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PART ONE
TRENDS IN INTERNATIONAL PRODUCTION

Chapter III
Regional Trends

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CHAPTER III

REGIONAL TRENDS

Nearly all regions of the world shared in the global decline in FDI in 2001. By far the largest fall in flows took place in the developed world. Inward FDI flows to a number of developed countries plunged as TNCs responded to the economic recession, and as cross-border M&As decreased substantially in number and value. Outward FDI from developed countries plunged as well. FDI flows to and from developing countries declined much less, and the picture there was more varied. Flows to Africa and to the economies in transition of Central and Eastern Europe (CEE) increased, while flows to the least developed countries (LDCs) remained steady. This chapter takes a closer look at trends in FDI by region.

A. Developed countries

After reaching a peak in 2000, FDI flows to and from developed countries fell sharply in 2001. Outflows declined by 55 per cent in 2001, to $621 billion, while inflows more than halved, to $735 billion (annex tables B.1 and B.2). Twenty-three out of 26 developed countries experienced a decline in FDI inflows, as TNCs curtailed their cross-border M&As significantly against the background of the economic slowdown in major industrialized economies and the consolidation of industries that had taken place during the 1990s. FDI outflows also declined, and are expected to remain low in 2002.

1. United States

Despite the economic slowdown and the events of September 11, the United States retained its position as the largest FDI recipient and regained that of the world's largest investor, although both inward and outward flows in 2001 fell below the 1998 levels. Outward FDI declined by 30 per cent, down to $114 billion (figure III.1), while inflows more than halved, to reach $124 billion. The fall in inflows reflected fewer and smaller M&A transactions by foreign firms in the United States, partly in response to the economic slowdown in major home countries. Few transactions exceeded a value of $4 billion, as against more than 10 transactions above that level in 2000 (Bach, 2002). The relative weakness of the euro against the dollar may also have played a role in reducing cross-border M&As in the United States. Nevertheless, such activity continued to be the primary mode of FDI entry, with TNCs from Germany taking the lead.[1] In fact, Germany became the second largest home country for investment in the United States, behind Switzerland, pushing the United Kingdom to the fifth place. The share of EU countries in FDI inflows to the United States declined from 74 per cent in 2000 to 48 per cent in 2001 (figure III.2). Flows of FDI to the United States from Latin America and the Caribbean, West Asia, Japan and developing Asia decreased, with FDI flows by Japanese firms turning negative on balance (partly due to intercompany debt outflows and negative reinvested earnings), the latter presumably weakened by the recession in their home economy and also, to some extent, because they redirected their investments to Asia.

The services sector, led by finance and insurance, accounted for one-third of United States inward FDI in 2001 (figure III.3). Retail trade and real estate were the only activities that attracted increased inflows. Compared to the beginning of the decade, FDI in services (and, in particular, financial services) has outperformed investment in the traditional manufacturing industries in recent years.

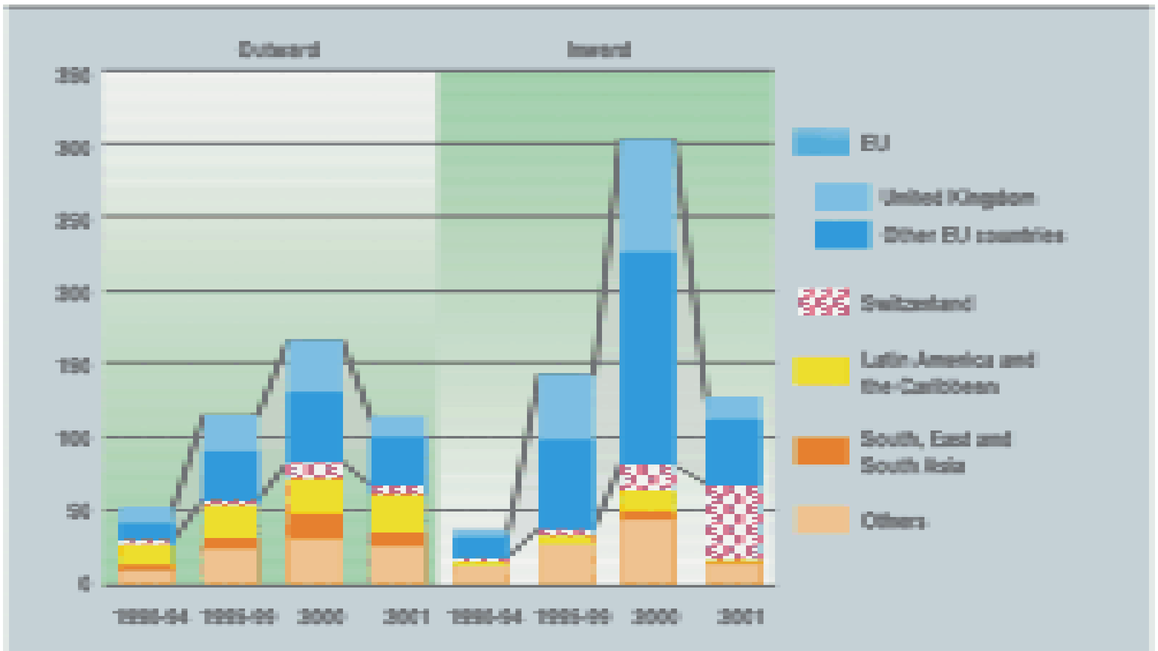
According to the UNCTAD indices of Inward FDI Performance and Potential, the United States leads in investment potential but ranks much lower in its FDI relative to GDP (figure III.4 and table II.1). Indeed the country's performance position has weakened over the past decade. This asymmetry may be explained by the

Figure III.1. Developed countries: FDI flows, top 10 countries, 2000 and 2001[a]
(Billions of dollars)

Source: UNCTAD, FDI/TNC database.

