UNITED NATIONS

TD

United Nations Conference on Trade and Development

Distr.
GENERAL

TD/B/COM.2/64
4 February 2005

Original: ENGLISH

TRADE AND DEVELOPMENT BOARD
Commission on Investment, Technology and Related Financial Flows
Ninth session
Geneva, 7–11 March 2005
Item 3 of the provisional agenda

POLICY ISSUES RELATED TO INVESTMENT AND DEVELOPMENT

*Emerging FDI from developing countries**

Note by the UNCTAD secretariat

Executive summary

Changes in the geographical patterns of foreign direct investment (FDI) show the growing importance of developing countries as both host countries and home countries for FDI. In 2004, developing countries attracted an estimated $255 billion of FDI inflows, corresponding to 42 per cent of world FDI flows and increasing the FDI stock of developing countries to more than $2.5 trillion in 2004. Meanwhile, the value of outward FDI stock from developing countries rose from $129 billion in 1990 to $859 billion in 2003.

The expansion of outward FDI from the South is mainly accounted for by a number of economies notably in Asia, and some in Latin America and the Caribbean. Further work is needed to improve the underlying data, but it is clear that the growth of FDI from the South may have important policy implications. This note addresses a number of issues related to the impact on home and host countries of outward FDI from developing countries, particularly in a South–South context. Further analysis is needed in order to properly assess the positive and negative impacts of South–South FDI flows, and deal with the constraints and risks associated with such flows, as suggested at the Group of 77 High Level Forum Meeting held in Doha in December 2004. Policies at the national and international level that could facilitate South–South FDI and promote its development benefits should also be explored.

* This document was submitted at the date indicated above due to technical delays.

GE.05-50228

Contents

Page

Introduction....................3

I. The global FDI environment....................3

II. Outward FDI from developing countries....................5
1. Trends....................5
2. Drivers and determinants....................8
3. Impacts on host and home economies....................9

III. The case of South–South FDI....................11

IV. Policy trends concerning FDI from developing countries....................15

Conclusion....................17

References....................19

Introduction

1. In response to the decision of the Commission on Investment, Technology and Related Financial Issues at its eighth session in January 2004, the UNCTAD secretariat has prepared this note to help identify policy issues for discussion by the Commission at its ninth session. The note examines changes in foreign direct investment (FDI) patterns, and in particular the role of developing countries in world FDI outflows. It draws in part on the analysis in the *World Investment Report 2004: The Shift Towards Services (WIR04)*.

2. Patterns of *inward FDI* are changing, reflecting responses key transnational corporations (TNCs) to policy developments in the direction of more liberalization and deregulation in developing countries and growing business opportunities in those countries. Similarly, *outward FDI* from developing countries is also on the rise, a fact that suggests that more firms based in developing countries are accumulating the necessary financial and technological capabilities to invest abroad. By investing abroad firms may gain access to foreign markets and technology, improve their efficiency and enhance their firm – specific advantages. Recently, some developing country firms have also initiated research and development (R&D) activities abroad, notably to tap knowledge centres around the world.[1]

3. The growing importance of the South in the global economy was highlighted most recently at the G77 High Level Forum Meeting, held in Doha in December 2004, which addressed the issue of investment with a special focus on South–South investment flows. The Forum stressed the need to better understand the scale, potential and opportunities for outward investment from developing countries, in particular South–South investment, and to explore ways in which the risks and constraints associated with outward investment among developing countries, in particular investment flows to LDCs, could be mitigated.[2]

4. The objective of this note is to examine the extent to which developing countries are emerging as a growing source of FDI and the patterns and driving forces involved. This note also explores the implications of such developments for developing economies as well as possible approaches to facilitating and maximizing development benefits from FDI, in particular in a South–South context.

I. The global FDI environment

5. Following three years of decline, global FDI inflows are estimated to have increased by 6 per cent in 2004 to some $612 billion.[3] This increase is related mainly to inflows into developing

---

[1] See "Globalization of R&D by transnational corporations and implications for developing countries", note by the UNCTAD secretariat, Expert Meeting on the Impact of FDI on Development, 24–26 January 2005, TD/B/COM.2/EM.16/2.

[2] Presentation by H.E. Ambassador Nassir Abdulaziz Al-Nasser, Permanent Representative of the State of Qatar to the United Nations, Chairman of the Group of 77 in New York, on the outcome of the the G77 High Level Forum Meeting held in Doha, 6 December 2004.

[3] Data in this section are based on an estimation using FDI flow data available as of December 2004.

and transition economies, while FDI into developed countries declined further. As a result, the share of developing countries and Central and Eastern Europe (CEE) increased from 34 per cent of total flows in 2003 to 48 per cent in 2004.

6. FDI inflows into developed countries fell by an estimated 16 per cent to $321 billion in 2004. The continued decline was mainly due to large repayments of intra-company loans for some host countries, notably Belgium, Germany and the Netherlands. Luxembourg and Spain, both major recipients of FDI in 2003, received lower FDI inflows last year. Meanwhile, FDI flows bounced back in the United Kingdom and the United States. Overall, FDI flows are expected to increase over the medium term because of improvements in the main fundamentals that drive FDI – a broad-based economic recovery, equity market valuations and mergers and acquisitions (M&As) activity.

7. Flows to developing countries appear to lead the recovery in global FDI. Inflows – estimated at $255 billion in 2004 – were 48 per cent higher than the previous year and at a historic high. Each of the developing regions experienced an increase in FDI inflows in 2004.

