

Assessing the impact of the current financial and economic crisis on global FDI flows

April 2009



United Nations Conference on Trade and Development

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Transition economies: South-East Europe and the Commonwealth of Independent States.

Developing economies: in general all economies not specified above. For statistical purposes, the data for China do not include those for Hong Kong Special Administrative Region (Hong Kong SAR), Macao Special Administrative Region (Macao SAR) and Taiwan Province of China.

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Two dots (..) indicate that data are not available or are not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;

A dash (–) indicates that the item is equal to zero or its value is negligible;

A blank in a table indicates that the item is not applicable, unless otherwise indicated;

A slash (/) between dates representing years, e.g. 1994/95, indicates a financial year;

Use of an en dash (–) between dates representing years, e.g. 1994–1995, signifies the full period involved, including the beginning and end years;

Reference to “dollars” (\$) means United States dollars, unless otherwise indicated;

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates;

Details and percentages in tables do not necessarily add up to totals because of rounding.

The material contained in this study may be freely quoted with appropriate acknowledgement.

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CONTENTS

	ACKNOWLEDGMENTSiii
	EXECUTIVE SUMMARY.	vii
	INTRODUCTION	1
CHAPTER I	WORLDWIDE FDI DOWN BY 15 PER CENT IN 2008	3
	A. Global trends.	3
	B. Geographical imbalance: the relative resilience of FDI flows to developing countries in 2008	8
	1. FDI inflows.	8
	2. FDI outflows	11
	C. Sectoral imbalance: the example of M&As.	12
CHAPTER II	CHANNELS OF TRANSMISSION OF THE CRISIS TO FDI FLOWS	19
CHAPTER III	WHAT NEXT? SCENARIOS FOR THE MEDIUM TERM	29
	A. The specific features of the crisis	29
	B. Short term prospects for developing countries.	35
	C. Medium term scenarios	37
CHAPTER IV	POLICY IMPLICATIONS	41
	A. General policy measures in response to the crisis: potential effect on FDI	41
	1. National bailout programmes and rescue packages	43
	2. Fiscal stimulus and public infrastructure programmes	45
	3. International policy actions	46
	B. Policy implications for developing countries	47
	1. Inward FDI in developing countries.	48
	2. Outward investment from developing countries	49
	CONCLUSION	51
	REFERENCES	53
	SELECTED UNCTAD PUBLICATIONS ON TNCs AND FDI	57
	QUESTIONNAIRE.	61

Boxes

Box 1.	The impact of the crisis on the largest TNCs from developing countries	13
Box 2.	Various types of investment motives are affected unequally by the crisis	23
Box 3.	Examples of divestments and postponement of investment projects.	25
Box 4.	Examples of projects announced recently in emerging and transition economies	31

Figures

Figure 1.	FDI inflows, global and by group of economies, 1980-2008	6
Figure 2.	Value of cross-border M&As, by quarter, 2006-2009	7
Figure 3.	Value of cross-border M&As in developed countries, by quarter, 2006-2009	7
Figure 4.	Value of cross-border M&As in developing countries, by quarter, 2006-2009	7
Figure 5.	Value of cross-border M&As in transition countries, by quarter, 2006-2009.	7
Figure 6.	Regions in which FDI plans have been most affected by the impact of the crisis	10
Figure 7.	Impact of various aspects of the crisis on the company's investment plans	22
Figure 8.	Worldwide FDI inflows with three different trajectories, 1990-2012	38

Tables

Table 1.	FDI inflows and cross-border M&As, by region and major economy, 2007-2008.	6
Table 2.	FDI outflows and cross-border M&As purchases, by region and major economy, 2007-2008	12
Table 3.	Value of global cross-border M&As sales, by sector/industry, 2007-2008	16
Table 4.	World GDP growth and growth prospects, 2008-2010.	21
Table 5.	Selected cross-border M&As and privatization programmes dropped or halted due to the global financial crisis	24
Table 6.	Summary of the possible implications of the crisis for FDI in the short-to-medium term . . .	36
Table 7.	Some examples of recent FDI policy measures introduced after September 2008	42

Annex table

FDI inflows and cross-border M&As, by region and major economy, 2007-2008	57
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EXECUTIVE SUMMARY

The year 2008 marked the end of a growth cycle in international investment that started in 2004 and saw world foreign direct investment (FDI) inflows reach a historic record of \$1.9 trillion in 2007. Due to the impact of the ongoing worldwide financial and economic crisis, FDI flows are estimated to have declined by 15 per cent in 2008. A further decrease in FDI flows can be expected in 2009, as the full consequences of the crisis on transnational corporations' (TNCs) investment expenditures continue to unfold.

The fall in global FDI in 2008–2009 is the result of two major factors affecting domestic as well as international investment. First, the capability of firms to invest has been reduced by a fall in access to financial resources, both internally – due to a decline in corporate profits – and externally – due to the lower availability and higher cost of finance. Second, the propensity to invest has been affected negatively by economic prospects, especially in developed countries that are hit by the most

severe recession of the post-war era. The impact of both factors is compounded by the fact that, as of early 2009, a very high level of risk perception is leading companies to extensively curtail their costs and investment programmes in order to become more resilient to any further deterioration of their business environment. All of the three major types of FDI (market-seeking, efficiency-seeking and resources-seeking) will be impacted by these factors, although with different magnitudes and consequences on location patterns.

The setback in FDI has particularly affected cross-border mergers and acquisitions (M&As), the value of which was in sharp decline in 2008 and early 2009 as compared to the previous year's historic high. It has also taken the form of a rising wave of divestments and restructurings. International greenfield investments were less impacted in 2008, but are likely to be increasingly affected in 2009 as a large number of new investment projects are presently being cancelled or postponed.

The impact of the crisis on FDI differs, depending on region and sector. Developed countries have so far been the most affected, with a significant decline in FDI inflows in 2008, due mainly to sluggish market prospects.

Flows into developing economies continued to grow in 2008, but at a much lower rate than the year before. All developing regions except West Asia experienced higher FDI inflows in 2008. The impact of the crisis on FDI to developing countries is expected to be much more dramatic in 2009: an outright decline in FDI inflows to those countries is likely to take place due to a pull-back both in efficiency- and resources-seeking FDI aimed at exporting to advanced economies that are currently depressed, and in market-seeking FDI aimed at servicing local markets where growth prospects – though still positive – are receding.

Among industries, FDI flows to financial services, automotive industries, building materials, intermediate goods and some consumption goods have been the most significantly affected in 2008. But the consequences of the crisis are quickly expanding to FDI in other activities, ranging from the

primary sector to non-financial services. Practically all sectors have been affected by a decrease in cross-border M&A in 2008, with the exception of oil, mining and agri-food businesses.

In the short term, the negative impact of the present economic recession on global FDI prospects should be the dominant one. Preliminary results of the UNCTAD World Investment Prospects Survey 2009–2011 (WIPS) confirm this: some four fifths of TNCs surveyed expressed the view that there were negative impacts of the financial crisis and the economic downturn on their international investment plans. Medium-term FDI prospects are more difficult to assess, due to the exceptional magnitude of the present crisis and to the fact that it could lead to major structural changes in the world economy. Nevertheless, some favourable factors for FDI growth are still at work, some of which are even a consequence of the crisis itself. Driving forces such as investment opportunities triggered by cheap asset prices and industry restructuring, large amounts of financial resources available in a number of emerging countries, quick expansion of new activities such as new energies and environment-related industries

and a resilient trend in the internationalization of companies will presumably trigger, sooner or later, a new pickup in FDI flows.

The exact date of this upward shift will, however, depend on a series of uncertain factors such as the speed of economic and financial recovery, the effectiveness of public policy in addressing the causes of the present crisis, the return of investor confidence and the ability to prevent protectionist tendencies. To illustrate those uncertainties and provide a framework for further discussion and analysis, this paper presents a set of three possible scenarios: V (quick recovery of FDI as soon as 2010), U (slow recovery beginning in 2011) and L (no recovery before 2012). Preliminary results of WIPS show that the U-shape scenario is the one presently considered as the most probable by TNC executives.

Public policies will obviously play a major role in the restoration of favourable conditions for a quick recovery in FDI flows. Structural reforms aimed at ensuring more stability in the global financial system, renewed commitment to an open environment for inward and outward FDI and the implementation of policies aimed at promoting investment and innovation are key issues in this respect. For dealing effectively with the crisis and its economic aftermath, it is important for policymakers to resist the temptation of “quick fix” solutions or protectionism, and to maintain a favourable business and investment climate overall. Recent announcements and commitments made at the London Group of Twenty (G-20) Summit in April 2009 have reconfirmed this policy stance.

INTRODUCTION

The unusual magnitude of the ongoing crisis is raising major concerns about the future of the economic outlook for the world, including among others the outlook for international investment. In this context, and at the request of the UNCTAD Trade and Development Board, UNCTAD has undertaken the present analysis to update member states on the impact of the crisis on FDI and facilitate ongoing intergovernmental deliberations.

This paper is organized as follows. Chapter I provides a quantitative analysis/picture of FDI flows in 2008, in the light

of the evolution of the overall economic environment, including the instability in the financial sector and the global economic slowdown. It also shows the uneven magnitude of the setback in international investment among regions and industries. Chapter II analyzes the channels of transmission of the present crisis to FDI and assesses its impact by type of FDI. Chapter III explores various scenarios for the medium term, ranging from quick recovery to persistent stagnation of FDI flows. Finally, chapter IV deals with policy implications, in particular for developing countries.

I WORLDWIDE FDI DOWN BY 15 PER CENT IN 2008

A. Global trends

A record year for FDI in 2007. During 2003–2007, FDI flows followed an upward trend, fuelled by steady world economic growth, ongoing liberalization in investment regimes and the implementation of large-scale internationalization strategies by a growing number of transnational corporations (TNCs). This led to an unprecedented level of FDI flows in 2007, with inflows reaching a historic record of \$1.9 trillion.

The crisis left its first marks on FDI in early 2008. The financial instability triggered by the United States subprime crisis that began in summer 2007 led to a progressive deterioration of the investment situation. Various indicators during the first half of 2008 already suggested a decline in world growth prospects as well as in investors' confidence. This

deteriorating climate began to leave its first negative marks on investment programmes, including FDI, in early 2008. According to the UNCTAD 2008–2010 *World Investment Prospects Survey*, conducted April–June 2008, 40 per cent of the respondent companies already mentioned at that time that the financial instability had a “negative” or “very negative” impact on their investment expenditures and programmes. The same study showed that, on average, TNCs' views on their medium-term investment prospects were already significantly less optimistic than in the previous year's survey (UNCTAD, 2008a). Data available during summer 2008 already showed a downward trend for the first semester of 2008, both for cross-border mergers and acquisitions (M&As) and FDI flows, as compared to the same period of the previous year (UNCTAD, 2008b).

A brutal shock in October 2008. During the first eight months of 2008, however, the world financial system went through a period of relative relief, leading to some optimism regarding the outcome of the ongoing crisis. But subsequently, a brutal crisis erupted again, when first major United States financial firms such as Lehman Brothers and AIG, and then European financial institutions, such as Fortis, Dexia, and a number of Icelandic banks, showed signs of insolvency and some of them even collapsed. It then became clear that this crash was a symptom of a wider underlying malaise in the global financial services industry, reflecting in particular serious lacunae in the regulatory system.³⁶

The crisis then expanded in magnitude, and full-scale turmoil ensued in financial markets, buffeting many developed and emerging economies. A number of emerging economies such as

Hungary, Iceland, Latvia and Ukraine had then to turn to the International Monetary Fund (IMF) for assistance. Since the beginning of 2009, this list has extended to new countries, such as Indonesia, Pakistan and Romania.

The crisis then quickly spread far beyond the financial sector, with serious repercussions for the “real economy”. Much tighter credit conditions unavoidably affected firms’ ability to spend on factories and equipment as well as on acquisitions. Consumer confidence fell sharply in many parts of the world, reaching historical lows first in the United States and later in the European Union.³⁷ And large companies in many industries were seriously affected by the decline in sales. Starting with financial services, which have been directly affected by the crisis, the shock waves have hit many other industries, ranging from extractive industries and manufacturing to infrastructure services.

³⁶ For the UNCTAD view on the financial crisis, see, for example, UNCTAD (2008c); and “Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus”, Issues note by the UNCTAD secretariat, Trade and Development Board, Forty-fifth executive session, Geneva, 13 November 2008 (TD/B/EX(45)/2).

³⁷ The United States consumer confidence index, for example, plummeted in February 2009 to an all-time low since records began in 1978. For the same month, The Economic Confidence Index in the Eurozone fell to its lowest level since its creation in 1995 (*Source: Financial Times*, 26 February 2009).

A global decline in world gross domestic product (GDP) is now projected for 2009³⁸ and recession is already gripping all major developed economies. Business cycle-sensitive industries like automobiles, aircraft, electronic equipment, construction, building materials and steel, as well as some services such as airlines, have been especially affected, while activities with a more cycle-resilient market base, such as utilities, telecommunications and food and beverages may be less impacted.