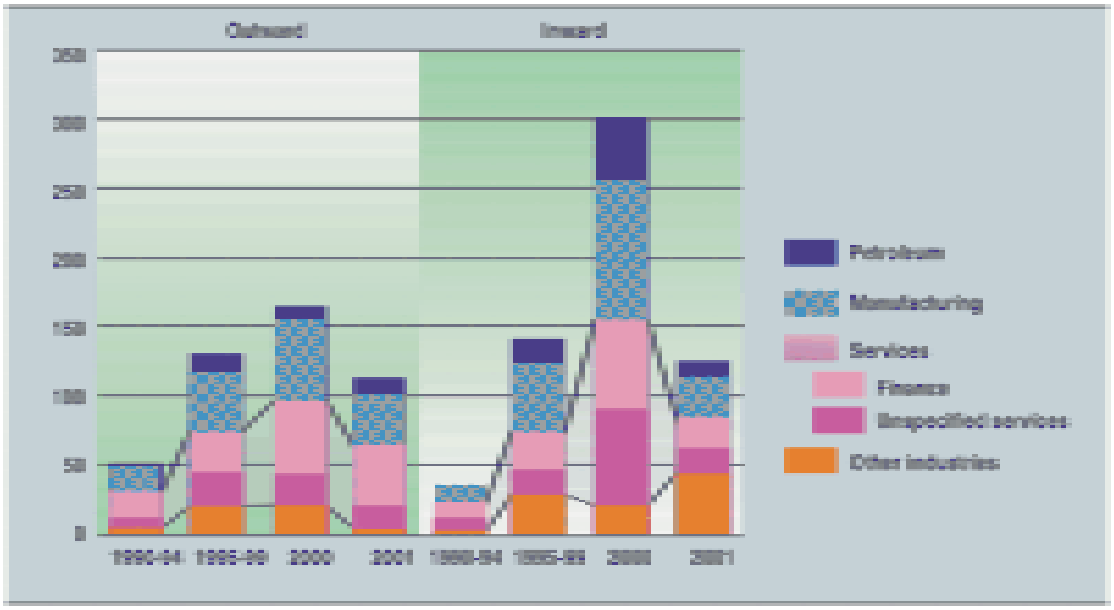
[a] Ranked on the basis of the magnitude of 2001 FDI flows.

Figure III.2. United States FDI inflows and outflows, by major partner, 1990-2001
(Billions of dollars)



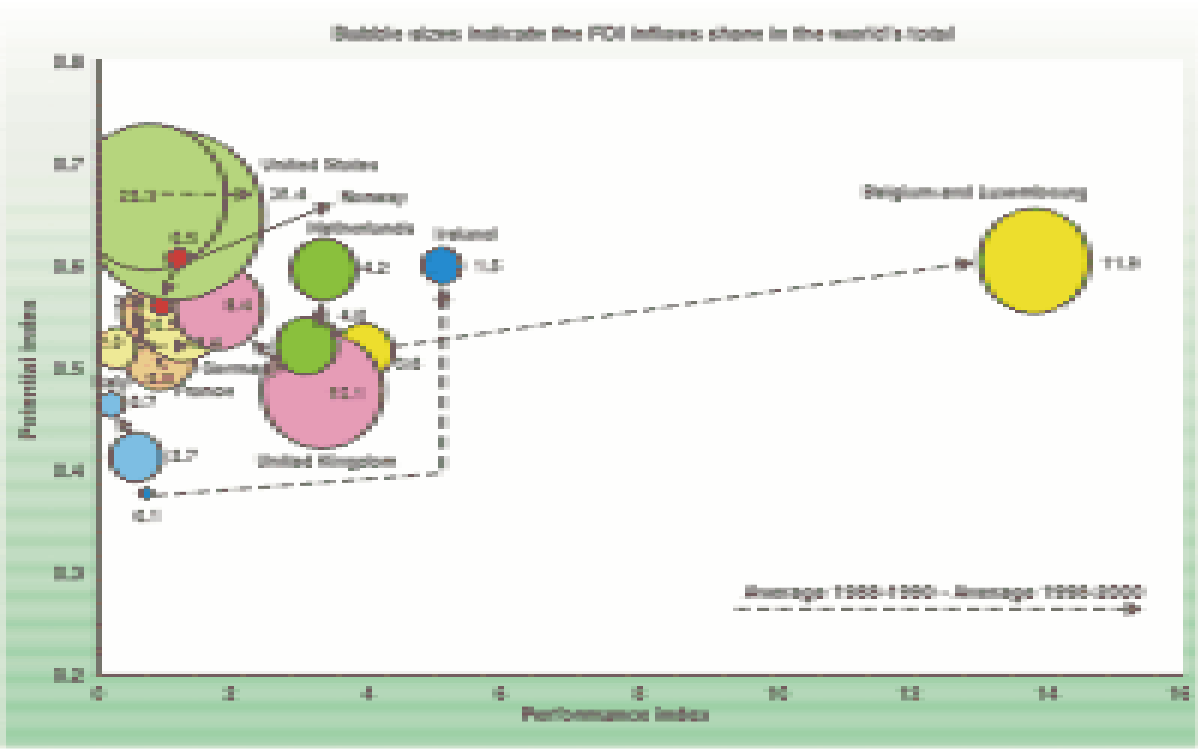
Source: UNCTAD, FDI/TNC database, based on the United States Department of Commerce, Bureau of Economic Analysis, www.bea.doc.gov, data retrieved in June 2002.

Figure III.3. United States FDI inflows and outflows, by major sector and industry, 1990-2001
(Billions of dollars)



Source: UNCTAD, FDI/TNC database, based on the United States Department of Commerce, Bureau of Economic Analysis, www.bea.doc.gov, data retrieved in June 2002.

Figure III.4. The UNCTAD Inward FDI Performance Index and Inward FDI Potential Index for the United States and selected Western European countries, 1988-1990 and 1998-2000



Source: UNCTAD, based on table II.1 and annex table B.1.

competitive strengths of United States firms. Still, the United States remains an attractive site for investment, and leading TNCs continue to regard it favourably, according to surveys of major investors.[2]

As in previous years, the main destination for United States outward FDI in 2001 was again the EU, which received more than 40 per cent of these outflows (figure III.2). The country's NAFTA partners – Canada and Mexico – together accounted for more than a quarter of total outflows, a major recipient being financial services in Mexico. FDI flows thus continue to strengthen the consolidation of the North American market, with Mexico emerging as an increasingly important partner. Developing countries accounted for more than a third of outflows, up from the previous year, but these were strongly affected by a single large acquisition in Mexico.[3] Other major transactions undertaken by United States firms include acquisitions in Germany (pharmaceuticals), Canada (natural gas, computer-related services), Asia (electronics, pharmaceuticals), and the United Kingdom (publishing) (Bach, 2002; annex table A.I.2).

Services continued to account for more than half of outward FDI, with financial services responsible for the largest share (figure III.3). Investment in machinery and equipment increased while that in transport services and electronics plunged, at least partly reflecting the economic slowdown and the impact of September 11 (EIU, 2002c). As the economy revived, FDI into and out of the United States picked up as well: inflows, having plunged in the third quarter of 2001 (accounting for only 10 per cent of total inflows during that year), increased in the fourth quarter partly in response to a revival in consumer confidence, a positive growth of GDP of 1.3 per cent, and low interest rates that encouraged consumer spending. During the first quarter of 2002, both inflows and outflows continued to grow.

2. Western Europe

a. European Union

FDI inflows and outflows to and from the EU (including intra-EU FDI) declined by about 60 per cent in 2001 (to $323 billion and $365 billion, respectively). Most flows remained within the EU, and most concentrated increasingly on services (particularly utilities, media and finance).[4] Cross-border M&As involving EU firms fell in number and value (annex tables B.7 and B.8).