8. From a very low base, FDI in *Africa* increased for the second consecutive year to $20 billion. A large part of this was related to investment in natural resources, supported by a strong rise in global commodity prices and growing demand for diamonds, gold, oil, platinum and palladium. As a result, such natural-resource-rich countries as Algeria, Angola, the Libyan Arab Jamahiriya, Mauritania, Nigeria and South Africa are expected to receive more FDI. The Libyan Arab Jamahiriya will significantly increase its FDI inflows as a result of the end of sanctions in 2003. High prices for key commodities are expected to encourage TNCs to pursue new exploration projects in African countries, which will lead to sustained high levels of FDI inflows.

9. FDI flows to *Asia and the Pacific* reached an estimated $166 billion, which suggests a 55 per cent increase over the level in 2003. Improved economic performance, a more favourable policy environment and corporate profitability, as well as an increase in M&A activity in the region, are key underlying factors. China, India, the Republic of Korea, Hong Kong (China) and Singapore projected higher inflows. Flows to the region remain unevenly distributed, however, with a few countries dominating the picture. All subregions saw an increase in flows as compared with 2003. North-East Asia (mainly owing to flows to China and the Republic of Korea) continue to dominate the picture, followed by the ASEAN and South Asia subregions. Flows to Central Asia and West Asia went up as a result of higher oil investment, while flows to the Pacific subregion increased marginally.

10. For the first time in five years, FDI to *Latin America and the Caribbean* (LAC) in 2004 increased by 37 per cent to an estimated $69 billion. Improvements in the economic situation and the policy environment appear to be the key factors behind this rebound. Mexico and Brazil accounted for half of the regional total inflows. However, Mexico recorded a strong recovery in FDI, and inflows into Brazil are picking up again. Flows to Chile doubled.

11. Following the temporary decline of the 2003 level to $27 billion, FDI inflows to *CEE*[4]

---

[4] The eight countries that acceded from this region to the EU in 2004 are covered under the term CEE in the present note. These are the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

were at an estimated $36 billion in 2004, reaching a record high. The eight new CEE member countries of the European Union (EU) – the group mostly affected by the downturn in 2003 – experienced the most vigorous increase. Led by Romania and Bulgaria, flows to South-East Europe also grew fast. Preliminary data on FDI in the Russian Federation indicate a record $10 billion inflow.

II. Outward FDI from developing countries

1. Trends

12. Over the past decade and half, some developing countries have emerged as significant sources of FDI. In absolute terms, the outward FDI stock from developing countries increased – from $60 billion in 1980 to $129 billion in 1990 and $859 billion in 2003 (table 1).[5]

13. The developed world still accounts for nine tenths of world outward FDI flows, but FDI from developing countries has shown higher growth rates in the recent past. Accounting for 7 per cent of the world FDI outward stock in 1990, their share rose to over 10 per cent in 2003 ($0.9 trillion) (table 1). The evolution in the share of developing countries in outward FDI needs to be seen against the background of substantial outflows from developed countries, in particular through M&As which account for a substantial share of the volume of FDI. In addition, if viewed in terms of their outward FDI flows in relation to gross fixed capital formation (GFCF), a number of developing economies (Singapore, Hong Kong (China), Taiwan Province of China, Chile or Malaysia) show higher FDI/GFCF ratios than some developed economies (Germany, Japan and – except for Malaysia – the United States) (table 2).

14. The fastest growth in outward FDI was noted for South, East and South-East Asia: the share of this region in the world outward FDI stock rose from 2.3 per cent to 7.4 per cent between 1990 and 2003.

Table 1. FDI outward stock, by region and major economies, 1980-2003
(Billions of dollars and percentage)

Region/economy	Value				Distribution share			
	1990	1995	2000	2003	1990	1995	2000	2003
Developed countries	1 629	2 583	5 164	7 272	92.7	89.1	86.3	88.7
TRIAD	1 429	2 236	4 543	6 440	81.3	77.2	75.9	78.6
European Union	797	1 298	2 971	4 036	45.3	44.8	49.7	49.2
Japan	201	238	278	335	11.5	8.2	4.7	4.1
United States	431	699	1 293	2 069	24.5	24.1	21.6	25.2

[5] This figure is based on data on outward FDI stocks provided by the home countries. If inward FDI stock data from the host economy are used, the value of FDI stock from developing countries is somewhat higher ($877 billion). In both cases, FDI from developing countries is likely to be underestimated: in the case of the figure based on outward data ($859 billion), outward FDI stock may not be fully reported by some offshore financial centres; and in that of the figure based on inward data ($877 billion), information on the sources of FDI is not available for those centres.

Table 1. FDI outward stock, by region and major economies, 1980–2003 (concluded)
(Billions of dollars and percentage)

Region/economy	Value				Distribution share			
	1990	1995	2000	2003	1990	1995	2000	2003
Developing economies	129	309	793	859	7.3	10.7	13.3	10.5
Africa	21	33	46	39	1.2	1.1	0.8	0.5
South Africa	15	23	32	24	0.9	0.8	0.5	0.3
Latin America and the Caribbean	59	86	155	184	3.3	3.0	2.6	2.2
Brazil	41	44	52	55	2.3	1.5	0.9	0.7
Cayman Islands (British)	1	2	16	22	..	0.1	0.3	0.3
Chile	..	2	11	14	..	0.1	0.2	0.2
Mexico	1	3	8	14	0.1	0.1	0.1	0.2
Virgin Islands (British)	..	9	16	27	..	0.3	0.3	0.3
Asia and the Pacific	49	189	592	635	2.8	6.5	9.9	7.8
South, East and South-East Asia	41	182	578	607	2.3	6.3	9.7	7.4
China	2	16	26	37	0.1	0.5	0.4	0.5
Hong Kong	12	79	388	336	0.7	2.7	6.5	4.1
India	..	..	2	5	..	..	..	..
Korea, Republic of	2	10	27	35	0.1	0.4	0.4	0.4
Malaysia	3	11	21	30	0.2	0.4	0.4	0.4
Singapore	8	35	57	91	0.4	1.2	0.9	1.1
Taiwan Province of China	13	25	49	65	0.7	0.9	0.8	0.8
Central and Eastern Europe	1	6	26	66	..	0.2	0.4	0.8
World	1 758	2 898	5 983	8 197	100.0	100.0	100.0	100.0

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdi statistics).