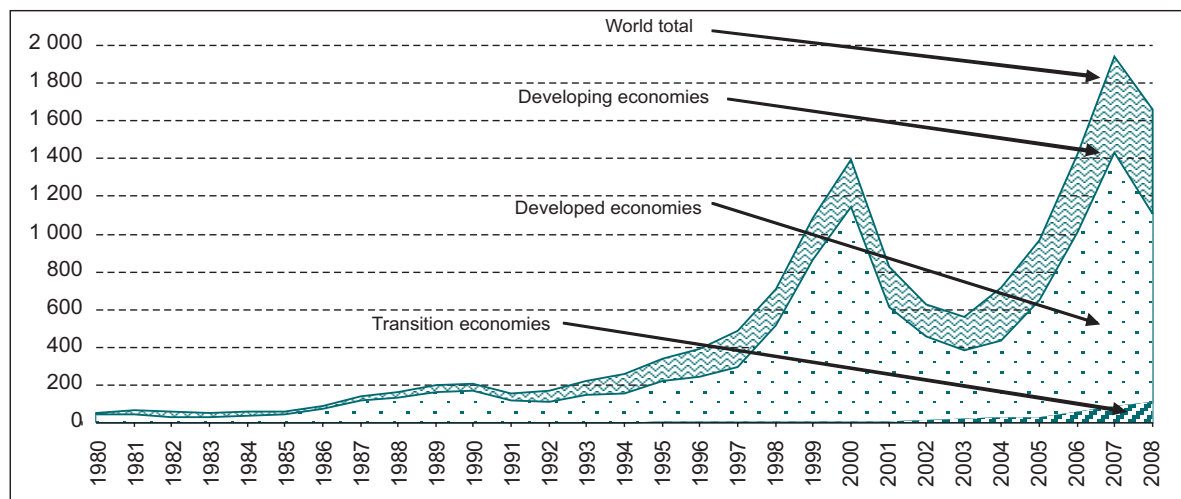
FDI declined by 15 per cent in 2008. In the face of the global economic slowdown (and recession in a number of major economies), due to tighter credit conditions and falling corporate profits, many

companies have announced plans to curtail production, lay off workers and cut capital expenditure, all of which has implications for FDI. According to a preliminary estimate by UNCTAD, world FDI flows have declined in 2008 by 15 per cent (figure 1 and table 1), due among other things to a sharp fall in flows during the last quarter of the year. A dramatic decline in the value of cross-border M&As sales was also recorded in 2008 (-29 per cent) (table 1).

A more dramatic decline is expected in 2009. Judging by preliminary data for the first quarter of 2009 on cross-border M&As (figures 2–5), there was a nosedive in FDI in all three groups of economies: developed countries, developing countries and transition economies (South-East Europe and the CIS). While in both developed and transition economies FDI flows seem to have fallen gradually over 2008 and the first quarter of 2009, in developing countries a dramatic fall was observed only in the first quarter of 2009. For example, China showed a 26 per cent decline in FDI inflows during the first two months of 2009 over the same period of 2008 and flows to the Republic of Korea were down by 38 per cent in the first quarter of 2009.

³⁸ Forecasts for the world economy are quickly worsening. At the beginning of this year, United Nations forecasts looked quite pessimistic compared to others, with a meager 1 per cent growth projected for the world economy by the most recent *World Economic Situation and Prospects* (United Nations, 2009). But other institutions have since then dramatically revised their forecasts downwards. For instance, the latest IMF forecasts, released in April 2009 (see also table 2), project a decrease of world output by -1.3 per cent in 2009, down by 3.5 per cent compared to its December projection and down by 5.0 per cent as compared to the IMF projection in April 2008 (IMF, 2009).

Figure 1. FDI inflows, global and by group of economies, 1980–2008
(Billions of dollars)



Source: UNCTAD, based on FDI/TNC database (www.unctad.org/fdi statistics) and UNCTAD own estimates.

Table 1. FDI inflows and cross-border M&A sales, by region and major economy, 2007–2008^a
(Billions of dollars)

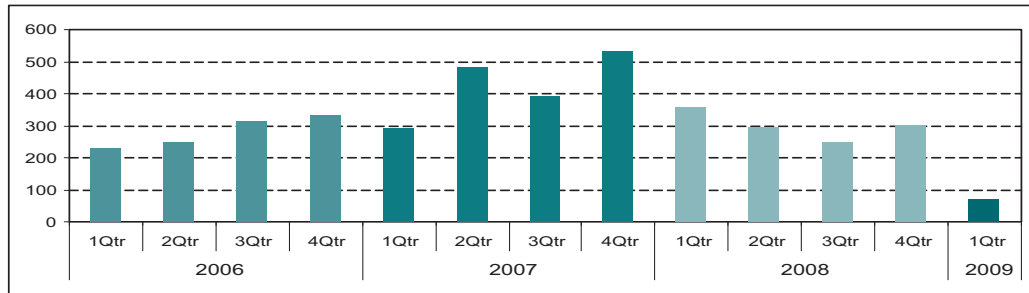
Region/economy	FDI inflows			Cross-border M&A sales		
	2007	2008 ^a	Growth rate (%)	2007	2008 ^a	Growth rate (%)
World	1 940.9	1 658.5	- 14.5	1 699.8	1 205.4	- 29.1
Developed economies	1 341.8	1 001.8	- 25.3	1 504.1	998.3	- 33.6
Europe	920.9	559.0	- 39.3	859.4	561.4	- 34.7
United States	232.8	320.9	37.8	389.2	318.2	-18.2
Japan	22.5	19.0	- 15.6	24.6	19.5	-20.6
Developing economies	512.2	549.1	7.2	161.6	182.1	12.7
Africa	53.5	72.0	34.7	12.5	27.0	116.5
Latin America and the Caribbean	127.3	139.3	9.4	31.1	32.8	5.5
Asia and Oceania	331.4	337.8	1.9	118.1	122.3	3.6
West Asia	71.5	61.4	- 14.2	33.8	31.6	-6.6
South, East and South-East Asia	258.7	275.2	6.4	84.0	90.4	7.6
Transition economies	86.9	107.6	23.8	34.1	24.9	-27.0

Source: UNCTAD.

^a Preliminary estimates. Final figures will be in the *World Investment Report 2009*.

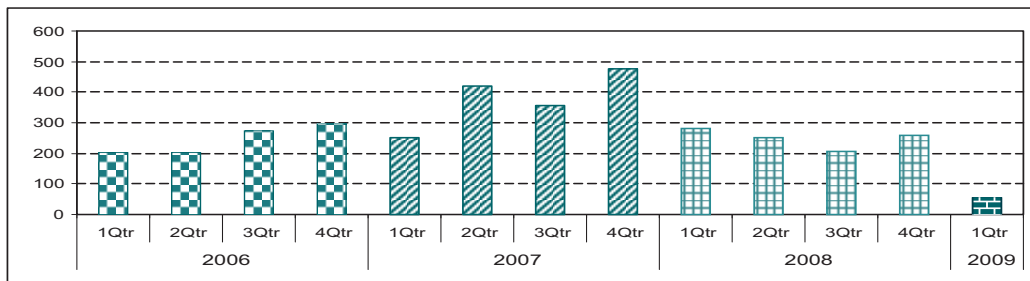
Note: World FDI inflows in 2008 are projected on the basis of data for 103 economies for which data were available for either all or part of 2008 as of 6 April 2009. Data for which only part of 2008 are available are estimated by annualizing the data. The proportion of inflows to these economies in total inflows to their respective region or subregion in 2007 is used to extrapolate the 2008 data. For cross-border M&As, estimates were made on the basis of data available as of 5 January 2009.

Figure 2. Value of worldwide cross-border M&As, by quarter, 2006–2009
(Billions of dollars)



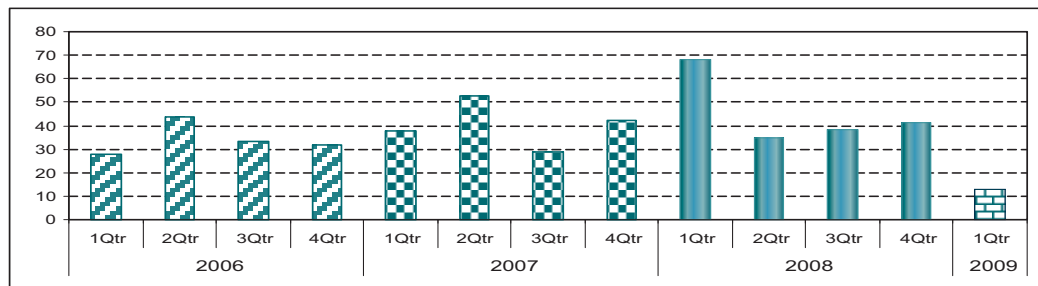
Source: UNCTAD, cross-border M&A database.

Figure 3. Value of cross-border M&As in developed countries, by quarter, 2006–2009
(Billions of dollars)



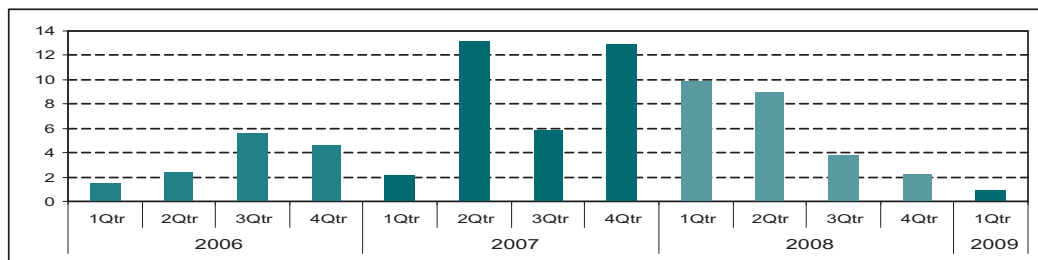
Source: UNCTAD, cross-border M&A database.

Figure 4. Value of cross-border M&As in developing countries, by quarter, 2006–2009
(Billions of dollars)



Source: UNCTAD, cross-border M&A database.

Figure 5. Value of cross-border M&As in transition countries^a, by quarter, 2006–2009
(Billions of dollars)



Source: UNCTAD, cross-border M&A database.

^a South-East Europe and the Commonwealth of Independent States.

B. Geographical imbalance: the relative resilience of FDI flows to developing countries in 2008

1. FDI inflows

The impact of the crisis varies widely, depending on region and country, with consequences for the geographic pattern of FDI flows. One has to keep in mind that the present situation is very different from that of the previous major financial crisis – the 1997 Asian crisis – which originated in developing countries (see UNCTAD, 1998a) and had a significant negative influence on FDI inflows in a number of them (such as Indonesia).³⁹ In contrast, the current financial crisis began in the developed world, though it is rapidly spreading to developing and transition economies. Developed countries have thus been directly hit by the financial crisis, while its effects on developing economies in 2008 have been indirect in most cases, with varying degrees of severity among regions and countries. This has had clear

³⁹ In other countries, the crisis speeded up liberalization and actually led to an increase in FDI inflows (as in the Republic of Korea).

consequences on the geographical patterns of FDI inflows in the past year.

Developed countries were the most affected in 2008. In many developed countries, preliminary data suggest that in 2008 FDI flows declined by about 25 per cent. This is the result of the protracted and deepening problems affecting financial institutions, the liquidity crisis in the money and debt markets and finally the deepening recession. Inward flows are likely to have been particularly low in Finland, Germany and Italy, even compared with 2006 levels, while flows to France and the United Kingdom⁴⁰ are estimated to have declined by a significant margin compared to their 2007 historical high levels (annex table). A major exception is the United States, where FDI flows may have risen by 38 per cent in 2008 to \$321 billion (annex table). This can be explained by two major factors: foreign parent companies may have transferred capital to

⁴⁰ According to a survey of French affiliates of United States TNCs released in October 2008, 83 per cent of respondents said that their groups as a whole had been affected by the worldwide economic slowdown, and 60 per cent said that their French affiliates had been affected. (*Source*: American Chamber of Commerce in France and Bain & Co. (2008), *2008 Amcham-Bain Barometer*.)

their United States affiliates in financial distress, in the form of equity or intra-company loans, and/or the crisis in the United States economy has triggered new opportunities for the acquisition of local firms by foreign interests.⁴¹ This is in sharp contrast to other capital flows (such as portfolio flows) to the United States which showed a dramatic decline in 2008. In general, decreased earnings of developed country TNCs and a decline of syndicated bank loans have particularly limited financing for investment. A decline in leveraged buyout transactions also dampened cross-border M&As, further depressing FDI flows. Cross-border M&A sales in developed countries fell by 33 per cent in 2008 (table 1).

Preliminary results of the *World Investment Prospects Survey 2009-2011* (WIPS),⁴² conducted by UNCTAD, also show that

⁴¹ Equity capital inflows and intra-company debt increased by 59 per cent to \$234 billion and by 128 per cent to \$49 billion, respectively. Increases were mainly in finance, originating in Belgium, Switzerland and the United Kingdom, including through special purpose entities located in these countries.

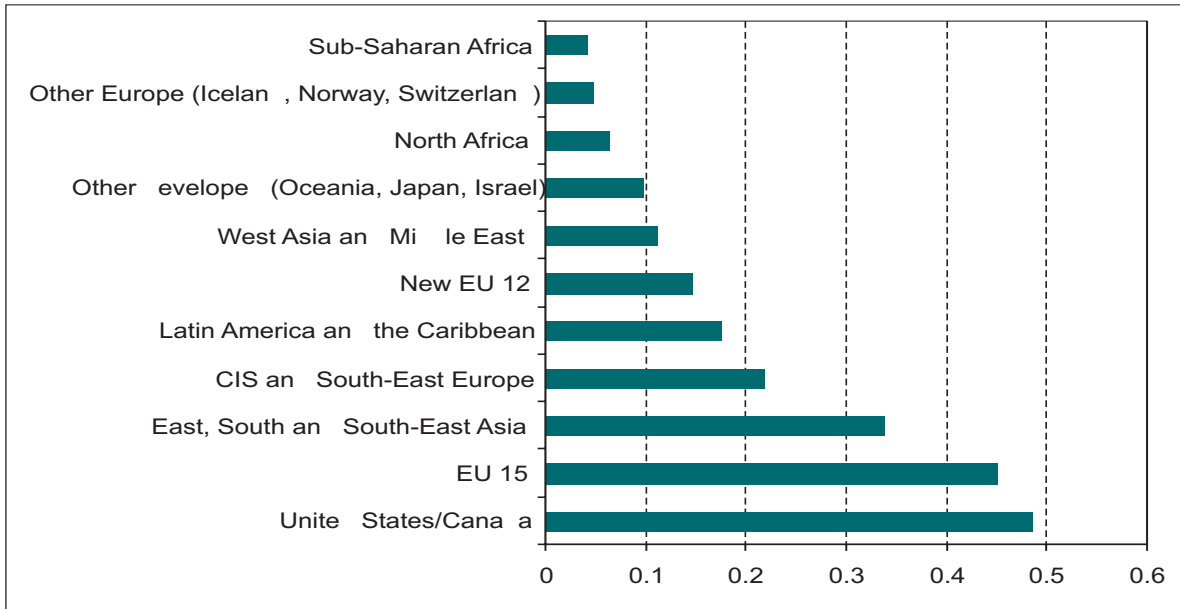
⁴² The full report will be released in July 2009. The interim results are based on responses from some 150 large TNCs. The survey was undertaken between February and May 2009.

developed economies in Europe and North America – which still host the major share of world FDI flows and stocks – have so far been the most affected by the reduction in these international investment programmes (figure 6). Roughly 45 per cent of respondents noted that their investment plans were most impacted in the United States and Canada, while another 42 per cent highlighted the EU-15.