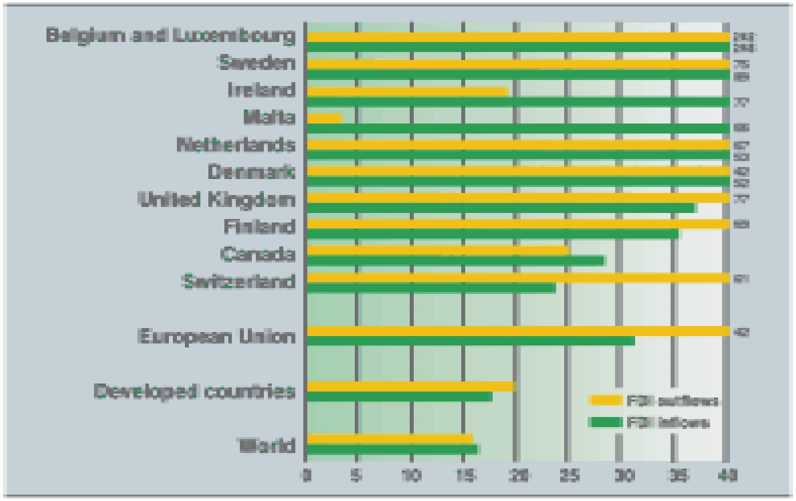
Although the largest share of the EU's FDI flows goes to other EU members, the region as a whole continues to outperform the United States, as both investor and recipient, as it has done since 1998. Despite the recession in 2001 and the September 11 events, the United States remains the most attractive location for FDI from the EU (MIGA, 2002).

The overall trends as well as inter-country differences in FDI flows in the EU reflect trends and differences in cross-border M&As, since most flows into and from the EU (like those into and from other developed countries) occur through M&As. Cross-border M&As involving EU firms declined in number and value in 2001 (annex tables B.7 and B.8); there were fewer large deals, and none was comparable to the mega deals undertaken during 1999 and 2000, when there was a surge in such deals.

Some EU countries experienced a significant decline in FDI inflows in 2001 compared to the previous year. Examples include Germany (where inflows were unusually high in 2000 due to a single cross-border acquisition), the United Kingdom and, on a smaller scale, Denmark and Finland (where FDI inflows decreased by more than half and where M&As had also boosted inflows in 2000). On the other hand, FDI inflows remained steady or increased in only three countries – France, Greece and Italy – in 2001. Similarly, on the outward side, several EU countries had undertaken exceptionally large cross-border M&A deals in 2000, resulting in high FDI outflows, compared to which 2001 outflows fell considerably. These countries include France and the United Kingdom and, on a smaller scale, Denmark, Finland and Sweden. At the same time, increased or steady outflows were also observed in some countries, such as Ireland, Italy and Portugal.

Countries of the EU rank high, well ahead of the United States, when FDI inflows are considered in relation to domestic investment (figure III.5), with Belgium and Luxembourg, Sweden, and Ireland leading

Figure III.5. Developed countries: FDI flows as a percentage of gross fixed capital formation, top 10 countries, 1998-2000[a]
(Percentage)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 1998-2000 FDI inflows as a percentage of gross fixed capital formation.

the list. They also generally rank high on UNCTAD's Transnationality Index (figure I.16) as well as on the UNCTAD indices of Inward FDI Performance and Potential (figures II.2, II.3 and III.4), their investment performance broadly matching their potential, with above average performances by Belgium and Luxembourg, and Ireland. Nevertheless, there are a few "below-potential" economies, including Austria and Italy, which, like Iceland, the United States and Japan, combine a relatively low ranking in FDI performance with a relatively high ranking in FDI potential. The asymmetry in these cases might be partly due to policy or investment-facilitation-related factors or short-term factors specific to the period covered by the indices. Germany, the United Kingdom and France, in that order, are the most favoured investment locations for the next three years, according to the survey on corporate investment strategies cited earlier (UNCTAD, 2001a).

The five largest home and host economies for FDI to and from the countries of the EU (including intra-EU FDI) were the same in 2001 as in 2000 – Belgium and Luxembourg, France, Germany, the Netherlands and the United Kingdom – although the order changed (figure III.1). Different factors contributed to the performance of individual countries.

FDI into *France* rose by 23 per cent, or $9.7 billion – the largest increase in flows to a developed country in 2001.[5] In *Greece*, FDI inflows increased by about 50 per cent, to $1.6 billion, mainly due to market-oriented FDI made through acquisitions by European and United States companies.[6] In *Italy*, inward flows increased by 11 per cent, partly due to the acquisition of Elettrogen by a Spanish investor group for $3.2 billion. Flows into *the Netherlands* remained steady. This country, given its openness, favourable investment environment, good infrastructure, and privileged location at the centre of the EU, has become an important FDI recipient in the region; it continues to attract European headquarters and European distribution centres of foreign TNCs.[7] *United Kingdom* inflows, on the other hand, dropped sharply as cross-border M&As by foreign firms fell.[8] Despite these developments, the country regained its position as the region's largest FDI recipient. Flows to *Belgium and Luxembourg* also declined substantially, in the light of revised 2000 figures; comparing data on FDI flows to and from *Belgium and Luxembourg* in 2001 with those in 2000 illustrates the difficulty of assigning values to FDI taking place through M&As.[9] The most significant decline in inflows (over 80 per cent) occurred in *Germany*,[10] where an increasing share of recent FDI has gone to the eastern part of Germany (box III.1). Inflows into Ireland declined by 60 per cent, reflecting the economic downturn that particularly affected United States electronics affiliates in the country (which represent a large share of FDI into Ireland).

The largest EU outward investor in 2001 was *France* (the second largest investor worldwide), but its outflows fell by over half compared to 2000.[11] *Belgium and Luxembourg* retained its position as the second largest outward investor from the region due to large cross-border M&As in insurance and communications industries (annex table A.I.2). *The Netherlands* was the third largest, with outflows falling by more than a third

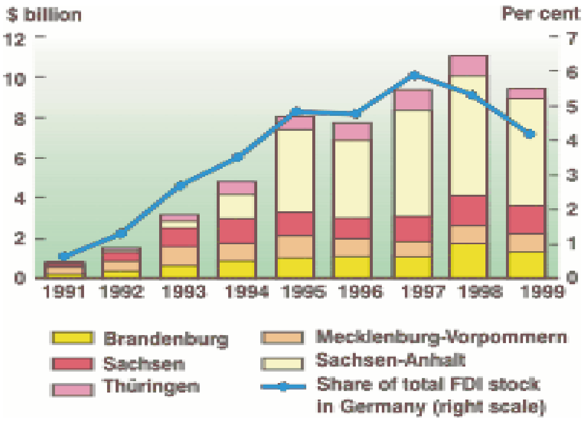
Box III.1. Going east: FDI in Germany's new *Länder*