15. The emergence of TNCs based in developing countries has been recognized for some time (Kumar and McLeod, 1981; Wells, 1983). Judging from FDI data, some developing countries – for example, Malaysia, the Republic of Korea and Singapore – have already an established track record in this regard. Others – for example, Chile, Mexico and South Africa – have emerged as FDI sources more recently. And yet others – for example, Brazil,[6] China,[7] and India[8] – are still at the take-off stage.

Table 2. FDI outflows as a percentage of gross fixed capital formation in selected economies, 2001–2003[a]
(percentage)

Economy	Percentage
Singapore	36.3
Hong Kong, China	28.2
Taiwan Province of China	10.5

[6] For recent trends, see "Outward FDI from Brazil: Poised to take off?", UNCTAD/WEB/ITE/IIA/2004/16, 7 December 2004, mimeo.
[7] For recent trends, see "China: An emerging FDI outward investor", *UNCTAD e-Brief*, UNCTAD/PRESS/EB/2003/08, 3 December 2003.
[8] For recent trends, see "India's outward FDI: A giant awakening?", UNCTAD/ITE/IIA/2004/7, 20 October 2004, mimeo.

Table 2. FDI outflows as a percentage of gross fixed capital formation in selected economies, 2001–2003[a] (concluded)
(percentage)

Economy	Percentage
Chile	7.4
Malaysia	5.3
India	1.0
China	0.8
Brazil	0.2
South Africa	-5.0
Memorandum:	
Sweden	27.4
France	22.0
United Kingdom	19.0
United States	6.6
Germany	4.1
Japan	3.2
Greece	1.8

Source: UNCTAD, FDI/TNC database. (www.unctad.org/fdistatistics).
[a] Annual average.

16. Outward FDI from developing countries is highly concentrated. Four of the five top home developing economies in terms of FDI stocks are in Asia (China, Hong Kong (China), Singapore and Taiwan Province of China)[9] and one is from LAC (Brazil). These five economies accounted for 72 per cent of the total FDI stock from the South in 2002.

17. *Asia and the Pacific* are by far the largest regional source of outward investment among developing countries. The subregion *South, East and South-East Asia* alone accounts for almost three quarters of all outward FDI from developing countries. The Asian and Pacific region's outward FDI stock was estimated at $607 billion in 2003. Its share in the world FDI stock increased from 2 per cent in 1985 to 8 per cent in 2003 (table 1). The rapid rise of Chinese FDI, particularly in resource extraction, is noteworthy. Chinese TNCs invest not only in neighboring countries, but also in Africa (Zambia, South Africa) and Latin America (Peru, Mexico, Brazil and, more recently, Chile). Some Chinese firms have also taken steps to expand into developed countries. For example, in December 2004 the $1.75 billion takeover of IBM's PC division by Lenovo, a leading Chinese PC maker, was announced.

18. *Latin America and the Caribbean* are the second largest investing region in the developing world, with an outward FDI stock reaching $184 billion in 2003. The bulk of these investments (56 per cent of regional outflows in 2003) emanate from offshore financial centres, such as the British Virgin Islands and the Cayman Islands. The main other LAC source countries

[9] Significant FDI from Hong Kong (China) and Singapore is undertaken by foreign affiliates operating in these economies. Some of this involves "roundtripping", whereby investment is made abroad for tax reasons and ends up back in the home economy (e.g. investment from China in Hong Kong (China), that is channelled back to China).

are Argentina, Brazil, Colombia, Mexico and Venezuela. Compared with the size of their economies, the level of outward FDI is low, but efforts have been made to create a conducive environment for further outward expansion, including through the conclusion of a number of international agreements with other developing countries.

19. *Africa* has the smallest stock of outward FDI, concentrated in five countries – South Africa, Nigeria, the Libyan Arab Jamahiriya, Liberia and Botswana (in that order) – that together accounted for about 85 per cent of Africa's outward stock of $39 billion in 2003. South Africa is by far the most important African source of FDI. While almost all (90 per cent) of its FDI stock is in developed countries, investment in other neighbouring African countries has recently increased, mainly targeting natural resources and basic industries. In October 2004, the Government of South Africa took further steps to facilitate outward FDI by abolishing exchange control limits on such flows. Seven of the top 50 TNCs from the South are South African (*WIR04*).

20. Information on the sectoral composition of outward FDI from developing countries is limited. However, available data suggest that, as in developed countries, the sectoral composition of outward FDI from developing countries has shifted towards services. Four fifths of the FDI stocks from developing countries were in services in 2002.[10] The global stock of outward FDI in services from developing countries was multiplied by a factor of 43 between 1990 and 2002, compared with a factor of 5 for FDI from developed countries. In the manufacturing sector the respective figures are 14 for FDI from developing countries and 2.5 for FDI from developed countries (*WIR04*). Developing countries accounted for at least 4 per cent and 10 per cent of outward FDI stock in the manufacturing and services sectors, respectively, by 2002.[11] In certain industries, such as construction and business services, the share of developing countries reached more than 15 per cent of world FDI stock (annex table). More detailed data are required, however, for a more in-depth sectoral analysis of outward FDI from developing countries.

2. Drivers and determinants

21. The main factors that motivate firms from the South to invest abroad are similar to those that motivate FDI from developed countries. The selection of host locations by TNCs from the South is based on considerations such as the market size of the host economy, production or transportation costs, skills, supply chains, infrastructure and technology support, as well as, in some cases, tax considerations.