In developing and transition economies, FDI inflows remained more resilient until the end of 2008. The growth rate of FDI inflows to developing countries in 2008, while lower than in 2007 (when it exceeded 20 per cent), has reached an estimated 7 per cent. This is mainly due to positive and even relatively high economic growth rates that still prevailed in several developing and transition economies including, among others, BRICs (Brazil, China, India and Russian Federation) in 2008. While other private financing flows to developing countries were on the decline, FDI flows still remained a major external source of financing for developing countries (see also section 3).

By region, preliminary estimates suggest that flows to Africa have grown further to more than \$70 billion despite the slowdown

Figure 6. Regions in which FDI plans have been most affected by the impact of the crisis
(% of respondents; 1=100%)



Source: preliminary results of WIPS (UNCTAD 2009 forthcoming).

in global economic growth and its negative consequences for the region. Flows to East, South and South-East Asia (the largest recipient of FDI among developing economies, accounting for almost half of all flows to developing countries) might rise, but by a lower rate compared with 2007. West Asia has seen flows decline by an estimated 14 per cent, following the record level registered last year, due to slower growth in oil demand, rising costs and lower funds from export proceeds (due to lower oil prices). By contrast, FDI flows to Latin America and the Caribbean have shown significant

resilience to the world economic slowdown, with an estimated 9 per cent increase, partly as a result of a strong rise in FDI flows to South America. However, Central America and the Caribbean – which are traditionally highly dependent on the United States economy – are most likely to register a decline. FDI flows to the transition economies of South-East Europe and the Commonwealth of Independent States should maintain their upward trend despite the financial crisis (and in spite of the regional conflicts affecting some of them), registering an increase of about 6 per cent. In contrast to M&As

in developed countries, those in developing countries rose in value by 12 per cent in 2008, particularly in Africa (table 1), although from a generally low level.

Preliminary results of WIPS show that among developing host regions, East and South-East Asia is most affected by the crisis (28 per cent of respondents),⁴³ though to a lesser degree compared to developed countries (figure 6). The least affected region is sub-Saharan Africa (figure 6).

While the decrease in FDI inflows has hit developed countries the hardest, some developing economies are also very vulnerable to external shocks. For example, FDI inflows have declined sharply in countries such as Indonesia, Pakistan, the Republic of Korea, Singapore and Turkey, due to fallout from the financial crisis.

2. FDI outflows

FDI outflows of developed countries as a group declined in 2008, with some notable

exceptions. The stock market crash reduced the market value of assets of many parent firms and their affiliates all over the world. Falling business expectations led to the cutting of investment plans. Rising debt financing costs reduced the possibilities for debt-financed foreign expansion.

FDI outflows from the United States went down as large repatriations of reinvested earnings and debt from foreign affiliates of the United States corporate sector took place and new investments abroad were halted. FDI outflows from Europe also declined (table 2). United Kingdom TNCs cut their FDI abroad by more than 50 per cent in 2008, reflecting their deteriorating financial capabilities. Only Japan could significantly increase its FDI outflows in 2008 – a process which continued in early 2009. The Japanese corporate sector was in a relatively strong position in terms of cash and a healthy debt-equity ratio. This has facilitated the acquisition of foreign firms, the asset values of which have been lowered by the global financial crisis and economic slowdown. The value of cross-border M&As by Japanese companies in 2008 thus reached \$64 billion (table 2) – a record level. This has brought Japan back into

⁴³ This result, however, may simply reflect the fact that East and South-East Asia accounts for the largest part of FDI flows into developing countries, and not necessarily that it has been relatively more affected by the crisis than other developing regions.

Table 2. FDI outflows and cross-border M&A purchases, by region and major economy, 2007-2008^a

(Billions of dollars)

Region/economy	FDI outflows			Cross-border M&A purchases		
	2007	2008 ^a	Growth rate (%)	2007	2008 ^a	Growth rate (%)
World	2 063.4	1 868.9	- 9.4	1 699.8	1 205.4	-29.1
Developed economies	1 743.4	1 536.4	- 11.9	1 447.6	986.0	-31.9
Europe	1 270.7	990.3	- 22.1	856.0	647.5	-24.4
United States	313.8	298.6	- 4.8	402.6	166.5	-58.7
Japan	73.5	127.4	73.2	38.8	64.3	65.6
Developing economies	268.8	274.1	2.0	199.4	181.1	-9.1
Africa	5.3	9.4	14.3	51.2
Latin America and the Caribbean	52.1	36.1	- 30.7	48.7	20.3	-58.3
Asia and Oceania	211.4	239.6	13.4	141.2	146.6	3.8
West Asia	44.8	47.9	37.4	-21.9
South, East and South-East Asia	166.5	185.2	11.2	93.3	108.3	16.1
Transition economies	51.2	58.3	13.9	25.2	25.0	-0.5

Source: UNCTAD.

^a Preliminary estimates. Final figures will be in the *World Investment Report 2009*.

Note: World FDI outflows in 2008 are projected on the basis of data for 79 economies for which data were available for either all or part of 2008 as of 6 April 2008. Data for which only part of 2008 are available are estimated by annualizing the data. The proportion of inflows to these economies in total inflows to their respective region or subregion in 2007 is used to extrapolate the 2008 data. For cross-border M&As, estimates were made on the basis of data available as of 5 January 2009.

the group of countries with the largest outflows of FDI.

FDI outflows of developing countries are estimated to have risen by 2 per cent in 2008 but have begun to decline in the first half of 2009. Asian economies and especially China continued to dominate as sources of developing country outward FDI. TNCs from some West Asian countries, along with sovereign wealth funds (SWFs) from the subregion, continue to invest abroad. Developing country

TNCs thus now account for a larger share of global FDI than before (15 per cent in global FDI outflows in 2008 (table 2 and box 1). FDI outflows of transition economies also grew considerably in 2008, accounting for 3 per cent of the world total (table 2).

C. Sectoral imbalance: the example of M&As

No precise data are available yet regarding global FDI flows

Box 1. The impact of the crisis on the largest TNCs from developing countries

Although large TNCs from developing countries have been affected by the crisis, they also benefited from the ongoing sustained growth of their internal market in 2008 as well as from governmental support in their internationalization strategies. Those in a cash-rich position may take advantage of the present low price of assets to carry out new acquisitions in order to strengthen their presence in developed countries markets and foster their technological capabilities. The impact of the crisis, however, has been very uneven, as some activities have been especially affected:

- (a) Companies involved in petroleum and gas activities have seen their revenues shrink in recent months, as a result of a marked decline in the price of commodities; however, investments are still being made in order to acquire new sources of energy. Chinese energy TNCs, in particular, are boosting acquisitions overseas, taking advantage of the present low prices of assets. The Government of China is considering setting up an oil fund to help domestic companies expand abroad.
- (b) Metal and metal products producers have also largely posted strong declines in sales in recent months. For example, the Brazilian company Metalurgica Gerdau SA has suffered from drops in sales, production and profits, according to its 2008 results. Given the lower demand for steel, the company has been taking a series of measures to adapt to the downturn, including postponing previously announced investments. A handful of companies, however, show better results and prospects. Supported by high worldwide demand for gold, Gold Fields Limited (South Africa) reports favourable prospects and plans to become a leading precious metals producer.
- (c) Electrical and electronics manufacturers also face a decline in demand, mainly from their western markets. But some of them are carrying out aggressive innovation and technology diversification strategies that might alleviate the consequences of this downturn. For example, Quanta Computer (Taiwan Province of China) has announced a major investment in touch screen technology, used extensively in the /...

Box 1. The impact of the crisis on the largest TNCs from developing countries (concluded)

growing smartphone segment worldwide. Furthermore, it expects to benefit from Acer's good sales forecast for notebook computers. Lenovo, like other Chinese companies, has decided to focus on China — and its large domestic market — and other emerging markets, while making efforts to stabilize its high-end market overseas.

- (d) The real estate business has also been considerably affected by the crisis. For instance, the net income of CapitaLand Limited (Singapore) fell significantly in 2008. The company has cancelled plans to build 12 malls in China.
- (e) In telecommunications, however, the situation looks better. Companies such as

Qatar Telecom, América Movil (Mexico) and Zain (Kuwait) have benefited from a quite robust market. They enjoy good results and even significant growth of their sales. All expect to further expand their international presence.

- (f) Some diversified groups, especially those well positioned in East Asia and China, seem to have been quite resilient to the present economic downturn. For example, Hutchison Whampoa (Hong Kong (China)) saw revenue rise 13 per cent in 2008 to \$348.4 billion dollars, although its profits dropped 42 per cent. Despite a more cautious expansion strategy, it is still examining potential new investments, especially land and property deals in China.

Source: UNCTAD, based on reports in newspapers and other media.

by sector in 2008. However, some industry-level statistics already exist for cross-border M&As. As this kind of investment accounts for a very large part of FDI flows, it is interesting to have a look at their sectoral pattern for the year 2008.⁴⁴

⁴⁴ It should also be noted that the impact of the crisis on top TNCs differs widely depending on industry and company: on the one hand, many business cycle-

sensitive industries such as automotive and other transport materials, construction, electronic equipment, intermediate goods and the financial sector, have been among the most affected by the crisis. An exception is the oil and gas industry, for which 2008 has been a year of record profits for many major companies. Many of them, such as Shell, BP or ExxonMobil intend to maintain large investment programmes for 2009 onwards. On the other hand, some other less cyclical industries, relying upon more stable demand patterns, have so far been less affected. This is the case, among others, for agro-business,

The decline in cross-border M&A affected practically all industries. However, a handful of activities such as the primary sector and agrifood business showed resilience to this downturn (table 3).

In 2008, the value of cross-border M&A sales in the primary sector increased by 16.5 per cent. Rising prices of oil and other commodities in the first half of 2008 triggered a further increase in the value of cross-border M&A investments in the mining, quarrying and the petroleum industry to \$125 billion.⁴⁵

In manufacturing – which accounts for nearly one third of the estimated world inward FDI stock – the value of cross-border M&As decreased by 29 per cent. The decline in different industries was very uneven. Textiles and clothing, publishing and printing, rubber and plastic products as well as metals and metal products saw a

decline in cross-border M&As sales of 80 per cent on average. In some other industries – like electrical and electronic equipment – M&A sales decreased much less. In contrast, cross-border M&A activity in the food, beverages and tobacco industry rose considerably (by 76 per cent to \$122 billion in 2008),⁴⁶ making it the only industry in the manufacturing sector with a rise in cross-border M&A sales.

In the services sector – that accounts for around three fifths of the worldwide FDI stock – cross-border M&A flows declined by 29 per cent in 2008. Most of the larger service industries were hit by this downturn, with the exception of the business services sector where cross-border M&As shrank by only 11 per cent. In the finance industry the value of cross-border M&As declined in 2008 by 34 per cent. There were however several larger cross-border acquisitions in the North American and European

utilities and telecommunication services, pharmaceuticals and retailing. It should also be noted that, even in crisis-shaken industries, some companies have achieved positive performance, such as LG in the electronics industry.

⁴⁵ Examples include a 12 per cent share of Rio Tinto (United Kingdom) by Shining Prospect Pte Ltd (Singapore), a subsidiary of Chinalco (China), for \$14 billion.

⁴⁶ Several large TNCs took the opportunity to improve their competitive position on foreign markets. Four megadeals of more than \$10 billion each drove the value of cross-border M&As in this industry. Anheuser Busch, a United States brewery, was acquired by the Belgium Stichting Interbrew for \$52 billion. Altadis, a Spanish cigarette company, was bought for \$18 billion by British Imperial Tobacco.

Table 3. Value of global cross-border M&As sales, by sector/industry, 2007-2008 ^a
(Millions of dollars)

Sector/industry	2007	2008 ^a
Total	1 699 798	1 205 350
Primary	110 886	129 532
Agriculture, hunting, forestry and fishing	5 313	3 192
Mining, quarrying and petroleum	105 573	126 340
Manufacturing	582 403	405 760
Food, beverages and tobacco	69 225	122 131
Textiles, clothing and leather	12 912	2 245
Wood and wood products	18 975	9 569
Publishing and printing	25 245	5 387
Coke, petroleum and nuclear fuel	9 238	5 475
Chemicals and chemical products	141 717	100 087
Rubber and plastic products	9 900	1 545
Non-metallic mineral products	45 506	31 077
Metals and metal products	124 168	29 092
Machinery and equipment	25 556	15 611
Electrical and electronic equipment	28 520	25 054
Precision instruments	30 307	17 598
Motor vehicles and other transport equipment	40 059	34 992
Other manufacturing	1 073	5 897
Services	1 006 510	670 043
Electricity, gas and water	134 666	97 376
Construction	16 243	3 388
Trade	83 861	53 798
Hotels and restaurants	29 019	9 215
Transport, storage and communications	126 405	85 685
Finance	355 835	227 496
Business services	192 370	166 218
Public administration and defence	42	33
Education	13 863	6 271
Health and social services	1 191	1 127
Community, social and personal service activities	44 276	14 438
Other services	8 740	4 998
Unknown ^b	-	15

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics).