In the more than 10 years since reunification, the new *Länder* region in the eastern part of Germany has succeeded in attracting about 2,000 foreign companies from over 50 countries. In comparison with domestic firms, foreign affiliates in the region typically are more export oriented. They are also more likely to establish linkages with suppliers in the local economy and bring in significant technological know-how. In some cases, they are important employers, especially for the automobile industry around Leipzig, semiconductor manufacturing in Dresden and the chemical industry in the "Chemical Triangle" of Saxony-Anhalt (Belitz, Brenke and Fleischer, 2000; IIC 2001b; Dickman and Ritter, 2002). FDI in the region, mainly in natural-resource-based manufacturing activities, and chemicals and machinery, accounted for about 4 per cent of the total FDI stock in Germany in 1999 (box figure III.1.1).[a] A recent survey by the American Chamber of Commerce underlined the attractiveness of the region.[b]

The factors driving these developments include a long industrial tradition and availability of a skilled labour force in certain regions, as well as market access (not only to the regional market, but also to the western part of Germany and CEE), cost advantages and investment opportunities arising from privatization (Belitz, Brenke and Fleischer, 2000). The majority of privatization-related acquisitions were undertaken by investors from the western part of Germany. Only about 6 per cent of privatized companies during 1991-1994 were acquired by foreign companies, and their share in total investment and employment was estimated at 10 per cent. In the second half of the 1990s, the involvement of foreign investors might have increased slightly, as they acquired projects that had failed under investors from the western part of Germany.

Box figure III.1.1. Distribution of inward FDI stock in Germany' new *Länder*,[a] by region, 1991-1999

(Billions of dollars and percentage)



Source: UNCTAD, based on Deutsche Bundesbank, unpublished data.

[a] Not including East Berlin.

Recently, factors such as more flexibility in labour-market negotiations (as compared to western Germany) and emerging industrial clusters have become important. Government assistance also plays a role. Incentives related to transfer payments for the post-reunification structural adjustment of the eastern part of Germany are available to both domestic and foreign investors. During 1991-1999, the share of grants in total investment was about 30 per cent, for both domestic and foreign investments (IIC, 2001a). However, certain incentives for enterprises operating in the region have to be phased out by 2004 (and by 2003 for in the case of investments in certain industries, such as automobiles), following a decision by EU competition authorities.[c]

Source: UNCTAD, based on data and information from the Deutsche Bundesbank; the New German Länder Industrial Investment Council (www.iic.de) and the five regional economic promotion agencies.

[a] Data on FDI in the new *Länder* have been compiled by the Deutsche Bundesbank since July 1991. Data on East Berlin are included in the figures for the western part of Germany.

[b] Of the 1,200 United States companies that responded to a survey (including the 50 largest United States investors in Germany), 80 per cent considered the new *Länder* a feasible investment location, and over 33 per cent thought that this region had special advantages for foreign investors. While proximity to CEE markets was cited as part of the attractiveness of the new *Länder,* more flexible labour markets and regulatory systems as well as advantageous wage levels, compared with other parts of Germany, were also considered important (IIC, 2001b).

[c] *Neue Züricher Zeitung,* "EU Gelder für Ostdeutschland werden erst 2004 reduziert", 12 February 2002.

and the United States replacing the EU as the main destination. *Germany* came fourth; its outflows remained almost steady. Again, its major destination was the United States, led by the acquisition of VoiceStream Wireless by Deutsche Telekom. The largest decline in outflows from the EU, in both absolute and relative terms, was recorded by the *United Kingdom,*[12] which ranked fifth among EU countries in outward FDI (figure III.1). Outflows from *Spain* almost halved, as investors cut back in Latin America, despite large acquisitions by Telefónica.[13] The crisis in Argentina resulted in heavy losses for some Spanish firms. Contrary to this trend, outflows from Italy increased by 75 per cent from a relatively low level, partly as the country had participated only modestly in cross-border M&As during the 1990s.[14]

b. Other Western Europe

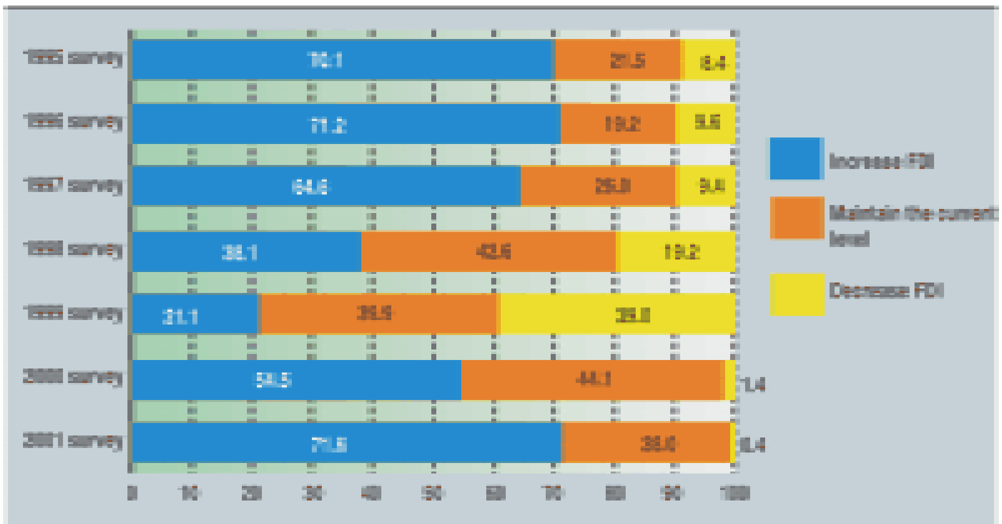
The rest of Western Europe followed similar patterns. FDI inflows ($13 billion) and outflows ($15 billion) fell in 2001. Countries under this grouping, taken together, rank higher than EU countries in FDI potential, although this is not matched by their FDI performance, according to the UNCTAD indices (table II.1).

FDI flows into *Switzerland* declined by almost 40 per cent, after the surge in 2000 led by two acquisitions (Alusuisse Lonza Group by Alcan Aluminium of Canada, and Cablecom Holding by the United States firm, NTL, for $4.8 billion and $3.7 billion, respectively). Increased inflows from the United States, the largest investor in Switzerland since 1986, and stable FDI from EU countries, together accounted for more than two-thirds of the inflows during 1996-2000, mainly in finance and insurance. FDI outflows from Switzerland declined even more: by 60 per cent. Most outward FDI took the form of M&As. Examples include the acquisition of Ralston Purina (United States) by Nestlé and Lincoln Re (United States) by Swiss Reinsurance. Pharmaceutical TNCs and finance and insurance companies have also become strong investors abroad, accounting for about half the outflows during 1996-2000. Most of the expansion has been in CEE, Latin America and the United States – a shift away from the EU destinations that traditionally accounted for more than half of total outward FDI. FDI inflows into *Norway* continued their declining trend, falling by half in 2001. FDI in natural-resource-related activities accounted for the largest share of inflows. Outflows also declined, and became negative (annex table B.2). *Iceland* has recently attracted North American TNCs, which, perhaps, consider the country as a stepping stone into the European market.[15] Furthermore, the country is increasingly investing abroad through cross-border M&As (*WIR01*), although at modest levels compared to other developed countries.