22. Successful foreign expansion of TNCs requires so-called ownership advantages, such as innovation capabilities, brand names, managerial and organizational skills, access to information, financial or natural resources, size or network advantages. More firms in developing countries are building up such advantages. At the same time, outward expansion is also driven by a need to improve export competitiveness, access technology (particularly in developed countries) and meet increased competition at home. Some TNCs from developing countries invest in efficiency-

---

[10] A significant share of this FDI was in offshore financial centres.

[11] On the basis of data from 10 developing countries. Therefore, the actual shares are higher.

seeking activities following an erosion in their export competitiveness. Tariff and non-tariff barriers to imports and exports imposed on a (developing) country may also encourage its TNCs to invest in other countries as a means of obtaining or delivering goods. Asian FDI in other developing countries in response to quotas and various preferential trade arrangements is a good example.

23. The factors driving outward FDI have been in place in some developing countries in an embryonic form for decades. What triggered the recent increase in FDI from the South, however, was the growing wealth in some emerging economies that increased the supply of capital (Aykut and Ratha, 2004). Furthermore, in certain developing countries, capital account liberalization has enabled companies to invest abroad, while Governments stimulated outward FDI by offering fiscal and other incentives. For example, the Government of China is promoting outward FDI by providing loans on preferential terms, tax rebates and investment insurance.

24. Apart from the immediate drivers, the combination of factors and drivers for outward FDI differs by region and country. The key drivers, for instance, of Asian FDI are the growing capabilities of Asian firms, strong export orientation, and a need to access technology, brand names and strategic assets abroad. Some Asian Governments are also actively encouraging their firms to become transnational. The growing number of regional free trade agreements, particularly between economies in Northeast and South–East Asia, is also increasing investor interest in the region. In LAC, most outward investment is intra regional. As illustrated by Brazil, which is the largest investor from LAC, a large part of outward FDI has been undertaken for financial rather than production reasons (to avoid taxes and undertake currency transactions).[12] FDI is negligible in primary activities and low in manufacturing. An exception is Mexico, from which relatively more outward FDI has been in manufacturing.[13]

3. Impacts on host and home countries

25. The expansion of FDI from developing countries gives rise to questions concerning the potential impact on the home and host economies involved. In general, the potential development impact depends crucially on the purpose and mode of investment. In addition, the characteristics of the host economy (level of development, absorptive capacity and market structure in individual industries) are also crucial to assessing the impact of potential investments. While a full evaluation is beyond the scope of this note, some pertinent aspects are worth highlighting.

26. From the home country perspective, an often debated question is whether outward FDI complements or substitutes for exports and/or employment.[14] In many cases, establishing a presence abroad is necessary in order to market a product in a foreign market and sell it effectively. This applies to many services that are "non-tradable", but may also be relevant for manufactured goods that need adaptation to local conditions. In such situations, outward FDI is

---

[12] See footnote 6.

[13] The acquisition of RMC (United Kingdom) by Cemex (Mexico) in early 2004 is a typical example of this.

[14] For a review of various impacts on home countries, see for example Lipsey (2002) and *WIR95*. Most evidence, however, is based on data from a few selected developed countries.

likely to complement home country production. Natural resource-seeking FDI is also likely to have complementary effects on home country operations, in that it may help to secure access to important inputs.

27. In other cases, firms may expand abroad to develop a more effective and competitive production structure, by exploiting country differences with regard to skills availability, costs and infrastructure, for example. This typically involves a fragmentation of the value chain, with different activities being located in different areas. In such a situation, while it may enhance the competitiveness of the firm as such, it is difficult a priori to determine the impact on the home economy. The net outcome will depend on the resulting international production structure and the respective roles assigned to the home and host economies. To the extent that the firm becomes more competitive, and to the extent that it retains important parts of its activities at home, the home economy is also likely to benefit from becoming better connected to international markets. On the other hand, there may be adjustment costs, especially social costs in the case of the offshoring of labour-intensive activities. Such costs may be difficult to deal with in economies that do not have a diversified or strong productive base or that cannot provide social safety nets for their population, as is the case in many developing countries.

28. Not much is known about the impact of outward FDI from developing countries in offshore financial centres. Such investment is often undertaken with a view to minimizing the overall tax burden of a company and may also be undertaken to hedge against currency movements. While this may enhance the overall profitability of a firm, it may also imply reduced tax revenue for the home economy. Moreover, such FDI per se is unlikely to help a parent company expand in foreign markets or access new technology. Thus, the potential positive impacts on the home economy are in this case likely to be more limited. Such impacts may even be detrimental.

29. Determining the net impact on host economies requires careful analysis, taking into account the specific situation in different countries. In principle, there is no reason to expect that the impact of FDI from developing countries should be significantly different as compared with FDI by firms in developed countries. Such investment provides a package of resources, including capital, knowledge and technology, as well as employment opportunities and access to markets. From a developing host country perspective, it is possible that firms based in other developing countries are more willing to expand, to the extent that they are more familiar with operating in emerging economy environments. This may be true particularly for FDI from neighboring countries, for which such internationalization may involve a relatively small effort. It has been argued that the impact of developing countries' TNCs on host developing economies in terms of linkages with local firms, use of locally available inputs, or technology transfer and upgrading may be more favourable than that of their counterparts from developed countries (Kumar, 1982; Wells, 1983). On the other hand, there may also be disadvantages. For instance, TNCs from developing countries may be less dynamic in the development of advanced technologies. The impact of South–South FDI on host developing countries has not been much studied recently. Further analysis is needed to shed light on this phenomenon, properly assess its positive and negative aspects, and address policy-related issues.