^a Preliminary estimates. Final figures will be in the *World Investment Report 2009*.

^b Including non-classified establishments.

Note: The data cover only those deals that involved an acquisition of an equity stake of more than 10%.

banking sector, partly prompted by the fact that low stock prices offered the chance to step into markets that had before been difficult to enter.⁴⁷ Japanese banks

⁴⁷ In Europe there were two very large M&A transactions with intra-European targets and acquirers. The Belgium bank Fortis SA/NV was acquired by a Netherlands bank for \$23 billion and an Italian subsidiary of Banco Santander SA was bought by the Italian BMPS for \$13.2 billion. In the United States several large banks nearly collapsed during the financial crisis and were acquired by other United States institutions supported by state funds. Foreign banks seized the chance to acquire

with relatively abundant funds at home are gradually returning to the international banking scene as major investors: this move is similar to the one observed in the 1980s, although Japanese banks focus more today on international banking services for non-Japanese clients.

equity stakes in several large banks in the United States. Toronto Dominion bank (Canada) and the Japanese Mitsubishi UFJ Financial Group acquired larger stakes in the United States Commerce Bancorp and Morgan Stanley for \$8.6 billion and \$7.8 billion respectively.

II CHANNELS OF TRANSMISSION OF THE CRISIS TO FDI FLOWS

The current global financial and economic crisis influences both firms' capacity to invest as a result of reduced availability of finance and their propensity to invest due to gloomy economic and market prospects.

Reduced access to finance. Financial factors have negatively affected TNCs' capacity to invest, both internally and externally, as tighter credit conditions and lower corporate profits curtail TNCs' financial resources for overseas investment projects (as well as domestic ones). On the one hand, credit has become less abundant and more expensive (IMF, 2009). For instance, spreads in corporate bonds soared dramatically in the last months of 2008 and still remain at a very high level. Syndicated bank loans, as well as funds available for leveraged buyout transactions, also declined dramatically. This deterioration of

the external funding environment for non-financial companies makes it more difficult for them to invest in foreign operations or to make cross-border M&A deals. On the other hand, poor earnings of large companies in a broad range of industries in Europe, Japan and the United States, as evidenced by declared or projected profits from the fourth quarter of 2008 onwards, have reduced the companies' self-financing capabilities. For example, losses of S&P 500 companies amounted to \$182 billion for the fourth quarter of 2008, the first negative figure since 1935. More than one quarter of these companies have published losses for the whole year 2008. In Europe the 310 companies of the DJ Stock 600 lost 2.2 billion euros during the fourth quarter of 2008, as against \$75.1 billion in profits for the same period one year earlier. Almost one third (90) are expected

to publish negative results for the whole year.³⁶ At the same time, a decline of about 50 per cent in stock markets worldwide since January 2007 has reduced TNCs' ability to turn to stock markets for financing purposes and to leverage their M&A activities using stock shares.

Gloomy prospects. A pessimistic assessment of market prospects (especially in developed economies which are going through the worst recession of the post-war era) has also reduced firms' propensity to invest for to further expand (both domestically and internationally) their production capacity. As indicated above, according to the latest IMF forecasts, world output is predicted to decline in 2009, for the first time in 60 years. Total output in advanced economies as a whole would contract on a full-year basis in 2009, the first such fall in the post-war period, from 0.8 per cent in 2008 to -3.8 per cent in 2009, while emerging and developing economies would experience a reduced though still

positive growth rate (1.6 per cent). The OECD, United Nations and the World Bank point to similar negative trends (table 4).

Risk aversion. Companies' investment plans may also be scaled back due to a high level of perceived risks and uncertainties, in order to develop resilience to possible "worst case" scenarios regarding financial and economic conditions. Many confidence indicators have fallen to historical lows – as indicated, for example, by the fall in the Ifo World Economic Climate index,³⁷ the consumer confidence index of the Conference Board (United States) or the Euro Zone Economic Confidence Index. A large percentage of companies might implement cost-cutting programmes (including divestments, layoffs, postponing or cancellation of investment projects) beyond what would be justified by the grim scenarios regarding business prospects.

Preliminary results from the UNCTAD WIPS also suggest that

³⁶ Source. *Les Echos*, 18 March 2009. Similarly, 541 Japanese manufacturing companies listed in stock markets are projected to register a reduction of more than 20 per cent in their profits in 2008 (*Nikkei*, 2 November 2008).

³⁷ According to the latest issue of the *World Economic Survey*, published quarterly by the German Ifo Institute for Economic Research since 1987, the Ifo World Economic Climate index fell to its lowest historical level in March 2009.

Table 4. World GDP growth and growth prospects, 2008-2010

(Yearly GDP growth rate according to various sources)

Sources/regions	2008	2009	2010
IMF: world	3.2	-1.3	1.9
- Advanced economies	0.8	-3.8	1.0
- Emerging and developing economies	6.1	1.6	4.0
World Bank: world	1.9	-1.7	2.3
- high income countries	0.8	-2.9	1.6
- developing countries	5.8	2.1	4.4
United Nations: world	2.5	1.0 (baseline)	-
- Developed economies	1.2	-0.5 (baseline)	-
- Economies in transition	6.9	4.8 (baseline)	-
- Developing economies	5.9	4.6 (baseline)	-
OECD: OECD countries	0.9	-4.3	-0.1

Source: IMF (April 2009), World Bank (March 2009), OECD (March 2009) United Nations (January 2009).

large TNCs' investment plans have already been significantly affected by the various aspects of ongoing crisis. Respectively, 86 per cent, 79 per cent and 51 per cent of the TNCs responding to the WIPS declared that the economic downturn, the financial crisis and the volatility of exchange rates have had a "negative" or "very negative" impact on their investment expenditures (figure 7).

As shown in box 2, the impact of these negative factors may vary significantly depending on the type of investment as defined by its main motives: market-seeking, efficiency-seeking and resources-seeking.

The decline in the propensity to invest abroad can take various forms (including divestment and restructuring) and differ according to entry modes (e.g. M&As, greenfield investment).

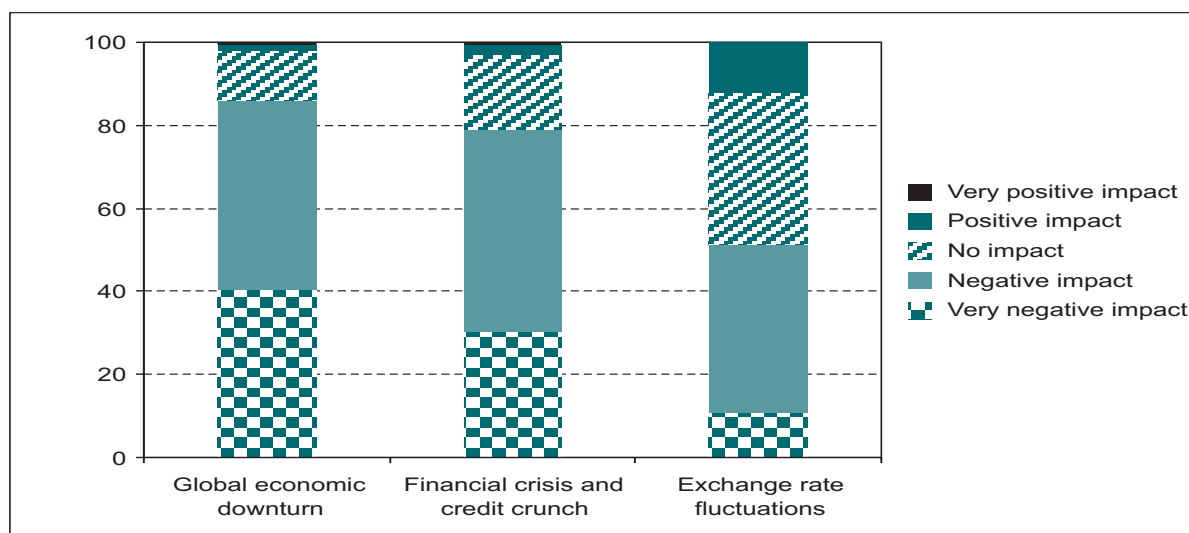
There has been a recent rise in divestments and restructuring of operations (see examples in box 3). Companies undertake divestments and make cuts in existing production capacity – either by shutting down plants or factory lines, or by selling some of their assets to other companies³⁸ – to restructure foreign operations, save costs or improve their balance sheet situation, especially through lowering the debt-equity ratio.³⁹

As already noted, there is also evidence that cross-border M&As in general have already been sharply affected as a direct consequence of the crisis, with a

³⁸ In the last-mentioned case, recording FDI flows in the balance-of-payments based statistics may vary depending on the location of the asset sold and the country of residence of the selling and buying companies.

³⁹ See e.g. Baghai M et al. (2008).

Figure 7. Impact of various aspects of the crisis on the company's investment plans
(% of responses)



Source: preliminary results of WIPS (UNCTAD 2009 forthcoming).

29 per cent decline in cross-border M&As in 2008 as compared to 2007 (table 1). A new fall has been recorded for the first quarter of 2009 as shown above, to \$70 billion (figure 2). For some countries, the difficulties emerging in M&A deals have brought large privatization projects to a halt (table 5).⁴⁰ The

⁴⁰ For example, the global financial crisis will bring the Swedish Government's \$26 billion privatization programme to a halt two years before it is due to be completed. The French Government is also to postpone the privatization of the state-owned company La Poste due to the financial crisis. (Source: *Financial Times*, 4 November 2008.) In Mexico, the government has pushed back the deadline of bidding for Punta Colonet, a \$6 billion port project. The privatization of Kuwait Airways Corporation might also be postponed due

decline in cross-border M&As is of utmost importance for FDI flows, which are strongly correlated with cross-border M&A amounts.

For greenfield investments (new investments and expansion of existing facilities), the impact of the crisis began to be felt only in the fourth quarter of 2008. The number of such investments even increased markedly during the first

to the present global financial crisis. (Source: Kuwait News Agency, 23 October 2008.) The Greek Government may have trouble meeting its 2009 privatization goals in the current economic climate, adding pressure to an economy already burdened by high levels of debt. (Source: *Reuters*, 16 February 2009).

Box 2. Various types of investment motives are affected unequally by the crisis

International investment theory usually distinguishes between types of FDI according to three major motives for investing abroad (see UNCTAD 1998b: 91): market-seeking, efficiency-seeking and resources-seeking. All three are impacted by the ongoing financial and economic crisis, but with differences in magnitude and location pattern of impact.

The most directly affected types of investment so far have been market-seeking projects, especially those aimed at developed countries. As advanced economies are expected to experience negative growth in 2009, companies are restraining the launching of new projects aimed at increasing their market-oriented production capabilities there, while they remain more committed to capacity expansion in emerging and developing economies (see examples in box 3). But this commitment might weaken in 2009 as growth slows in the latter group of economies, due – among other reasons – to a decline in the value of their exports and a fall in commodity and energy prices.

The impact of the crisis on efficiency-seeking projects is more difficult to assess. On the one hand, these projects will suffer globally from the decline in the companies' financial capabilities. On the other hand, many companies might be compelled by the ongoing crisis to restructure their international activities to cut cost and boost overall efficiency. This means above all closing or downsizing obsolete or non-cost-competitive facilities (often located in advanced economies), but also opening some new cost-efficient facilities, especially in emerging economies.

Finally, resource-seeking FDI projects could suffer, at least in the short-term, from the decline in world demand and consequently in prices, with particularly negative effects on resource-rich developing countries. It should be noted, however, that this setback in resource-seeking investment closely follows a period of euphoria, when quickly-rising world demand triggered imbalances in commodity markets, boosting prices and leading companies to launch many new projects. It is highly probable that these imbalances will quickly arise again once the present recession is over, putting resource-seeking FDI back on the road to growth.

Table 5. Selected cross-border M&As and privatization programmes dropped or halted due to the global financial crisis

Acquiring company (country)/privatization	Target company (country)	Value	Industry
Samsung Electronics (Rep. of Korea)	SanDisk (United States)	\$5.9 billion	Electronics
Xstrata (United Kingdom and Switzerland)	Lonmin (United States)	\$10 billion	Mining
AT&T, Vodafone, Blackstone	Huawei mobile handset business (China)	\$2 billion	Electronics
Ping An Insurance (China)	Fortis (Belgium)	Euro 2.2 billion	Finance
Privatization	Punta Colonet (Mexico)	\$6 billion	Port
Privatization	Kuwait Airways (Kuwait)	-	Airlines
Privatization	La Poste (France)	-	Postal services
Privatization	TeliaSonera (Sweden)	-	Telecom
Privatization	Nordea (Sweden)	-	Finance
Privatization	Oman Telecommunication Company (25%)	-	Telecom
Privatization	SBAB (Sweden)	-	Finance

Source: UNCTAD, based on various newspaper accounts.

three quarters of 2008, to reach over 15,000, largely exceeding the level registered for the whole year 2007. But since then, a downturn has taken place, with a marked decrease in the monthly flow of projects since September 2008. Between September and December 2008 for instance, the number of greenfield investment projects fell by 30 per

cent.⁴¹ Recent announcements in various industries point to the cancellation or postponement of many projects, the consequences of which will be fully felt in 2009 (see box 3).

⁴¹ Preliminary data for 2009 suggest that this trend has continued to gain momentum during the first months of the year. Source: UNCTAD, based on data from fDi Markets, fDi Intelligence www.fdimarkets.com.