3. Japan

Japan's domestic investment fell in 2001,[16] but its investment abroad grew by 21 per cent (to $38 billion) and is expected to keep growing. According to a survey of manufacturing TNCs by the Japan Bank for International Cooperation in 2001 (JBIC, 2002), 72 per cent of respondents planned to increase their outward investment over the next three years, compared to 21 per cent in 1999 and 55 per cent in 2000 (figure III.6).

Figure III.6. Planned FDI by Japanese manufacturing TNCs over the next three years, 1995-2001 surveys [a]
(Percentage)



Source: Japan Bank for International Cooperation (JBIC), 2000 and 2002.

[a] Fiscal year.

Note: Based on 422 respondent firms for the 1995 survey, 432 for the 1996 survey, 445 for the 1997 survey, 455 for the 1998 survey, 472 for the 1999 survey, 469 for the 2000 survey and 501 for the 2001 survey.

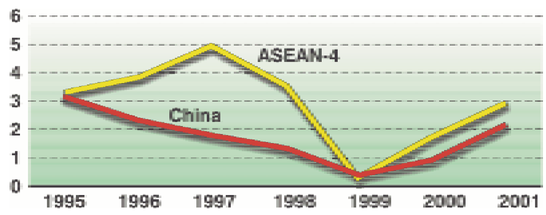
Outflows were fairly diversified by destination. For the first time, the largest recipient, with $13 billion, was the United Kingdom, followed by the United States.[17] FDI outflows doubled in the former and halved in the latter. These two countries alone accounted for 52 per cent of the total FDI outflows in 2001. More than half of Japanese investment in the United Kingdom in 2001 was in financial and insurance services. Service investments dominated Japanese FDI in both countries, accounting for more than one-third of the total.[18]

In other regions, however, manufacturing continued to dominate Japanese FDI. Investment in developing Asia remained steady, as production, particularly in electrical and electronics industries, was relocated in response to cost pressures. The rising share of East and South-East Asia (one fifth of total Japanese FDI in 2001) reflected the growing role of China, which took nearly 30 per cent of Japanese investment in the region. Other Asian countries, particularly members of the Association of South-East Asian Nations (ASEAN), received less, causing concern in ASEAN (box III.2). FDI in Latin America also declined, while it continued to remain marginal in Africa and West Asia.

Box III.2. Is China more attractive to Japanese investors than ASEAN?

The Japanese investment gap between China and the ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand) has narrowed since 1999 ($2.7 billion and $2.9 billion in 2001, respectively) (box figure III.2.1). Even before its accession to the WTO, China had become the most attractive location for Japanese TNCs. In a survey of planned FDI in the next three years by Japanese manufacturing TNCs (JBIC, 2002), China emerged as the leading destination by far. The ASEAN-4 ranked at some distance below China, though all, except for the Philippines, remained among the top 10 destinations (box table III.2.1).

Box figure III.2.1. Japanese FDI outflows to ASEAN-4 and China, 1995-2001
(Billions of dollars)



Source: UNCTAD, FDI/TNC database.

Japan accounted for 28 per cent of the FDI stock in Thailand (1999), 22 per cent in Malaysia (1997) and 20 per cent in Indonesia (1997). These countries are therefore eyeing the increasing flows to China with some apprehension. Surveys reinforce these concerns. Some 57 per cent of Japanese manufacturing TNCs find China more attractive than the ASEAN-4.[a] A survey by JETRO in October 2001 suggested that one-fifth of Japanese TNCs planned to relocate production sites from Japan and other countries to China because of its accession to the WTO (box figure III.2.2). At the same time, however, 99 per cent of Japanese TNCs with investments in the ASEAN countries said they would not relocate to China (JETRO, 2002). This does not, of course, mean that their production in China will not expand faster than in ASEAN.

Box table III.2.1. The 10 most promising destinations for manufacturing FDI by Japanese TNCs over the next three years,[a] 1995-2001 surveys [b]

(Per cent)

Rank	1996 survey	Ratio	1997 survey	Ratio	1998 survey	Ratio	1999 survey	Ratio	2000 survey	Ratio	2001 survey	Ratio
1	China	68	China	64	China	55	China	55	China	65	China	82
2	Thailand	36	United States	36	United States	41	United States	39	United States	41	United States	32
3	Indonesia	34	Indonesia	28	Thailand	23	Thailand	27	Thailand	24	Thailand	25
4	United States	32	Thailand	25	Indonesia	16	India	15	Indonesia	15	Indonesia	14
5	Viet Nam	27	India	23	India	15	Indonesia	15	Malaysia	12	India	13
6	Malaysia	20	Viet Nam	19	Philippines	14	Viet Nam	11	Taiwan Province of China	11	Viet Nam	12
7	India	18	Philippines	14	Malaysia	14	Malaysia	9	India	10	Taiwan Province of China	11
8	Philippines	13	Malaysia	13	Viet Nam	14	Philippines	9	Viet Nam	9	Korea, Rep. of	8
9	Singapore	10	Brazil	8	Brazil	11	United Kingdom	9	Korea, Rep. of	9	Malaysia	8
10	United Kingdom and Taiwan Province of China	7	Taiwan Province of China	8	United Kingdom	10	Brazil	8	Philippines	8	Singapore	6

Source: JBIC, 2000 and 2002.

[a] The share of firms that consider the country as promising in total respondent firms (multiple responses).

[b] Fiscal year.

Note: ASEAN-4 and China are highlighted.

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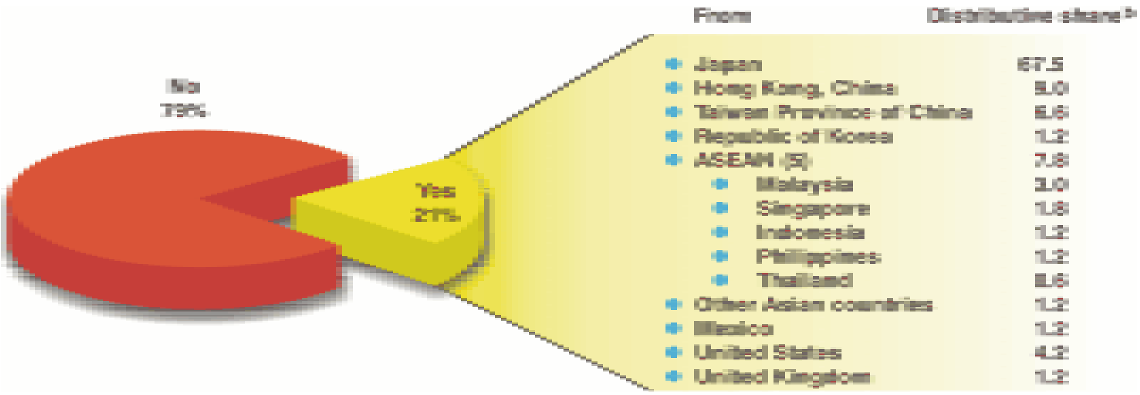
Box III.2. Is China more attractive to Japanese investors than ASEAN? (concluded)