III. The case of South–South FDI

30. To what extent are developing countries directing more FDI to other developing countries? Data are far from perfect. Indeed, not many developing countries provide a geographical breakdown of their outward investment destinations. Rough estimates, however, suggest that outward FDI from developing countries in other developing economies is increasing. The outward stock of South–South FDI, virtually nil at the end of the 1970s, was estimated at around $400 billion in 2002.[15] While this represents a mere 5 per cent of the global stock of outward FDI, it corresponds to about 50 per cent of the stock of FDI from developing countries. Some estimates suggest that South–South FDI flows grew from less than $5 billion in 1994 to over $50 billion in 2000 (Aykut and Ratha, 2004). The largest home sources of South–South FDI (based on outward FDI stock) were Hong Kong (China) – by far the largest ($283 billion in stock) – Brazil ($45 billion), Singapore ($40 billion), the Republic of Korea ($17 billion) and Malaysia ($15 billion).[16]

31. Some countries have emerged as significant sources of FDI not only in their own region but also in other developing regions (table 3): for example, China and Malaysia are among the top 10 sources for FDI in Africa. But overall, developing countries tend to invest primarily in their own region. For instance, most of the foreign investment of Brazil, Chile and Colombia is in other Latin American countries. Virtually all of South African investment in developing regions is in the rest of Africa. And nearly half of the investment flows from Asian developing economies is directed towards other developing economies in the region. Hong Kong (China), China, Singapore and Taiwan Province of China are all among the top 10 recorded investors in South, East and South-East Asia (table 3).

32. South–South FDI flows have been motivated by push and pull factors, and similar structural, cyclical and policy factors similar to those between developed and developing countries. Liberalization and deregulation in a growing number of developing economies, sometimes combined with the provision of investment incentives, have stimulated TNCs from both the North and the South to invest in developing countries (Aykut and Ratha, 2004). In spite of the trend towards liberalization, however, the motivation to circumvent tariff and non-tariff barriers to imports and exports is still present, especially in those host economies that remain relatively closed and regulated.

---

[15] As indicated, detailed outward FDI data reported by home developing countries are limited. Estimates of South–South FDI can be obtained by using information from home developing countries (on the destination of their outward FDI) or from host developing countries (on the source of their inward FDI). The estimate of $400 billion of outward stock of South–South FDI is based on home country data. If inward FDI stock data from recipient countries are used, the value of South–South FDI is higher, at least about $700 billion. This corresponds to about a third of the inward FDI stock in developing countries.

[16] On an approval basis, Taiwan Province of China recorded $43 billion. If inward FDI stock data from recipient countries are used, the largest sources of South–South FDI were Hong Kong (China) ($223 billion), the British Virgin Islands ($111 billion), China (81 billion), Singapore ($54 billion) and Taiwan Province of China ($49 billion).

Table 3. Major sources of FDI stock of selected regions, 2002
(percentage)

(a) Africa: Major sources of inward FDI stock, as reported by investing economies

Rank	Stock of FDI in Africa From:[a]	Shares in total
	Developed countries	87.7
	Developing economies	12.0
	Africa (South Africa)	**2.9**
	Central and Eastern Europe	0.3
1	United Kingdom	31.3
2	United States	26.5
3	Germany	7.7
4	Netherlands	6.9
5	Switzerland	4.4
6	Canada	3.9
7	China	3.0
8	South Africa	2.9
9	Malaysia	2.8
10	Portugal	2.2
11	Japan	2.2
12	India	1.3
13	Norway	1.3
14	Denmark	0.9
15	Republic of Korea	0.8
16	Taiwan Province of China	0.7
17	Brazil	0.3
18	Latvia	0.2
19	Pakistan	0.2
20	Finland	0.1

[a] Geographical breakdown of inward FDI in Africa is not available for most African countries. This table is based on outward stock data of Australia (2001), Austria, Brazil and Bulgaria (2000), the Czech Republic, Denmark (2001), Finland, Germany, Hungary, Iceland, Ireland, Japan and Latvia (1999), Malaysia, the Netherlands (2001), Norway (2001), Pakistan (2001), Poland (2000), Portugal, the Republic of Korea, Slovenia, South Africa, Switzerland, the United Kingdom and the United States, as well as estimated data for China and Taiwan Province of China. These economies accounted for about 38 per cent of the total inward FDI stock of Africa in 2002.

(b) Latin America and the Caribbean, South, East, and South-East Asia and Central and Eastern Europe: Major sources of inward FDI stock as reported by host economies

	Latin America and the Caribbean countries[a]		South, East and South-East Asian economies[b]		Countries in Central and Eastern Europe[c]	
Rank	Inward stock from	Shares in total	Inward stock from	Shares in total	Inward stock from	Shares in total
	Developed countries	7.4	Developed countries	38.2	Developed countries	87.9
	Developing economies	16.3	Developing economies	53.4	Developing economies	5.4
	Latin America and the Caribbean	**14.9**	**South, East and South-East Asia**	**37.7**		
	Central and Eastern Europe	0.0	Central and Eastern Europe	0.1	**Central and Eastern Europe**	2.9
	Unspecified	7.3	Unspecified	8.3	Unspecified	3.8
1	United States	26.5	Hong Kong, China	18.5	Germany	20.5

(b) Latin America and the Caribbean, South, East, and South-East Asia and Central and Eastern Europe: Major sources of inward FDI stock as reported by host economies (concluded)