Box 3. Examples of divestments and postponement of investment projects

A number of developments point to the negative impact of the crisis on FDI in specific industries and on specific companies. They include the following:

- (a) In the mining industry, BHP Billiton (Australia) announced at the end of 2008 that it will be slashing its workforce by 6 per cent, with 6,000 job cuts. Anglo American (United Kingdom) will slash its capital expenditures by more than half in 2009, to \$4.5 billion. Rio Tinto (Australia/United Kingdom), slammed by the global collapse in commodities demand and saddled with \$39 billion in debt, could sell \$15 billion in assets to the Chinese company Chinalco as well as assets in South America (an ore mine in Brazil and a potash project in Argentina);
- (b) In the oil and gas industry, oil companies, despite record profits in 2008 (see below) are writing off the value of inventories and assets and slashing costs as they face the biggest downturn in 25 years. British Petroleum (United Kingdom) announced in October 2008 that it will cut 5,000 jobs worldwide in 2009, mainly in developed markets. ConocoPhillips (United States) has set up a cutback plan, including job cuts, to deal with low commodities prices and problems resulting from the crippled credit market. Statoil (Norway) is to cut exploration spending for new sources of oil and gas by about 13 per cent in 2009 as oil prices fall, and will take advantage of the potential cost savings made possible from its merger last year with Norsk Hydro (Norway). Repsol (Spain) plans 1.5 billion Euros in cost savings (10 per cent of its total budget);
- (c) In the steel industry, as a result of a dramatic drop in demand, the German firm Thyssen Krupp is to scale back production, cut 3,000 jobs worldwide and delay the start of its stainless steel production in Alabama. ArcelorMittal (Luxembourg) is reviewing its global expansion programme released in 2007 and will partially close the Gandrange steel factory in France;
- (d) In building materials, Lafarge SA (France), the world's largest cement producer, will scale back international expansion and sell assets to reduce its debt ratio. The company is committed to completing only 60 per cent of previously planned investments in new plants amid a global slump in cement demand. Lafarge also sold its cement

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Box 3. Examples of divestments and postponement of investment projects (continued)

and aggregates units in Italy to local group Sacci. The world's second largest cement maker, Cemex (Mexico) intends to cut costs by \$700 million and will sell assets in Austria, Australia, Hungary and the Canary Islands, among others, to cut debt. Holcim (Switzerland) is about to cut 3,300 jobs and shut plants, mostly in the United States;

- (e) In the chemical industry, the material sciences division of Bayer (Germany), badly hit by the economic slowdown, has opened negotiations with trade unions over possible wage cuts to avoid jobs losses. BASF (Germany) announced early 2009 that it will temporarily shutter 80 plants around the world and curb or stop production at others, with plant closures in New Jersey and the Republic of Korea. Dow Chemical (United States), in financial distress, has cancelled a major investment deal with Kuwait (\$12 billion);
- (f) In pharmaceuticals, AstraZeneca (United Kingdom), with no growth in expected sales revenues in 2009, announced it would cut 15,000 jobs by 2013. GlaxoSmithKline (United Kingdom), confronted, among others, with the growing

competition of generics, is to cut up to 10,000 jobs worldwide. GSK (United Kingdom) is downsizing its operations in the United States and Europe, including a 800-job cut at its French factory in Evreux. Clariant (Switzerland), due to a slump in demand for its products, has announced early 2009 that it would make 1,000 additional layoffs. AkzoNobel (Netherlands) intends to slash 3,500 jobs;

- (g) In automotive and other transport equipment, General Motors (United States), amid its fight for short-term survival, announced major cost-cutting initiatives in the recent months, including the postponement of new vehicle development projects. Renault (France) and Daimler (Germany) announced that they would slash 6,000 and 3,000 jobs respectively. PSA (France) intends to cut 11,000 jobs worldwide in 2009. Saab, a troubled Swedish subsidiary of GM, has cut 750 jobs. Fiat (Italy) does not exclude shutting some of its factories in Italy. Honda (Japan), confronted by slow sales and reduced profit expectations, could additionally slash 4,800 managers' pay in Japan and has laid off thousands of temporary plant

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Box 3. Examples of divestments and postponement of investment projects (continued)

workers to adjust production. Nissan (Japan) could cut up to 20,000 of its workforce. Major equipment automotive equipment manufacturers, such as Faurecia (France), Valeo (France) or Continental (Germany) have cut jobs and shut factories. Johnson Control (United States) alone is to close 19 factories in the world. German equipment maker Leoni has cut 4,000 jobs;

(h) In the aircraft industry, EADS (Netherlands), confronted by a sluggish airplane market and cost overruns in its A380/400 airlifter programme, pulled out in early 2009 from an acquisition in the United States to save cash. The Canadian aircraft maker Bombardier is to cut 1,360 jobs (4.5 per cent of headcount), due to a decrease in demand for business planes;

(i) In electrical and electronics manufacturing, Hewlett-Packard (United States) has announced in early February 2009 that it will freeze wages and axe jobs, including 3,300 in the United Kingdom alone. IBM (United States) is implementing large-scale downsizing programmes in the United States, along with an increased recourse to outsourcing, in order to cut

costs. United Technologies (United States) will cut 8,000 jobs (e.g. 8.5 per cent of its workforce) over the two next years. Panasonic (Japan) intends to cut 15,000 jobs and close 27 factories due to a worsening financial situation. NEC Electronics (Japan) is about to eliminate 20,000 jobs at home and abroad. Philips Electronics (Netherlands) is to further reduce its headcount by 6,000 jobs amid heavy losses in the fourth quarter of 2008. Hitachi (Japan) could exit from unprofitable businesses, close plants and take other restructuring steps, including a 7,000 job cut. Sony (Japan) is to terminate production at its historic Ichinomiya plant in Japan, as part of its response to the dire consequences of the global recession on its sales;

(j) In consumer goods, French cosmetics group L'Oréal, faced with a sales slump, announced in November that it would close two factories in Europe, one in Monaco and one in Wales (United Kingdom). Unilever (Netherlands/United Kingdom), engaged since 2007 in a large-scale restructuring programme, is shutting, among others, two major factories in France. Diageo (United

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Box 3. Examples of divestments and postponement of investment projects (concluded)

Kingdom) has put its plans for a £600 million super-brewery in either Ireland or the United Kingdom on hold amid declining beer sales in the licensed trade in Ireland;

(k) In transport services, the logistics giant Deutsche Post (Germany) is practically putting an end to its United States operations, reducing its workforce there from 18,000 people to less than 4,000. Alitalia (Italy) is to cut 3,000 jobs;

(l) In utilities and telecommunications, Telia Sonera (Sweden) is to cut 1,000–3,000 jobs in Finland. Hutchison Whampoa (Hong Kong, China) has bought back \$5 billion of its debt to reduce interest payments and has announced a very conservative stance in its investment plans in face of the crisis. France Telecom (France), although it still holds large amounts of cash and keeps debt under control, might stick to a low-risk strategy in its new three-year business plan and plans no major acquisitions;

(m) In retailing and other non-financial services, KPMG —

a consultancy — predicts a 100,000 job loss for 2009 in the United Kingdom retailing sector alone. French mail-order retailer La Redoute is to cut 670 jobs. E.ON (Germany) is to cut 450 jobs in its United Kingdom power retail business.

(n) In the financial services industry, Citigroup (United States), in an effort to raise over five billion dollars, has begun the process of divesting its Japanese brokerage unit, Nikko Cordial, as well as its 12 per cent stake in Redecard SA, the Brazilian processor of payments for MasterCard. Several major western financial companies have reduced their stakes in Chinese banks: Bank of America (United States) sold part of its stake in China Construction Bank and the Royal Bank of Scotland (United Kingdom), as part of a larger divestment program, sold its entire stake in Bank of China, ending their strategic partnership. Goldman Sachs Groups (United States) is considering selling part of its 4.9 per cent stake in Industrial and Commercial Bank of China.

Source: UNCTAD, based on reports in newspapers and other media.

III WHAT NEXT? SCENARIOS FOR THE MEDIUM TERM

While the negative impacts of the financial and economic crisis on FDI will presumably remain dominant in 2009, various positive factors are still at work that will trigger, sooner or later, a recovery of international investment flows. The date of this recovery is, however, dependant on many factors that are uncertain. Three different scenarios (V, U and L) are considered to depict these uncertainties, as well as the complex nature of the recovery mechanisms at work. These alternative scenarios are outlined below, following a discussion of the specific features of the current crisis and the various forces at work, and an examination of the short-term prospects for developing countries in particular.

A. The specific features of the crisis

The current financial and economic crisis is different in

nature and magnitude from those of the last 20 years, for at least three reasons: (a) originating in the developed countries, it has rapidly impacted the world economy as a whole due both to its unusual scale and to the existence of large diffusion channels related to globalization; (b) it is not a “usual” business cycle incident, but is of a more profound nature – it reveals structural weaknesses and shortcomings in the regulation of the world financial system, such as a lack of transparency and control mechanisms and the incapacity to prevent behaviours excessively focused on the search for short-term profitability; and (c) it might also reflect changes in economic power between the advanced economies – considerably affected by the crisis, including for inward FDI flows – and emerging and cash-rich developing countries, whose position in the world

economic and financial system is strengthening.³⁶

This situation has potentially two major consequences for FDI in 2009 and onwards. First, it could have a lasting negative effect on the dynamics of FDI flows, due to its forceful impacts on market growth and financial resources. A significant overall decrease in FDI is thus probable in 2009. Second, it creates a situation of widespread uncertainty regarding the future evolution of FDI and notably the timing and conditions of a future pickup of flows.

However, positive driving forces remain at work. There are a number of reasons why TNCs might remain committed to FDI, even in the midst of the crisis.

First, some large emerging economies, such as Brazil, China and India, still remain favourable locations for FDI, particularly market-seeking FDI. They maintained relatively high economic growth rates in 2008 compared with advanced economies. As prospects continue to deteriorate more markedly in developed countries, investors are likely to favour the relatively more profitable options available in the developing world. As a matter of

fact, recent announcements from TNCs show that a number of new projects are still being started or considered in emerging economies (box 4).

Second, financial crises and tough economic periods also offer opportunities to buy assets at “bargain prices” and take advantage of large-scale consolidations in some industries. For aggressive, cash-rich TNCs – or those from cash-rich countries – the acquisition of undervalued assets may boost their investment in both developed and developing countries, depending on the circumstance and opportunities. Dramatic exchange rate fluctuations and share price drops may lead to a round of acquisitions targeting bargain assets in a number of countries and a possible wave of consolidations in certain industries. A number of companies have already taken advantage of such opportunities in, for instance, the oil and gas, metal mining,³⁷ automotive and financial services industries.³⁸ In

³⁶ UNCTAD (2008d).

³⁷ Australia provides an example: the slump in share prices of mining companies in Australia and the sharp depreciation of the Australian dollar have created good acquisition opportunities for resource-hungry investors from developing Asia.

³⁸ Examples include, in mining, the recent purchase by Shell of the natural gas company Enspire Energy (United States).

Box 4. Examples of projects announced recently in emerging and transition economies

- (a) In intermediate goods and energy, Lafarge still has strong cement sales in the Middle East and will open a new cement factory in Saudi Arabia and a ready-mix concrete factory in Abu Dhabi. CRH has recently taken a 26 per cent stake in Chinese cement firm Yatai Cement. Marubeni will build a \$8.6 billion refinery in northeastern Brazil (state of Maranhao) with a daily production capacity of 600,000 barrels. Total is considering developing further in China and will keep on investing despite the financial crisis.
- (b) In the automotive industry, Nissan-Renault might partner with the Hinduja group to develop its activities in India, although it has delayed its ultra-cheap car project. Volkswagen has reiterated its investment plans in China (\$3.1 billion by 2010). Italian automaker Fiat Group and OJSC Sollers signed a letter of intent in November to expand production of Fiat cars in the Russian Federation, where demand remains strong, despite the slowdown in the automobile industry in Europe and the United States.^a
- (c) In pharmaceuticals, Sanofi-Aventis will purchase the Brazilian generic manufacturer Medley, for \$670 million.
- (d) In electronics and other equipment, Siemens has signed a partnership agreement with three Russian companies (Gazprom, Petromed and Rao) regarding the servicing of turbine facilities at heat generating stations.
- (e) In consumer goods and electronics, a new Samsung plant in Penang (Malaysia) could hire as many as 2,000 people. P&G will invest \$50 million in the Slovak city of Uralati to set up a shampoo factory (150 jobs).
- (f) In the agrofood industry, Diageo could expand its activities in India through a partial takeover of United Spirits Ltd. Itochu will boost food-related investments in China, investing 20 billion yen to take a 20 per cent stake in Ting Hsin Group and increase its distribution network in China. PepsiCo announced in early November that it would invest an additional \$1 billion to expand its production in China in the next four years, while at the same time shutting down six factories and laying off 3,300 workers in the United States in order to cut costs. Sab Miller will expand in China through the

/...

Box 4. Examples of projects announced recently in emerging and transition economies (concluded)

acquisition of Hupo brewery in the Northern Shandong province in JV with Chinese companies CR Snow and SRE.

- (g) In infrastructure industries, Telefonica will increase its investments in Brazil by 20 per cent in 2009. Telenor might acquire the Indian mobile operator Unitech Wireless in the coming months.

- (h) In other services and diversified industries, Carrefour will open in May 2009 its first supermarket in Moscow. Hutchison is still examining potential new investments, especially land and property deals in China and Hong Kong (China). Mitsui Sumitomo Insurance Group will strengthen its presence in China and India, mostly through acquisitions.

Source: UNCTAD, based on reports in newspapers and other media.