Box figure III.2.2. Planned relocation of production sites of Japanese TNCs to China as a result of China's accession to the WTO [a]

(Percentage of TNCs responding)



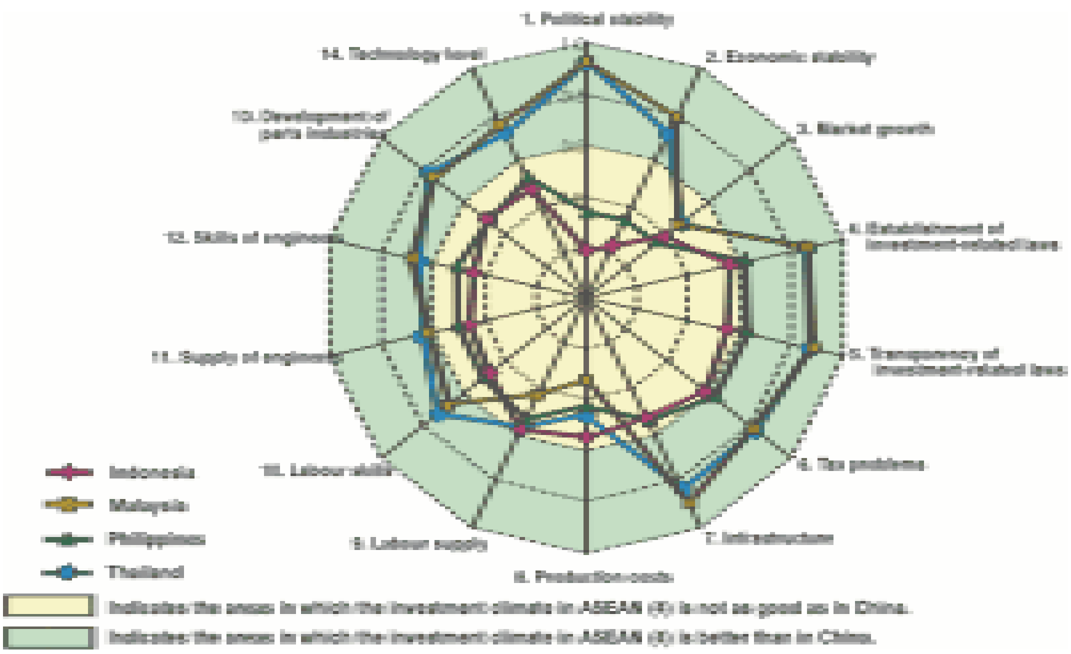
Source: JETRO, International Economic Research Division.

[a] Based on 645 responses among the 720 Japanese TNCs surveyed by JETRO in October 2001.

[b] Based on 136 out of the 645 responses (21.1 per cent) from TNCs planning to relocate their production to China. Multiple replies apply.

However, Japanese TNCs are concerned about the investment climate in China (box figure III.2.3), particularly about rules relating to establishment, the transparency of investment rules, and the tax system. While Malaysia and Thailand are better positioned in most aspects of the investment climate, they lag behind China in market growth, production costs and labour supply (box figure III.2.3). According to the JBIC survey, nearly twice as many Japanese manufacturing TNCs consider these economic attractions stronger in China as those who consider them stronger in ASEAN.

Box figure III.2.3. Investment climate of ASEAN-4 compared with China[a]



Source: UNCTAD, on the basis of data and figure provided by JETRO, International Economic Research Division.

[a] Japanese TNCs were asked to assess the investment climate of ASEAN (4) compared with that of China in each of the 14 areas according to the following scaling: 2 for much better; 1 for better; 0 for the same; -1 for worse; and -2 for much worse.

Note: Based on 340 responses for Indonesia, 335 for Malaysia, 317 for the Philippines and 386 for Thailand surveyed by JETRO in October 2001.

Source: UNCTAD.

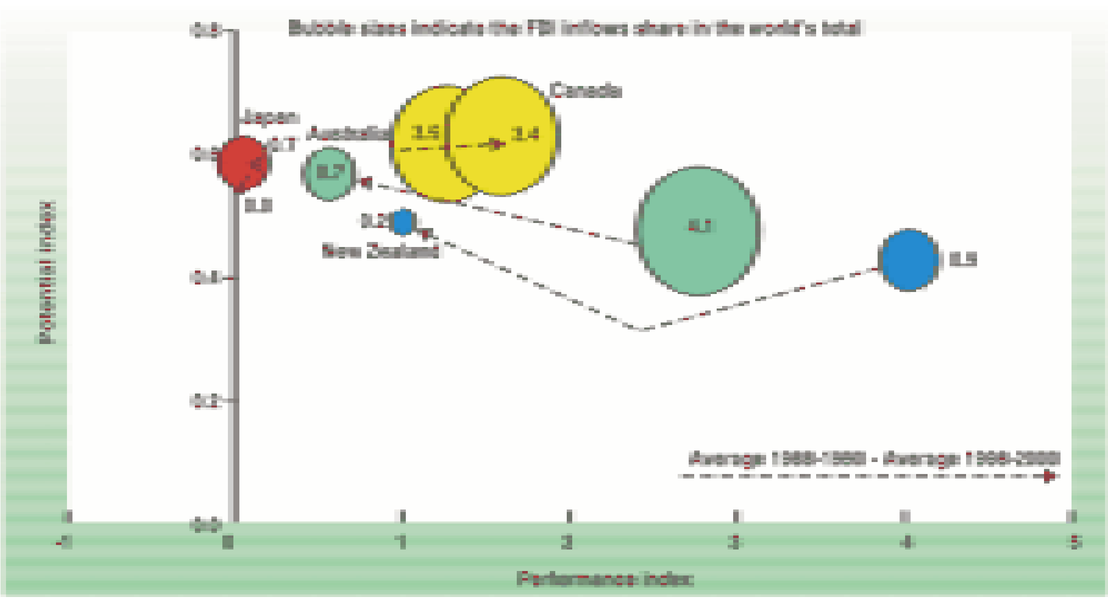
[a] JBIC, 2000; 2002. On the basis of 469 respondent Japanese manufacturing TNCs.