	Latin America and the Caribbean countries[a]		South, East and South-East Asian economies[b]		Countries in Central and Eastern Europe[c]	
Rank	Inward stock from	Shares in total	Inward stock from	Shares in total	Inward stock from	Shares in total
2	Spain	15.1	British Virgin Islands	10.9	Netherlands	20.4
3	Netherlands	7.0	United States	10.7	United States	9.7
4	France	5.6	Japan	10.7	Austria	8.2
5	Cayman Islands	3.8	China	6.5	France	6.2
6	United Kingdom	3.7	Netherlands	5.2	United Kingdom	3.8
7	Canada	3.6	Singapore	4.5	Sweden	3.5
8	Germany	3.2	United Kingdom	4.3	Cyprus	3.3
9	Italy	2.2	Taiwan Province of China	4.1	Switzerland	2.5
10	Japan	2.0	Bermuda	2.9	Italy	2.1
11	Panama	1.9	Germany	1.9	Finland	1.7
12	Portugal	1.8	Republic of Korea	1.9	Denmark	1.5
13	British Virgin Islands	1.7	Switzerland	1.1	Russian Federation	1.2
14	Switzerland	1.5	Australia	1.0	Japan	0.8
15	Bermuda	1.3	France	1.0	Ireland	0.7
16	Chile	1.2	Cayman Islands	0.9	Norway	0.6
17	Argentina	1.0	Malaysia	0.7	Spain	0.6
18	Uruguay	1.0	Canada	0.5	Republic of Korea	1.5
19	Sweden	0.7	Macao (China)	0.4	Bahamas	0.4
20	Bahamas	0.6	Thailand	0.4	British Virgin Islands	0.4

[a] Based on inward stock data of Argentina, Brazil (2000), Chile (2001), Colombia (2000), El Salvador and Paraguay (2001), Peru and Venezuela. They account for 42 per cent of the total inward FDI stock of Latin America and the Caribbean in 2002. Offshore financial centres in the region are not covered because they do not provide geographical breakdown by source of inward FDI stock.
[b] Based on inward stock data of Bangladesh (2001), Cambodia, China, Hong Kong (China), India (1997), Indonesia (1996), Pakistan (1997), the Philippines, the Republic of Korea, Singapore, Thailand and Viet Nam, as well as estimated data for the Lao People's Democratic Republic (1997), Malaysia, Mongolia, Myanmar and Nepal (1997), Sri Lanka and Taiwan Province of China. These economies account for 99 per cent of the total inward FDI stock of South, East and South-East Asia in 2002.
[c] Based on inward stock data of Bulgaria (1999), Croatia (2000), the Czech Republic, Estonia, Hungary and Latvia (2001), Lithuania (2001), Poland (2000), the Russian Federation, Slovakia (2000) and Slovenia. They accounted for 91 per cent of the total inward FDI stock of Central and Eastern Europe in 2002.

33. Push factors include increased competition or limited growth opportunities in domestic markets (e.g. South African retailing companies investing in other African countries), and efficiency seeking (e.g. Malaysian manufacturing companies investing in Indonesia and Viet Nam, and Asian investment in textiles and clothing in Africa to exploit opportunities created by the African Growth and Opportunity Act. Among economic factors, labour productivity based on low labour costs (for efficiency-seeking investors) and high GDP growth rates (for market-seeking investors) have been the most important determinants (Dasgupta and Ratha, 2000). In addition, the procurement of raw materials (including oil and gas) is another factor behind South–South FDI. Demand for raw materials has increased in tandem with economic development and population growth in developing countries that recently became major capital exporters (e.g. China and India). In order to secure access to these materials, some TNCs from

developing countries invest in critical sectors such as oil in other developing countries.[17] Another key economic factor stimulating South–South FDI is the relative ease with which developing country TNCs, especially small and medium-sized companies, can operate in similar economic environments, particularly neighbouring countries (Wells, 1983). In this respect, TNCs from the South can use their familiarity with the local business environment, geographical proximity and ethnic and cultural ties to leverage their competitive edge in other developing countries (Aykut and Ratha, 2004).

34. Some notable trends in FDI among developing countries are as follows:

Intra-Africa: Only about 3 per cent of FDI stock in Africa originated from Africa (table 3), mainly in the form of South Africa's FDI in neighbouring countries (Botswana, Mozambique, Mauritius). Much intra-African investment from South Africa is in mining and other natural resources.

Intra-South, East and Southeast Asia: Almost two fifths of the FDI stock in Asia is intraregional, with Hong Kong (China), China and Singapore as leading investors in their own region (table 3). Hong Kong (China) invests mainly in Malaysia, Singapore and Thailand. In the case of ASEAN, intraregional FDI accounts for close to one fifth of the total FDI.

Intra-Latin America and the Caribbean: Fifteen per cent of FDI stock in LAC originates within the region (table 3); the main host economies, by far, are the offshore financial centres of the Caribbean. For example, offshore financial centres – including the Bahamas, Bermuda and the British Virgin Islands – were host to for about 70 per cent of Brazil's total FDI outward stock in 2003.

Between LAC and South, East and Southeast Asia: Offshore financial centres in the Caribbean account for about 15 per cent of the FDI stock in Asia (table 3). In turn, a large part of outward FDI from Hong Kong (China), Malaysia and the Republic of Korea also goes to such centres. Other LAC countries benefiting from FDI from those countries are Brazil, Peru and Argentina. A series of recent investment projects emanating from China are noteworthy, for example $20 billion projects in Argentina in railways, oil and gas exploration, construction and communication satellites;[18] $5 billion worth of investment projects in Brazil ranging from a new railway to infrastructure for two ports; and a $600 million nickel plant in Cuba.[19]

Between Africa and South, East and Southeast Asia: South Africa is investing in Hong Kong (China) and Singapore. Meanwhile, countries of South, East and South-East Asia (mainly China, Malaysia and the Republic of Korea) locate almost 8 per cent of their total FDI stock in Africa (table 3). The main destinations are North Africa and Mauritius. India is also among the

---

[17] Recent examples include China's oil and gas exploration FDI projects in Argentina, in oil in Angola and Sudan, in tin in Bolivia, and iron ore and other minerals in Brazil, as well Malaysian State-owned Petronas' investments in South Africa, Viet Nam, Cambodia and the Lao People's Democratic Republic.