- a This is part of the shift of production towards emerging economies. For example, in 2008, the total number of car sales in the BRIC countries was expected to exceed that in the United States (Source: "A global love affair: a special report on cars in emerging markets", *The Economist*, 15 November 2008).

this last industry, Japanese financial companies have recently acquired several United States financial companies affected by the financial crisis.³⁹ Financial companies

In chemicals, while BASF will purchase Ciba, Dow Chemicals has already acquired Rohm and Haas. In the automotive industry, large United States auto makers such as General Motors have been saved so far from bankruptcy only by massive bailouts from the United States Government and are still fighting for survival. Fiat might acquire a majority stake in ailing United States car maker Chrysler. Various auto makers are interested in purchasing Volvo from Ford.

³⁹ Examples include the acquisition of Asian and European operations of Lehman Brothers by Nomura Holdings and of a

established abroad by Icelandic firms have also been bought up.⁴⁰ At the regional level, several mega M&A deals (those with an acquisition value of over \$1 billion) have occurred in the United States' manufacturing industries (such as computer equipment, aircraft and

21 per cent stake in Morgan Stanley by Mitsubishi UFJ Financial Group.

⁴⁰ Glitnir AB (a branch of Glitnir in Sweden), and DLG Ltd. and Kaupthing Singer & Friedland Premium Finance Ltd. in the United Kingdom, both of which were owned by Kaupthing Bank, were acquired by HQ AB (Sweden), DM Plc (United Kingdom) and Close Brothers Group Plc (United Kingdom), respectively, in 2008.

pharmaceuticals) since September 2008.⁴¹

Third, companies are still committed to increasing their level of internationalization in the medium term, a finding which constitutes a significant indicator for a future upturn in FDI flows. As shown in the latest WIPS (UNCTAD, forthcoming 2009), large TNCs around the world still seem to be eager to pursue internationalization strategies (and thus increase FDI expenditures in the medium to long term).

Fourth, new sources of FDI have emerged, especially from the South. Emerging economies and countries well endowed with natural resources are becoming a growing source of FDI, either through the internationalization strategies carried out by their TNCs or through the investment activities of their sovereign wealth funds (SWFs). TNCs from the South, in particular, are likely to continue to be active international investors. This will help boost FDI to developing countries, such

⁴¹ Examples of such significant deals include the purchase of IKON Office Solutions Inc, a computer and peripheral equipment and software company, by Ricoh (Japan); of DRS Technologies Inc by the Italian aircraft firm Finmeccanica SpA; and of APP Pharmaceuticals Inc and Sciele Pharma Inc by Fresenius SE (Germany) and Shionogi & Co Ltd (Japan).

as for example Viet Nam (where most FDI is from other developing countries), which is expected to register record FDI levels in 2008.⁴² China's outward FDI will remain oriented upwards, as indicated in late 2008 by Chen Jian, its Vice Minister of Commerce.⁴³

SWFs, most of which are based in developing countries, have been increasingly involved in FDI. Examples abound of investments by SWFs, which have particularly targeted financial services in developed countries since 2007.⁴⁴ Cross-border M&As by these funds reached \$15 billion in 2008, which

⁴² The three largest investment cases in Viet Nam in 2008 are in steel (two projects) and in an oil refinery (one project). Companies from Malaysia, Taiwan Province of China and Kuwait are involved, respectively, in these cases. In addition, in November 2008, Formosa Plastics (Taiwan Province of China) announced its intention to invest up to \$15 billion in a large-scale petrochemical complex in central Viet Nam.

⁴³ "Commerce Ministry: foreign investment strategy unchanged", *China Daily*, 21 October 2008.

⁴⁴ For instance, CIC invested in Morgan Stanley (United States); Abu Dhabi Investment Authority acquired a stake in Citigroup (United States); KIC (Republic of Korea) – together with the Kuwait Investment Authority – bought a stake in Merrill Lynch (United States); and GIC (Singapore) fund purchased a stake in UBS (Switzerland). Temasek Holdings (Pte) Ltd (Singapore) also bought a stake in Merrill Lynch; and Dubai International Financial Centre purchased OMS (Sweden).

was already 50 per cent larger than the amount registered in 2007. Significant M&A deals in non-financial industries have also taken place recently, as illustrated by the acquisition of Labroy Marine Ltd. of Singapore, a shipbuilding company, by Dubai Drydocks World LLC, or by the acquisition by the Abu-Dhabi SWF Aabar of a 9.1 per cent share in the capital of Daimler.⁴⁵

In the short term, the investment capability of these funds might be hampered by the impact of the financial crisis: according to some estimates the total value of assets of SWFs could have fallen by 25–30 per cent in 2008.⁴⁶ But, given the sheer size of assets under their management (expected to reach about \$10 trillion by 2015⁴⁷), the long-term FDI potential of SWFs is high (UNCTAD, 2008b).

Fifth, many fast-growing niches in different industries are presently characterized, even in

the midst of the present crisis, by promising medium-term FDI prospects. Among these, one could mention the following examples, sorted by type of industry (UNCTAD, 2008a): (a) in life sciences: equipment and services for medical diagnosis (notably in vitro), clinical tests, biotechnologies, biocosmetics, oncology and bioproduction; (b) in agro-food industries: intermediate food products, special ingredients (colourings, emulsifiers, preservatives), processed seafood, aquaculture products and high value added products (e.g. pastries, pre-cooked food, health food); (c) in transport equipment: automotive and aerospace electronics, hybrid motors, automotive logistics and innovative materials; (d) in business services: customer service centres, providers of outsourced logistics and business services, regional headquarters, research and development centres, technical engineering and financial services; (e) in personal services: retail, care of senior citizens, health care (e.g. medical care at home and remote diagnosis); (f) in information and communication technologies: micro and nano electronics, software for video games, interactive and virtual image technologies, Internet technologies

⁴⁵ Aabar will thus become the first shareholder of Daimler, overtaking Kuwait in that respect.

⁴⁶ *Source*: “Sovereign Wealth Funds lose their gloss”, *Financial Times*, 28 February 2009.

⁴⁷ *Source*: Deutsche Bank Research, “SWFs and foreign investment policies - an update”, 22 October 2008.

and embedded technologies for wireless telecommunication systems; (g) in energy, chemistry and environmental conservation: nanomaterials, improvements in existing materials, photovoltaic energy, wind power, water processing, recycling of wastes and non-food use of agricultural products (e.g. biofuels, biopolymers, biosolvents, biomaterials); (h) in other industries: technical textiles (e.g. textiles with particular qualities in terms of robustness, suppleness or adaptability) and robotics.

Whether these positive factors will offset the impact of the financial constraints facing firms and the reduced demand and slower economic growth in many parts of the world remains an open question. Different answers can be considered depending on the time horizon. The key factors at work in the short to medium term are summarized in table 6.

B. Short-term prospects for developing countries

In the short term (2009), various factors (such as the severity of the crisis, the fact that it is affecting a significant number of large TNCs in the United States and Europe and that both the

financial and non-financial sectors have been seriously disrupted), lead to the expectation that the offsetting factors will have much less impact than the downward forces. Companies are more likely to undertake divestments than to seize investment opportunities during this initial phase of the downturn.⁴⁸ This is why a further decline in global FDI in 2009 can be expected.

It is very likely in particular that FDI flows to developing countries – which have exhibited resilience in 2008 – will slow down more markedly in 2009 than has been observed to date. Despite still positive GDP growth rates in many developing countries, various factors might exert a downward influence on FDI inflows to the developing world. Certain categories of developing countries may be particularly vulnerable. For instance, those with open but fragile financial systems, faced with rising financial and macroeconomic instability,⁴⁹ may see a sharp decline in FDI flows due to a perceived high level of risk. In others, a fall

⁴⁸ See Baghai M et al. (2008).

⁴⁹ As noted, that has been the case in recent months for instance for a number of Asian countries, including Pakistan, the Republic of Korea and Turkey.

Table 6. Summary of the possible implications of the crisis for FDI in the short-to-medium term

Variable affected by the crisis	Present evolution	Impact on FDI flows in 2009	Uncertainties in the medium term
Availability of financial resources	Intensive credit squeeze (less availability and higher costs). Decreased company profits Necessity to repatriate capital to compensate for losses	Growing financial constraints on investments, although some companies and institutions still have large amounts of cash	Speed of the recovery in the financial sector and end of the credit squeeze. Capacity of new types of investors (companies from emerging countries, SWFs), to act as a major engine of FDI growth
Asset prices	Large decrease in the value of stocks	Reduced M&A activity including leveraged buy-outs. At the same time, some M&A operations are encouraged by companies well-endowed with cash, but at a lower value by definition	Recovery patterns of the stock-exchange market (with an impact on the value of international M&As)
Market growth	Slowed world economic growth at least until 2009	Reduced incentives for market-oriented FDI, especially in developed countries	Time schedule and geographic patterns of the economic recovery
Degree of uncertainty	Very negative evolution of all available business confidence indices	Companies to restrain further investment plans and cut extensively in existing costs and assets, especially in hardly-hit advanced countries	A progressive return of confidence is a prerequisite for a new pick-up in investment
Public policies	Monetary and fiscal stimulus policies are being carried out in various countries in the world. The reform to the financial system has not yet begun: No specific impact of the crisis on FDI policies, but existence of some neo protectionist tensions	No immediate direct impact so far	Capacity of public policies to ensure stability of the financial system, to renew commitment to an open attitude to FDI, to encourage investment and innovation, and to foster confidence of economic actors
Sector-specific crisis and restructuring	The financial sector, automotive, construction and intermediate goods have been especially hit, but the crisis rapidly extends to other industries and services	Divestments, sales of assets and M&As for restructuring in the most hard-hit industries	Speed and scope of the restructurings and shifts in market power triggered by the crisis (increased role of companies from emerging and developing countries?)
Location patterns of FDI	Market-seeking FDI projects in developed countries are the most affected due to the looming recession there	Export-oriented FDI projects in developing and emerging economies (both efficiency- and resource-seeking) could be increasingly affected due to the low dynamism of advanced country markets	Rising attractiveness of the south for both market oriented and efficiency-seeking FDI?
New sources of FDI	Growing role of SWFs and companies from emerging countries (but financial resources somewhat squeezed in the short term)	Growing share of the emerging and developing countries in FDI outflows	Will FDI from the newer sources compensate for the decline in FDI from advanced countries?

Source: UNCTAD.

in exports,⁵⁰ – reflecting depressed demand in major developed markets – is likely to affect TNCs’ interest in export-oriented investment projects (either in manufacturing or mining).⁵¹ FDI inflows may also lose momentum in developing countries highly dependent on commodities such as minerals, oil and gas. Finally, least developed countries (LDCs) – that are faced with unprecedented challenges from the possible dry-up of financial flows from both official and private sources and stiffer competition among countries for attracting FDI flows – risk being further marginalized in global FDI.

⁵⁰ According to the latest IMF projections (IMF, 2009), exports of goods and services by developing and transition countries should decline by 6 per cent in 2009.

⁵¹ The case of the garment industry provides a vivid example of the consequences of the crisis on developing countries. With world retailing down by 15 per cent from February 2008 to February 2009, the global recession badly hit garments suppliers and exporters in developing countries. For instance, garments exports from Mauritius to the United States dropped by 19 per cent, to reach the lowest volume in more than two decades. Garments export from China fell 33 per cent, reaching the lowest volume in four years. Garment export volume from Bangladesh declined 17 per cent, while export value declined by 23 per cent, reducing the profitability of many factories (information from Gherzi Textile Organization, March 2009).

FDI will nevertheless remain a major external source of financing for developing countries in 2009. As a matter of fact, it is the only component of private financing flows to developing countries that has not declined in 2008. Despite an anticipated slowdown in 2009, FDI inflows to developing countries should also remain at a relatively high level that year.⁵² In contrast, net flows of portfolio capital and other private capital flows (bank loans) to developing countries, already in sharp decline in 2008, are all expected to be negative in 2009 (IMF, 2008). FDI inflows, which already accounted for half of all net capital flows to developing countries in 2007, might therefore be the only private capital flows that will make positive contributions to the financing needs of developing countries in 2009.

C. Medium-term scenarios

In the medium term (2010–2012), there are three scenarios for a pickup in FDI. Prospects on how the balance between negative and positive factors for FDI will evolve are very open for 2010 onward, due to the variety of

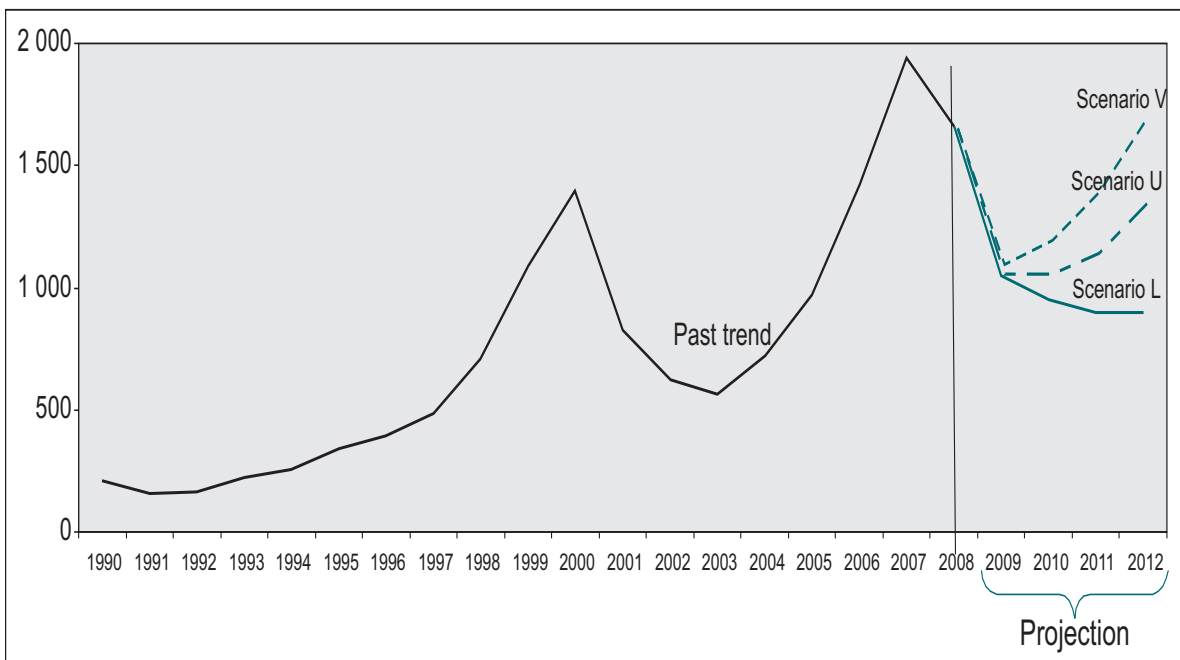
⁵² According to IMF forecasts, the value of net FDI flows (FDI inflows less FDI outflows) to developing countries should exceed \$400 billion in 2009 (IMF, 2008).

uncertainties and their complex potential interactions. As shown in table 6, these uncertainties relate to a wide range of factors, such as the severity or duration of the slowdown in global growth, the efficiency of global policy responses to the crisis (especially of initiatives aimed at stimulating investment), the stabilization and recovery of the financial system and the capacities of emerging countries' TNCs to become a major

engine of FDI growth. One of the key uncertainties is when the cross-border M&A flows will pick up again, as they are one of the major components of FDI flows.