Inward FDI in Japan declined for the second year in a row. By 2001, inflows ($6 billion) were half the peak reached in 1999.[19] While cross-border M&As fell, there were some large acquisitions in telecommunications and insurance.[20] Five global electronics contract manufacturers[21] also acquired plants (JETRO, 2002). According to both the UNCTAD/AFII/Andersen survey (UNCTAD, 2001a) and the MIGA survey (MIGA, 2002), prospects for FDI inflows to Japan are better than those for other developed countries such as Sweden and Ireland, both of which have shown dramatic improvements in the UNCTAD Inward FDI Performance Index (table II.1). Japan has also improved its own FDI performance over the past decade, but this remains much lower than its capacity to attract FDI as measured by the UNCTAD Inward FDI Potential Index (figure III.7).

In the light of Japan's position as a country with sustained surpluses in its balance of trade, increased FDI from Japan since the mid-1980s has drawn attention to the relationship between the country's trade and international production. Since 1993, the net effects of outward FDI on Japan's trade balance in the manufacturing sector are estimated to be negative (Japan, Institute for International Trade and Investment, 2000). However, the activities of Japanese manufacturing affiliates abroad rarely have negative effects on Japan's manufactured exports (Lipsey and Ramstetter, 2001). Indeed, of the top 30 exporters that accounted for half of Japanese total exports in 2001, only four (NEC, Mazda Motors, Isuzu Motors and Nippon Steel) experienced a decline in exports between 1996 and 2001 (table III.1).

The negative trade balance effects of outward FDI are apparently attributable to imports. Japan's imports from its affiliates abroad are increasing faster than exports by Japanese parent firms. In fact, the share of "reverse imports" in Japanese imports rose from 4 per cent a decade ago to 15 per cent in 1999 (figure III.8). In comparison, United States imports from overseas affiliates of its TNCs accounted for about one-fifth of total imports in 1998, a share that has remained the same since 1990. Simultaneously, the composition of Japanese imports is changing rapidly. Machinery and equipment, in particular, electrical and electronics machinery, now account for 31 per cent – 14 percentage points higher than a decade ago. This implies that a horizontal division of labour is taking place within TNCs in this industry. Japan provides an interesting case of outward FDI changing the structure of trade – both exports and imports – of host and home countries.

Figure III.7. The UNCTAD Inward FDI Performance Index and Inward FDI Potential Index for "other" developed countries, 1988-1990 and 1998-2000



Source: UNCTAD, based on table II.1 and annex table B.1.

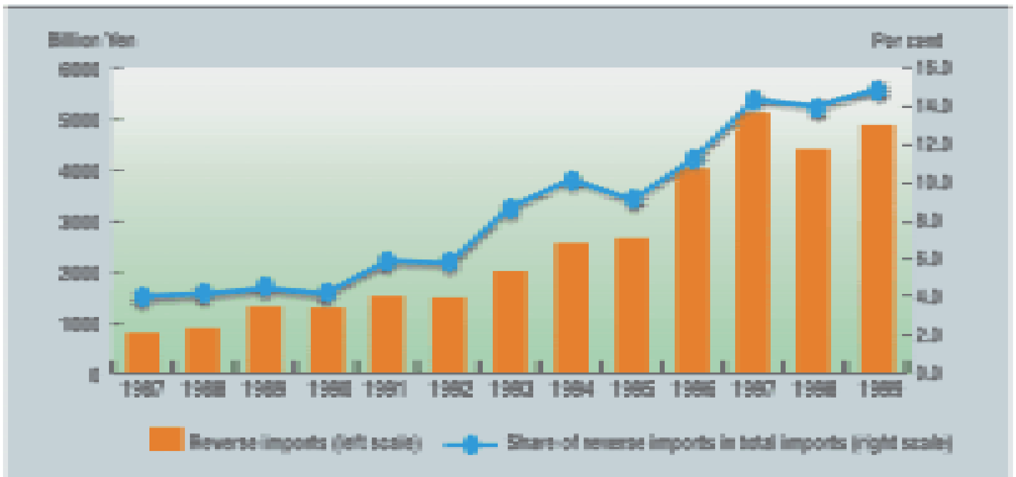
Table III.1. Exports, FDI and international production of 30 largest Japanese firms, 1996 and 2001
(Billions of yen)

	1996				2001			
TNCs [a]	Sales [b]	Exports from parent firms	FDI	International production	Sales[b]	Exports from parent firms	FDI	International production
Toyota Motor Corp.	10 719	2 829	331	2 037	13 424	4 136	718	7 652
Sony Corp.	4 593	1 251	1 209	919	7 315	1 961	..	1 463
Honda Motor Co., Ltd.	4 252	1 275	225	..	6 464	1 773	..	..
Matsushita Electric Industrial Co., Ltd.	6 795	1 445	..	951	7 682	1 529	..	2 243
Nissan Motor Co., Ltd. [c]	6 039	1 310	570	2 355	6 090	1 522	905	2 704
Canon Inc.	2 558	971	140	691	2 908	1 367	..	872
Toshiba Corp.	5 120	1 147	..	..	5 951	1 264	246	1 726
Mitsubishi Motors Corporation	3 537	989	..	..	3 277	1 133	..	..
Mitsubishi Heavy Industries, Ltd.	3 017	739	..	..	3 045	1 050	48	241
Hitachi, Ltd.	8 124	983	115	1 995	8 417	1 047	174	..
NEC Corporation	4 397	690	..	..	5 410	699	489	..
Mazda Motor Corp. [c]	1 843	709	125	602	2 016	683	155	1 125
Mitsubishi Electric Corp.	3 511	636	87	421	4 129	674	129	702
Suzuki Motor Corp. [c]	1 381	483	79	186	1 600	629	117	..
Fujitsu Ltd.	3 762	351	536	752	5 484	614	..	..
Seiko Epson Corp.	511	350	..	..	1 341	610	..	..
Sharp Corporation	1 651	584	..	..	2 013	596	..	..
Isuzu Motors Ltd. [c]	1 682	602	44	84	1 569	488	82	88
Yamaha Motor Co., Ltd.	733	292	74	..	884	448	..	613
Sanyo Electric Co., Ltd.	1 687	103	167	472	2 241	432	..	..
Nippon Steel Corp.	2 955	485	54	..	2 750	423	69	..
Fuji Heavy Industries Ltd.	1 077	165	86	346	1 312	395	..	..
Kawasaki Heavy Industries Ltd.	1 086	293	..	..	1 060	365	..	..
Victor Co. of Japan, Ltd.	807	281	..	..	934	351	..	..
Fuji Photo Film Co., Ltd.	1 085	238	91	..	1 440	336	..	785
Denso Corp.	1 423	229	..	..	2 015	318	..	..
Japan IBM [c]	1 497	289	..	..	1 585	312	..	..
Ricoh Co., Ltd.	1 113	169	..	223	1 538	300	..	..
Nikon Corporation	333	132	17	121	484	270	..	..
Murata Manufacturing Co., Ltd.	322	98	11	..	584	266	14	99

Source: UNCTAD, based on World Scope CD-ROM (for sales), Toyo Keizai, 1996 and 2001 (for FDI and international production), and *Nikkei Sangyo Shimbun*, 27 December 2001 (for exports).