[18] *International Herald Tribune*," China, facing shortages in Asia, aims at South American suppliers", 20–21 November 2004.

[19] "Latin America quick to dance to China's tune", *Financial Times*, 11 November 2004; "Hu lends friendship to Cuban comrades", *Financial Times*, 24 November 2004.

main investors in Africa but to a lesser extent (1.3 per cent) than other developing countries from Asia. Mauritius is the largest host country for FDI from India and Malaysia.

Between LAC and Africa: Apart from a small share of investments from Brazil (0.3 per cent) there is only limited investment in Africa from the LAC region. Conversely, there is virtually no investment from African countries in the LAC region, apart for a small amount of outward FDI from South Africa into offshore financial centres.

IV. Policy trends concerning FDI from developing countries

35. As indicated above, increased FDI from developing countries has been facilitated by capital account liberalization that permits firms from developing countries to invest abroad, and by a number of other policy measures adopted in developing countries broadly to encourage overseas investment.

36. In terms of *outward FDI policies*, several developing countries have established outward investment agencies (OIAs), whose primary function is to promote and facilitate investment abroad by helping domestic enterprises develop international business links and pursue overseas business opportunities. Assistance to smaller firms with little experience in investment projects abroad and with limited financial means is particularly important, especially in the first stages of the investment process. Some OIAs, including development finance institutions, provide technical assistance and funding for feasibility studies, project development and project start-up. Also important for the facilitation of outward FDI are investment guarantee schemes, especially for investments in countries in which the political and legal situation is not considered stable. Institutions that facilitate outward investment are particularly important for encouraging South–South FDI, as their programmes are mostly relevant for firms with little experience in overseas projects and geared to facilitate FDI in locations that are associated with higher political and commercial risks (UNCTAD, 1999).

37. In *Malaysia*, for example, there are different instruments aimed at promoting outward FDI, often as part of wider export promotion efforts. These instruments include tax exemption on income remitted into the country by Malaysian companies investing overseas, the provision of investment guarantees and investment promotion missions abroad. The EXIM Bank provides credits to overseas investments through the Overseas Investment Facility, and an Overseas Investment Insurance scheme is run by the Malaysia Export Credit Insurance Berhad to cover political risks. For an investment to be eligible for such insurance coverage, it should overcome market access problems, utilize Malaysian raw materials and parts, or contribute to South–South cooperation. Thus, Malaysian home country measures are closely linked to Malaysian companies and investment in countries in the South-East Asian region.

38. In *South Africa*, the Industrial Development Corporation (IDC) and the Development Bank of Southern Africa, are involved in, for example, equity financing of private sector projects in the Southern African region and elsewhere in Africa. In addition to participating directly in financing investments, IDC helps companies identify investment opportunities abroad.

Furthermore, the Department of Trade and Industry has had some schemes aimed at supporting the internationalization of notably the automotive sector in South Africa.

39. In terms of *investment promotion strategies,* investment promotion agencies (IPAs) are mainly focused on investors based in developed countries. The increase of FDI from some developing countries may motivate more attention to the South as a source of investment. IPAs in developing countries could take advantage of this potential by tailoring promotion and targeting strategies to encourage FDI. In this context, measures that lower the cost of entry could make it easier in developing countries to invest in other developing countries. Developed countries have also acknowledged the potential for FDI from the South. For example, investment promotion agencies in Denmark, Sweden and the United Kingdom have already established a presence in China.

40. The work of OIAs and IPAs is being underpinned by South–South international cooperation. During the past decade, the number of international investment agreement (IIAs) among developing countries increased substantially, both in number and in geographical coverage, pointing to growing South–South cooperation in investment. The recent proliferation of bilateral investment treaties (BITs), double taxation treaties and various types of preferential trade agreements with investment components confirms this trend. Both BITs and double taxation treaties registered rapid growth rates during the period of 1995–2001 (which, however, have slowed down since then). The number of BITs between developing countries rose dramatically from 36 in 1990 to 653 in November 2004, involving 114 developing countries. Many of these BITs are yet to enter into force, however. Double taxation treaties between developing countries also rose, from 96 in 1990 to 312 in 2004, involving 94 developing countries. Preferential trade and investment agreements similarly intensified among developing countries in the 1990s, rising to 49 in 2004. The leading outward investor economies from Asia and Latin America have been the most active countries in concluding IIAs.

41. Developing countries are actively signing IIAs with each other. Although they vary in the extent to which they contain provisions aimed at strengthening their development impacts, they are only one aspect of South–South cooperation. Further analysis is needed to establish how such cooperation can be used to strengthen the enabling international policy framework, from the perspective of developing countries as recipients as well as sources of FDI, in order to maximize the development benefits. Such an analysis could look carefully at the specific features of South–South IIAs, in particular their objectives, the breadth and depth of the issues they cover, including the scope of their commitments and/or reservations, as well as the specific developmental features, and identify relevant policy recommendations. Furthermore, it could assess the role of South–South in investment policy development within the broader range of South–South and North–South cooperation. It could aim to identify where there is need and space for complementing investment cooperation with South–South initiatives in related areas, especially trade. Finally, an opportunity for developing country negotiators and policy makers to share their experiences in the formulation and implementation of South–South IIAs would facilitate the identification of best practices.