To give a structured vision of these uncertainties, three different scenarios could be considered for the evolution of FDI up to 2012 (figure 8). The underlying hypotheses of these scenarios are as follows.

Figure 8. Worldwide FDI inflows with three different trajectories, 1990-2012
(Billions of dollars)



Source: UNCTAD, based on FDI/TNC database (www.unctad.org/fdi statistics) and UNCTAD own estimates.

Note: The shapes of V, U and L scenarios are based on different assumptions regarding recovery for illustrative purposes only and not based on any statistical analysis.

V scenario (optimistic): Quick upturn in FDI flows, beginning end 2009. The underlying assumptions are: (a) end of the recession as early as the second half of 2009; (b) quick return of investors' confidence due, among other reasons, to effective government policies; (c) no protectionist setback; (d) fresh wave of cross-border M&As due to industry restructurings and availability of cash in some companies and financial institutions. Because it is based on a combination of very optimistic assumptions, this scenario seems rather unlikely as seen from today.

U scenario (base case). FDI flows begin to pick up only in 2011. The major underlying assumptions are: (a) the global recession is worse than in the V scenario, lasting at least until the first semester of 2010; (b) the global value of cross-border M&As remains limited due to the low price of stocks; (c) the trend towards the internationalization of companies is still at work in the medium term. Responses to the WIPS 2009–2011 survey show

that business executives around the world presently consider this scenario as the most probable one, as most of the companies anticipate only a progressive restart of their international investment programmes after the low point of 2009 (UNCTAD, forthcoming 2009).

L scenario (pessimistic). FDI flows do not pick up before 2012. The underlying assumptions are: (a) a longer and worse-than-expected economic recession results, among others, in protectionist tensions affecting the overall trend in globalization; (b) due to the accumulation of negative factors, companies remain extremely cautious about investments, especially those aimed at financing their international operations.

Appropriate policy responses are required to limit the probability of this pessimistic scenario and favour a quicker recovery in FDI flows. The policy implications of the ongoing economic crisis with regard to international investment will be examined in the following section.

IV POLICY IMPLICATIONS

The effectiveness of government policy responses at both the national and international levels in addressing the financial crisis and its economic aftermath will play a crucial role in creating favourable conditions for a new pickup in FDI. The challenge is to restore the credibility and stability of the international financial system, to provide stimulus to economic growth in order to prevent the risk of a spiraling depression, to renew a pragmatic commitment to an open economy and to encourage investment and innovation. So far, and contrary to the situation in trade, the crisis has not resulted in clear signs of investment protectionism.

In this section, policy measures at the national and international levels in response to the crisis and their potential impact on global FDI are discussed. The section also considers specific policy implications for developing countries.

A. General policy measures in response to the crisis: potential effects on FDI

In the years before the crisis erupted, a trend towards less favourable attitudes vis-à-vis FDI could be observed. Although remaining at a low level, the percentage of restrictive regulatory changes as compared to more liberalizing measures has significantly increased since 2003 – with considerable differences between regions.³⁶ Whereas in 2003, 10 per cent of all FDI-related regulatory changes were less favourable for foreign investors, their share increased to approximately 25 per cent in 2007 (UNCTAD, 2008b: 13). New restrictions were introduced in particular in the extractive industries and with regard to acquisitions by SWFs.

³⁶ In Latin America, for instance, as much as 60 per cent of policy measures taken in 2007 were less favourable to FDI (UNCTAD, 2008b).

Up to now, the crisis had no major impact on FDI policies per se, since FDI is not at the root of the crisis. Although numerous countries have adopted FDI-related legislation since the beginning of the crisis, it is difficult to say as to

what extent, if any, these measures were taken in response to the crisis. Also, while some new legislation is likely to have a positive effect on FDI flows, other regulations might produce the opposite result (table 7).

Table 7. Some examples of recent policy measures directly impacting FDI introduced after September 2008^a

Country	Measure	Relevant features
Algeria	A fiscal measure introduced in the 2009 budget, January 2009.	A 15% tax will be levied on profits transferred abroad by foreign companies operating in Algeria,
Canada	Amendments to the investment Canada act and Canada Transportation Act, February 2009	Some obstacles to FDI are relieved and the transparency of government decision is increased. Introduction of national security test on investments by non-Canadians in new or existing Canadian businesses.
Canada	Amendments to the investment Canada act and Canada Transportation Act, February 2009	Limits of foreign ownership in Canadian Airlines are raised from 25% to 49%.
Columbia	Introduction of new capital-control measures (Sept. 2008)	Affects short-term capital flows.
India	Changes in FDI regulation, December 2008	Larger share of foreign ownership in many activities such as industrial parks, mining and petroleum, air transport.
India	Changes in FDI regulation, February 2009	Facilitate application of caps on foreign ownership in strategic sector (defence, aviation, telecommunications)
Japan	Existing export insurance schemes for Japanese affiliates operating in developing countries have been extended to affiliates in developed countries.	Facilitates activities and trade of Japanese affiliates abroad.
Japan	Granting of business loans by Japan Bank for International Cooperation (JBIC) to Japanese companies and their affiliates which operate in developed countries (March 2009), extension of loans that had been limited to those in developing countries.	Facilitates activities and trade of Japanese affiliates abroad.

Source: UNCTAD.

^a This list of examples is in no way exhaustive.

Some national policy measures of a more general scope (e.g. state aids for individual economic sectors, stricter regulation of the financial sector, as well as nationalizations, fiscal stimulus and public investment programmes) introduced in response to the crisis are likely to impact FDI in an indirect manner. Moreover, the crisis has had an important psychological effect inasmuch as it has triggered wide public support for a stronger role of the state in the economy, and this wish for more state involvement may continue beyond the actual crisis, with longer-term effects on FDI policies in the future.

1. National bailout programmes and rescue packages

Many developed countries, such as the Benelux countries, France, Germany, Italy, Switzerland the United Kingdom and the United States have adopted large-scale bailout plans and rescue packages, especially for the financial or automotive sector. These programmes may have both positive and negative effects on global inward and outward FDI flows.

Regarding inward flows, providing state guarantees could

have a “crowding-in” effect on FDI, as the companies benefiting from them might be considered as “safe” investments by foreign investors. Moreover, some countries have even encouraged the participation of foreign investors in individual rescue deals.³⁷

On the other hand, several rescue packages have included the partial or total nationalization of domestic financial institutions. For example, various countries – such as Belgium, Germany, Iceland, Luxembourg, Netherlands, the United Kingdom and the United States – have acquired shares in domestic banks or insurance companies. As long as state ownership continues, opportunities for private investment, including FDI, will be reduced. Also, some new operational conditions imposed on financial institutions in exchange for state assistance – such as restrictions on the payments of dividends – are likely to reduce the attractiveness of such companies to investors. In addition, public interventions in the non-financial sector may have the consequence of preventing the purchase of an ailing domestic company by a foreign interest.

³⁷ For instance, Belgium has been negotiating with the French BNP Paribas concerning the takeover of the Belgian bank Fortis.

Fears have also been expressed that government actions could result in investment protectionism by favouring domestic over foreign investors or by establishing obstacles for outward investment in order to keep the capital at home. To some extent, international investment agreements (IIAs) – in particular the non-discrimination principle and the minimum standard of treatment (fair and equitable treatment) – can be a “firewall” against protectionist tendencies, but much depends on the scope of the agreement, in particular whether it covers the pre-establishment phase and whether the measure is directed against inward or outward investment.³⁸ The crisis also raises questions about the meaning and content of national security exceptions in IIAs and under what conditions they can be invoked in an economic crisis.³⁹

A related question arising in this context is whether some of the regulatory measures could lead to investor-state litigation on grounds that these measures might result in damages to existing investments.

Once the global economy is on its way to recovery, the exit

³⁸ IIAs usually do not protect the freedom of outward investment.

³⁹ For more on this issue, see for instance UNCTAD (2008e).

of public funds from flagship industries will invite a boom of private investment, including FDI. However, for foreign investors to benefit from these opportunities it is important that they receive non-discriminatory treatment. IIAs – particularly those covering pre-establishment rights – could be an important policy instrument to ensure this.

Regarding outward FDI, a combination of political considerations and economic needs may induce governments to concentrate business operations of partially or fully nationalized enterprises on the domestic market and to reduce the taxpayers’ exposure by scaling down existing or limiting further overseas investment. For instance, lending conditions could extend to those cases where a domestic bank intends to use fresh capital received from the state for foreign acquisitions.⁴⁰ In addition, a new state enterprise wishing to maintain its foreign affiliates might be confronted with unexpected political obstacles in the host country – such as national security concerns – that might not

⁴⁰ For instance, concerns have been expressed that state money would enable BNP Paribas to finance its proposed acquisition of the Belgian subsidiaries of Fortis. See *The Economist*, 7 February 2009, p. 70.

have existed in the case of a non-publicly owned foreign investor.⁴¹

State interventions may also have a negative impact on outward FDI in non-financial industries. For instance, there is a risk that subsidies in the automobile industry result in less foreign investment or disinvestment abroad.⁴² The French support plan for the domestic car makers Renault and PSA, for example, initially foresaw that these producers do not locate production abroad, if such production aims at re-importing cars to the domestic market. The French Government later agreed with the EU Commission to withdraw this element of the plan. The German Government is currently considering financial help for the domestic car maker Opel – a GM affiliate – and the issue of whether state aid would be used at home was raised in this context.

⁴¹ An example is Citigroup's Mexican affiliate Banamex. The acquisition by the United States Government of a 36 per cent share in Citigroup has provoked a debate on whether Citigroup has to sell Banamex because Mexican law prohibits the control of domestic financial institutions by foreign governments. See *Neue Zürcher Zeitung*, 6 March 2009, p. 22.

⁴² Among the countries that support their car industry are Argentina, Australia, Brazil, Canada, China, France, Germany, Italy, Sweden, the United Kingdom and the United States.

However, it needs to be stressed that scaling down foreign investment, including through divestment abroad, is often a corporate necessity to avoid bankruptcy, in the context of a crisis. Much depends on whether the trend towards more state ownership and control remains temporary “fire fighting” or results in more permanent structural changes with long-term implications for global FDI flows.

2. Fiscal stimulus and public infrastructure programmes

A number of countries have adopted economic stimulus packages that might have some positive impact on global FDI flows. For example, the United Kingdom announced a value added tax cut, and Germany launched a financial package to help small and medium-sized enterprises (SMEs) in difficulty to access credit. Also, the French Government announced measures to make credit more easily available to SMEs. The United States Federal Reserve Board has cut interests rates to a level close to zero. More recently, Japan lowered the corporate tax rate for SMEs. For large Japanese TNCs, it decided to allow loans by the Japan Bank for International Cooperation to them and their foreign affiliates

that operate in developed countries, an extension of loans that had been previously limited to those operating in developing countries.⁴³ Many countries – such as France, Germany, Spain and the United States – have also announced large public investment programmes mainly aimed at infrastructure development. These programmes may likewise have a positive effect on inward foreign investment provided that they are designed in a non-discriminatory manner and open to participation by foreign investors.

Economic stimulus programmes have also been set up by numerous developing countries. Facing the negative impact of the global financial crisis, for example, the Chinese Government announced in November 2008 a RMB 4 trillion (about \$600 billion) public investment plan to boost economic growth, which will run until the end of 2010. By enhancing growth prospects and increasing investor confidence, the plan may contribute to attracting or maintaining FDI inflows to China. Though on a much smaller scale, the following countries have adopted similar packages – India (200 billion rupees or \$4 billion), Malaysia (7 billion ringgits or \$2

billion), Philippines (300 billion pesos or \$6.3 billion), the Republic of Korea (35 trillion won or \$32 billion), Thailand (300 billion Baht, or \$8.6 billion) and Viet Nam (up to \$6 billion). Regarding fiscal stimulus, corporate tax rates have been lowered, for instance, in the Philippines (from 35 per cent to 30 per cent) and the Republic of Korea (from 13–25 per cent to 10–20 per cent). Special measures are also provided for SMEs in such countries as Singapore and Viet Nam.

3. *International policy actions*

At the international level, various initiatives have been taken. At the Group of Twenty (G-20) Summit on Financial Markets and the World Economy, held on 14 November 2008 in Washington D.C., leaders renewed a political commitment to an open global economy, stating in their declaration that “...within the next 12 months, we will refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports...”⁴⁴ This commitment

⁴³ *Nikkei*, 24 December 2008.

