessment (GIPA) is designed to assess short- and medium-terms prospects for foreign direct investment (FDI). It analyses the future patterns of FDI flows at global, regional, national, and industry levels from the perspectives of global investors, host countries and international FDI experts. It also analyses evolving trends in the strategies of transnational corporations (TNCs) as well as FDI policies.

GIPA is aimed at filling a research and policy analysis gap. It will equip governments and business alike with a critical instrument for the pro-active development of policies and strategies as opposed to the post-facto assessment of foreign investment facts.

Aside from its own research and policy analysis, UNCTAD assessment is based on the findings of large-scale surveys that are tripartite in nature:

- A worldwide survey and follow-up interviews of the largest TNCs with headquarters in developed and developing countries as well as in Central and Eastern Europe.
- A worldwide survey and follow-up interviews of international FDI experts who typically assist TNCs in their overseas location decisions (in collaboration with Corporate Location Magazine).
- A worldwide survey of national investment promotion agencies on their perception of TNCs' investment strategies and FDI prospects for their respective countries and regions.

The above surveys are complementary to each other and allow for a direct comparison between the results obtained.

The GIPA is managed by a team comprising:

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