Conclusion

42. This note has shown that developing countries play a growing role not only as recipients but increasingly also as sources of FDI. Further examination of this trend is important not least in the context of growing South–South cooperation. In general, the drivers of FDI from the South are similar to those driving developed country firms to expand abroad. There is, of course, wide variation in the nature and motives of FDI from different regions of the developing world, with important examples of natural-resource-seeking, market-seeking and efficiency-seeking FDI. At the same time, a significant share of the overall FDI from the South is related to offshore financial centres. In the case of South–South FDI specifically, access to markets and resources, and differences within the developing world in terms of levels and forms of skills and technical know-how, provide conditions conducive to mutual exchanges of goods and services, opening up the way to increased FDI among developing countries.

43. Against this background, the Commission may wish to discuss the impact on home and host countries associated with outward FDI from developing countries, particularly in a South–South context. It may also wish to discuss the need for specific measures to facilitate South–South FDI in productive capacities and explore how policies at the national and international levels could help promote its development benefits.

Annex table. Estimated outward FDI stock from developing economies, by sector/industries, 1990 and 2002
(Millions of dollars and percentage)

	1990			2002		
Sector/industry	**Value**	**Share in total FDI from developing economies**	**Share of developing countries in world FDI**	**Value**	**Share in total FDI from developing economies**	**Share of developing countries in world FDI**
Primary	**862**	**4.7**	**0.5**	**3 450**	**0.5**	**1.3**
Agriculture, hunting, forestry and fishing	283	1.5	5.3	627	0.1	11.4
Mining, quarrying and petroleum	579	3.1	0.4	2 823	0.4	1.1
Manufacturing	**6 075**	**32.9**	**0.8**	**83 311**	**13.2**	**4.2**
Food, beverages and tobacco	418	2.3	0.6	1 467	0.2	0.7
Textiles, clothing and leather	186	1.0	1.0	1 541	0.2	1.6
Wood and wood products	80	0.4	0.4	915	0.1	1.3
Publishing, printing and reproduction of recorded media	-	-	-	-	-	-
Coke, petroleum products and nuclear fuel	-	-	-	302	-	1.2
Chemicals and chemical products	758	4.1	0.5	2 563	0.4	0.6
Rubber and plastic products	100	0.5	0.7	1 139	0.2	5.0
Non-metallic mineral products	182	1.0	1.4	712	0.1	4.2
Metal and metal products	84	0.5	0.1	1 606	0.3	0.8
Machinery and equipment	22	0.1	0.1	324	0.1	0.4
Electrical and electronic equipment	1 012	5.5	1.1	8 735	1.4	4.4
Precision instruments	-	-	-	218	-	1.0
Motor vehicles and other transport equipment	10	0.1	-	909	0.1	0.3
Other manufacturing	10	0.1	-	261	-	1.0
Unspecified secondary	3 213	17.4	2.3	62 619	10.0	23.6
Services	**11 286**	**61.1**	**1.4**	**491 076**	**78.1**	**10.3**
Electricity, gas and water	-	-	-	170	-	0.2
Construction	177	1.0	1.0	7 735	1.2	20.2
Trade	1 826	9.9	1.3	59 370	9.4	12.3
Hotels and restaurants	-	-	-	8 429	1.3	9.8
Transport, storage and communications	498	2.7	1.3	33 573	5.3	6.7
Finance	6 988	37.8	1.8	106 701	17.0	6.6
Business activities	1 275	6.9	2.4	264 680	42.1	15.6
Public administration and defence	-	-	-	-	-	-
Education	-	-	-	1	-	-
Health and social services	-	-	-	-	-	-
Community, social and personal service activities	-	-	-	122	-	0.8
Other services	523	2.8	0.5	10 295	1.6	10.3
Unspecified tertiary	-	-	-	-	-	-
Unspecified	238	1.3	6.7	51049	8.1	29.3

Source: UNCTAD.

Note: Data should be interpreted with caution. Owing to lack of data, only seven developing countries (Swaziland, Colombia, India, the Republic of Korea, Singapore, Taiwan Province of China and Thailand) and 10 developing economies (Brazil, Colombia, Kazakhstan, Hong Kong (China), India, Macao (China), the Republic of Korea, Singapore, Taiwan Province of China and Thailand), respectively in 1990 and in 2002, are covered. Therefore, the shares for developing economies in world FDI stock were underestimated. Approval data were used for Taiwan Province of China.

References

Aykut, Dilek and Dilip Ratha (2004). “South-South FDI flows: How big are they?”, *Transnational Corporations*, 13, 1, pp. 149–177.

Dasgupta, Dipak and Dilip Ratha (2000). “What factors appear to drive capital flows to developing countries? And how does official lending respond?”, *World Bank Policy Research Working Paper* 2392 (Washington, DC: World Bank).

Kumar, Krishna and M.G. McLeod., eds. (1981). *Multinationals from Developing Countries* (Lexington, DC: Heath).

Kumar, Krishna (1982). "Third World multinationals: A growing force in international relations", *International Studies Quarterly* 26 (3).

Lipsey, Robert (2002). "Home and host country effects of FDI", NBER Working Paper No. 9293 (Cambridge, MA: National Bureau of Economic Research).

(UNCTAD) (1995) (*WIR95*). *World Investment Report 1995: Transnational Corporations and Competitiveness* (New York and Geneva: United Nations), United Nations publication, sales no. E.95.II.A.4.

________ (1999). *Handbook on Outward Investment Agencies and Institutions* (New York and Geneva), United Nations publication, sales no. E.99.II.D.22.

________ (2004) (*WIR04*). *World Investment Report 2004: The Shift Towards Services* (New York and Geneva: United Nations), United Nations publication, sales no. E.04.II.D.33.

Wells, Louis T. Jr. (1983). *Third World Multinationals: The Role of Foreign Direct Investment from Developing Countries* (Cambridge, MA: MIT Press).