⁴⁴ Paragraph 13 of the Declaration of Summit on Financial Markets and the World Economy.

was reaffirmed at the G-20 Summit in London, held on 2 April 2009, where leaders further committed to “...minimize any negative impact on trade and investment of our domestic policy actions including fiscal policy and action in support of the financial sector”.⁴⁵ They additionally pledged, “We will not retreat into financial protectionism, particularly measures that constrain worldwide capital flows, especially to developing countries”.⁴⁶ In total, the G-20 leaders committed to a \$1.1 trillion programme that seeks to restore credit, growth and jobs throughout the world. More recently, the OECD has urged governments “to preserve and expand an open environment for international investment” (OECD, 2009).

With regard to its impact on FDI, the London Summit statement — like that of the previous G-20 statement from Washington D.C. — alone is unlikely to stimulate further FDI. However, it would already be a major accomplishment if it succeeded in inhibiting a slide into financial and economic protectionism by countries around the world. Perhaps a more tangible impact of the statement, and

subsequent actions, will come in the form of the pledged availability of at least \$250 billion over the next two years to support trade finance. As TNCs are highly involved in world trade, any actions to restore trade growth would benefit them and, in turn, their investment plans.

B. Policy implications for developing countries

The above considerations concerning the potential impact of government responses to the financial crisis on global FDI apply to investment flows irrespective of whether their origin or destination is a developed or developing country. However, there are some issues that are particularly relevant for developing countries, both as recipients and sources of foreign investment. The challenges derive from two intertwined developments: first, the decline of investment flows due the worsening economic environment and second, government policies in response to the crisis that might have a negative impact on investment flows to developing countries. At the same time, the crisis and the new policy setting also offer some opportunities for developing countries.

⁴⁵ Paragraph 22 of the Leader’s Statement, London Summit of the Group of Twenty, 2 April 2009.

⁴⁶ Ibid.

1. Inward FDI in developing countries

One major challenge for developing countries is to remain attractive for FDI in the crisis, especially for such investment that serves their long-term development goals and enhances competitiveness (e.g. investment in areas such as infrastructure, agriculture, sustainable energy and technology). Public investment programmes adopted by several developing countries, as noted above, can have a positive effect on inward foreign investment. However, huge economic stimulus packages may not be an option for many developing countries, in particular LDCs. Bilateral and regional investment agreements, including those that aim for broader economic partnership between the contracting parties, can help encourage foreign investment (UNCTAD, 2009). FDI and development enhancing effects are more likely to result from such agreements when they contain effective and operational provisions on investment promotion⁴⁷ and

⁴⁷ For the time being, IIAs do not contain commitments by capital exporting countries other than vague language relating to investment promotion and do not give any protection to developing countries against policies restricting outward FDI.

when they take into account the need of developing countries for policy space. Investment insurance and other home country measures encouraging outward FDI are cases in point.

Retaining existing investment is also important, especially since TNCs in financial difficulty may consider closing foreign affiliates or transferring them to cheaper locations. To avoid such divestment, developing countries need to consider to what extent they can accommodate TNCs' cost-saving strategies. As indicated above, a number of developing countries have included tax relief in their economic stimulus packages. However, national efforts to maintain and attract foreign investment must not result in "race to the bottom" policies, under which developing countries lower social and environmental standards or offer unsustainable financial or fiscal advantages. International coordination, in particular in a regional context, can help to prevent such an outcome.

The crisis also has severe implications for the work of investment promotion agencies (IPAs) and calls for a reassessment of their activities. Although each geographical area is affected differently, there are remedies that

should be considered by each IPA in reviewing its operations in this new environment.

First, IPAs should look at their existing investor community and take measures when possible to reduce the impact of the crisis. Effective aftercare services should soften the blow of the economic slowdown and help these companies adjust to the new realities. Second, not all industries are equally affected by the crisis, so IPAs in their investment promotion efforts should carefully target investors based on sector prospects and investment motives. Third, IPAs should further strengthen their role in the improvement of the business climate through policy advocacy. These efforts should address short-term problems that investors are facing due to the crisis, such as liquidity constraints, slow market growth and declining exports, but also longer-term goals to strengthen the competitiveness of locations. And fourth, IPAs should increase efficiency by directing resources to areas where they make the most difference, by upgrading staff skills and by regular evaluations of the effects of their operations.

In times of crisis and increased strains on public funds, governments will closely review the

usefulness of public programmes and institutions, including IPAs. In developing countries, especially the most vulnerable, agencies may face more difficulties in securing public funding, including for measures aimed at dealing with the new challenges. These measures could include new priorities in investment promotion with a stronger focus on investor aftercare and policy advocacy, accelerating a trend that could already be observed in IPAs before the crisis.

2. Outward investment from developing countries

Since most developing countries are recipients rather than sources of foreign investment, they must be primarily concerned by the effects of the financial crisis on investment inflows. However, some developing countries, in particular the more rapidly emerging economies, also need to consider the impact of the crisis and the evolving policy environment on their outward investment flows, which have become an increasingly important part of their development strategies.

While more state intervention may – as said above – reduce investment opportunities to some extent, rising global demand

for fresh capital also offers new investment prospects for enterprises in developing countries that have enough financial resources to invest abroad. In particular, divestment strategies of companies in financial difficulties could offer an opportunity for companies from developing countries to purchase these foreign subsidiaries at an attractive price and to acquire technology, brands and other assets.⁴⁸

In a few cases, state support has directly benefited TNCs from developing countries, for instance the United Kingdom's financial aid programme for its car industry, which – inter alia – aims to rescue Jaguar Land Rover, a company bought by India's Tata Motors Group in 2008. Sometimes, the participation of SWFs from developing countries has been

⁴⁸ For instance, it has been reported that two Chinese car makers, Chery and Geely, are interested in buying Volvo from Ford. Mahindra & Mahindra, an Indian producer of utility vehicles, is in the running to buy LDV, an ailing British truck maker. Vale, Brazil's mining giant, recently picked up a clutch of assets from Rio Tinto, its debt-laden Anglo-Australian rival; see *The Economist*, 28 March 2009, p. 18.

actively sought.⁴⁹ However, SWFs have also become more risk averse.

If the crisis worsens, it might also trigger a general reassessment of some developed countries' policies vis-à-vis SWFs and the national security concerns that increasingly have been raised against individual foreign investors.⁵⁰ Rather than seeing investments by SWFs as a potential problem, governments may regard their overseas activities as part of the solution. Also, the adoption of the Santiago Principles in October 2008 to enhance the transparency of such funds might contribute to a softening of the restrictive tendencies that their rapid international expansion provoked.⁵¹

⁴⁹ For instance, the Swiss UBS attracted capital from the Government of Singapore Investment Corporation in December 2007.

⁵⁰ For example, the Committee on Foreign Investment of the United States (CFIUS) investigated 22 national security-related investment cases in 2008 as compared to only 7 in 2007.

⁵¹ See the Generally Accepted Principles and Practices (GAPP) of the International Working Group on Sovereign Wealth Funds, at <http://www.iwg-swf.org/pubs/gapplist.htm>.

CONCLUSION

The global financial crisis poses new challenges for the foreign investment policies of developing countries. The degree to which this is the case varies between individual countries and regional groupings. There is a fear of investment protectionism and of the potentially negative indirect impact of bailout and rescue packages on FDI flows. Among the main risks is that investment policies of governments become more inward-oriented with negative consequences for outward investment and an open investment environment.

One major concern of developing countries is how to retain existing investment and attract new FDI in times of global recession. Economic stimulus programmes can be an incentive for foreign investment, but many developing countries do not have the financial resources to successfully compete with the investment promotion packages of developed countries. Moreover, incentives-based competition for foreign

investment may risk lowering social and environmental standards which would be detrimental for sustainable development.

The crisis, however, also provides a chance to develop and implement policies aimed at enhancing the stability of the financial system and stimulating economic growth. Various voices advocate the necessity of going beyond the mere short-term management of the ongoing crisis and of setting up the bases of sounder economic regulations, especially in banking, with more control and restriction on the activities of commercial banks, hedge funds and other financial institutions (UNCTAD, 2008c; Stiglitz JE, 2008). This requires coordinated action at the international level to rebuild financial multilateralism, foster the stability and equity of the global financial system, promote stronger transparency or disclosure standards and create guarantee funds to help emerging and developing countries secure the debt of their corporations and

reassert the importance of public policies and regulations.

The current institutional reform of the global financial system suggests that governments should pay more attention to the interaction and coherence between the global financial system and international investment agreements, since the latter cover both long-term and short-term capital movements.

Apart from the much needed international regulation of the financial markets, economic stimulus packages should be built around common principles that embrace open markets and avoid “beggar thy neighbour” policies. It is important that developing countries are actively engaged in ongoing discussions on these issues.

On the positive side, the financial crisis may also trigger renewed efforts of developing countries to improve their investment climate. More important than “quick fix” solutions are structural and institutional reforms that enhance the long-term competitiveness of host countries. Investment promotion agencies could play a key role in fostering aftercare policies aimed at retaining existing activities by TNCs and in implementing targeted investment promotion programmes in promising activities.

In sum, for effectively dealing with the crisis and the period of major uncertainty it has opened, it is important that policymakers maintain a favourable business and investment climate and refrain from protectionist tendencies.

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Annex table. FDI inflows and cross-border M&As, by region and major economy, 2007-2008

Region/economy	(Billions of dollars)					
	FDI inflows			Cross-border M&As		
	2007	2008 ^a	Growth rate (%)	2007	2008 ^a	Growth rate (%)
World	1 940.9	1 658.5	- 14.5	1 699.8	1 205.4	- 29.1
Developed economies	1 341.8	1 001.8	- 25.3	1 504.1	998.3	- 33.6
Europe	920.9	559.0	- 39.3	859.4	561.4	- 34.7
European Union	864.0	544.9	- 36.9	811.6	518.2	- 36.2
Austria	29.7	12.4	- 58.2	10.4	3.0	- 71.2
Belgium	70.0	94.2	34.6	5.9	28.3	380.5
Czech Republic	10.6	10.9	2.6	0.3	5.2	1 887.9
Denmark	11.8	10.9	- 7.8	12.0	6.4	- 46.6
Finland	12.4	- 4.2	- 134.0	12.0	4.3	- 64.0
France	158.0	126.1	- 20.2	62.9	37.9	- 39.8
Germany	56.4	24.9	- 55.8	100.8	51.8	- 48.7
Hungary	6.1	6.6	7.7	0.7	1.6	122.1
Ireland	30.6	- 12.3	- 140.2	5.8	4.2	- 27.7
Italy	40.2	13.3	- 66.9	33.8	26.5	- 21.6
Netherlands	118.4	- 3.5	- 103.0	211.0	25.5	- 87.9
Poland	23.0	16.5	- 28.0	1.5	1.3	- 17.9
Romania	9.9	13.3	34.1	1.9	1.1	- 44.0
Spain	68.8	65.5	- 4.8	67.2	73.7	9.7
Sweden	22.1	40.4	83.1	14.5	25.4	74.6
United Kingdom	196.4	96.8	- 50.7	246.2	206.9	- 16.0
United States	232.8	320.9	37.8	389.2	318.2	- 18.2
Japan	22.5	19.0	- 15.6	24.6	19.5	- 20.6
Developing economies	512.2	549.1	7.2	161.6	182.1	12.7
<i>Africa</i>	53.5	72.0	34.7	12.5	27.0	116.5
Egypt	11.6	9.5	- 18.0	2.6	15.9	517.8
Morocco	2.6	2.0	- 20.5	0.3	0.1	- 64.7
South Africa	5.7	9.0	58.0	7.4	8.9	20.2
<i>Latin America and the Caribbean</i>	127.3	139.3	9.4	31.1	32.8	5.5
Argentina	5.7	7.3	27.9	1.4	0.8	- 46.5
Brazil	34.6	45.1	30.3	8.7	12.9	47.9
Chile	12.6	16.8	33.5	2.7	3.3	24.8
Colombia	9.0	10.6	16.7	4.3	0.6	- 85.7
Mexico	27.2	18.6	- 31.6	4.3	3.7	- 15.2
Peru	5.4	4.1	- 24.8	1.2	0.4	- 64.0
<i>Asia and Oceania</i>	331.4	337.8	1.9	118.1	122.3	3.6
West Asia	71.5	61.4	- 14.2	33.8	31.6	- 6.6
Turkey	22.0	18.0	- 18.4	17.4	12.0	- 31.3
South, East and South-East Asia	258.7	275.2	6.4	84.0	90.4	7.6
China	83.5	92.4	10.6	16.2	21.0	29.2
Hong Kong, China	59.9	63.0	5.2	27.3	18.3	- 33.0
India	25.1	46.5	85.1	5.8	11.2	93.5
Indonesia	6.9	8.3	20.4	2.7	2.7	- 0.3
Malaysia	8.5	8.0	- 5.6	5.1	5.5	7.8
Singapore	31.6	22.7	- 28.0	9.2	17.0	84.8
Thailand	11.2	10.1	- 10.2	2.9	0.7	- 76.8
South-East Europe and the CIS (Transition economies)	86.9	107.6	23.8	34.1	24.9	- 27.0
Russian Federation	52.5	70.3	34.0	24.9	17.7	- 28.9
Ukraine	9.9	10.7	8.1	1.8	6.0	227.0

Source: UNCTAD.

^a Preliminary estimates. Final figures will be in the *World Investment Report 2009*.

Note: World FDI inflows in 2008 are projected on the basis of data for 103 economies for which data were available for either all or part of 2008 as of 6 April 2009. Data for which only part of 2008 are available are estimated by annualizing the data. The proportion of inflows to these economies in total inflows to their respective region or subregion in 2007 is used to extrapolate the 2008 data. For cross-border M&As, estimates were made on the basis of data available as of 5 January 2009.

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