[a] Ranked according to export size.
[b] Consolidated.
[c] Foreign affiliate.

Figure III.8. Japan's imports from Japanese foreign affiliates, 1987-1999
(Billions of yen and percentage)



Source: Japan, Ministry of Economy, Trade and Industry (METI), 2001a, p. 60.

4. Other developed countries

Among other developed countries, Australia was less affected by the recession and other events in the United States, as its economy is more closely linked to Asia and the Pacific than to North America. FDI outflows from Australia doubled in 2001, reaching $11 billion, and reflecting the acquisition by BHP of Billiton (United Kingdom) for $11.5 billion[22] (annex table A.I.2). Manufacturing accounted for two-thirds of outward FDI, compared to about 50 per cent a decade earlier. Australia has been an important investor in the Asia-Pacific region, mainly in Japan, New Zealand, South-East Asia and the Pacific Island economies. The largest Australian affiliates are located in that region, predominantly in resource-based manufacturing. FDI flows into Australia showed a large fall, down to $4 billion, compared to a record high of $12 billion the previous year. Mining continued to decline in importance for inward FDI, while services continued to rise. The main investors in Australia were European firms, though the United States had accounted for an equal share during the period 1997-1999. Investors from the Pacific region contributed a significant but falling share.

FDI flows declined for *New Zealand*: inflows almost halved, from $3.2 billion to $1.7 billion, and outflows decreased by 70 per cent, from $0.9 billion to $0.3 billion. Inflows were mainly in resource-based industries, with Australia the main investor, followed by the United States, the United Kingdom and Japan. Australia was the main destination for outflows from New Zealand, traditionally accounting for about half of the latter's outward FDI and recently increasing this share to almost three-quarters, ahead of the United Kingdom, the United States and Japan.

Since *Canada's* main economic partner is the United States, the slowdown there affected Canadian FDI in 2001. Inflows fell by 60 per cent[23] and outflows by 25 per cent compared to the previous year, which was characterized by unprecedented FDI related to relatively large M&As (figure III.1). Although diminished in number and in volume, cross-border M&As in Canada continued to play an important role as a mode of entry for TNCs. Large M&As, mainly by United States (in utilities) and United Kingdom firms, drove inward FDI. Most outward FDI went to the United States, but investments in Mexico also rose rapidly (from low levels), reflecting the integrating effects of NAFTA. The services sector is gaining in importance over resource-based activities in Canadian outflows.

* * *

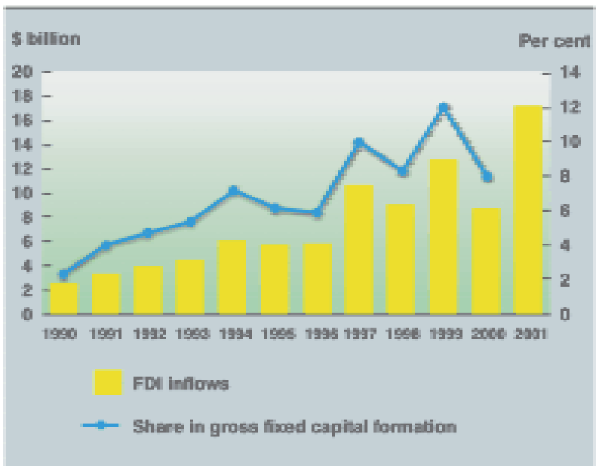
Data for early 2002 suggest that FDI to and from the developed countries will remain low (see chapter I). Cross-border M&As – the preferred mode of entry for TNCs (UNCTAD, 2001a; MIGA 2002) – are expected to remain low. However, as economic growth picks up, flows are likely to recover.

B. Developing countries

1. Africa

FDI flows to Africa (including South Africa) rose from $9 billion in 2000 to more than $17 billion in 2001, following relatively low levels in previous years (figure III.9). While this increase looks impressive at first sight, it masks the fact that, for most African countries, FDI flows remained at more or less the same level as in 2000. The increase by $8 billion is largely due to a few large FDI projects – notably in South Africa and Morocco (figure III.10) – and the way they are reflected in FDI statistics. Around 80 per cent of the growth is explained by a

Figure III.9. FDI inflows and their share in gross fixed capital formation in Africa, 1990-2001
(Billions of dollars and percentage)

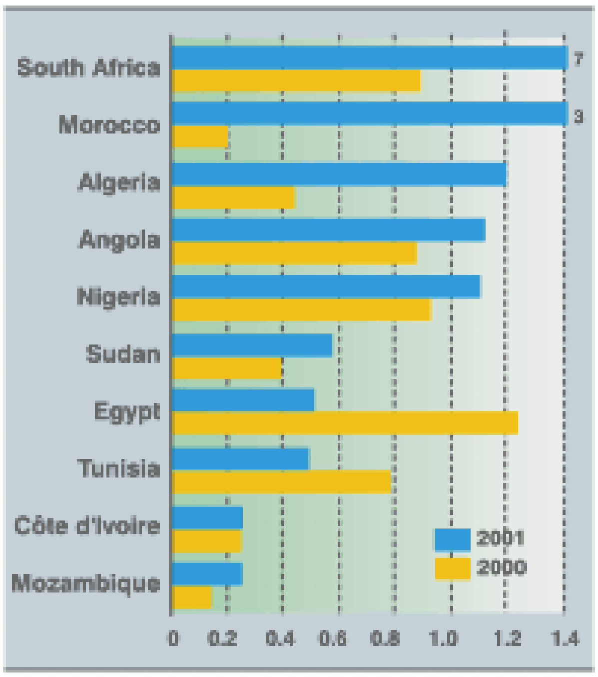


Source: UNCTAD, FDI/TNC database.

large increase in FDI flows into South Africa, the result of an unbundling of cross-share holdings involving London-listed Anglo American and De Beers of South Africa; it is recorded as an increase in FDI inflows because Anglo American purchased De Beers shares by paying the mainly South African-based owners in Anglo American shares.[24] The other main project responsible for the increase was the sale of a 35-per-cent stake of Maroc-Telecom to a foreign investor, boosting inflows into Morocco to almost $2.7 billion in 2001. Thus the higher FDI inflow figures for 2001 should not be mistaken for a fundamental change in the trend. Inflows stagnated for many other countries, though at levels higher than during the early 1990s, before the policy environment for FDI began to improve.

As a result of these exceptional transactions, the share of Africa in global FDI inflows increased from 1 per cent in 2000 to 2 per cent in 2001, but it remains small. If economic size is taken into account, however, there is little difference between Africa and other developing regions as regards inward FDI. In fact, some African countries receive more FDI relative to GDP than the average developing country. Moreover, for 22 of the 53 African countries, the ratio

Figure III.10. Africa: FDI inflows, top 10 countries, 2000 and 2001[a]
(Billions of dollars)



Source: UNCTAD, FDI/TNC database.

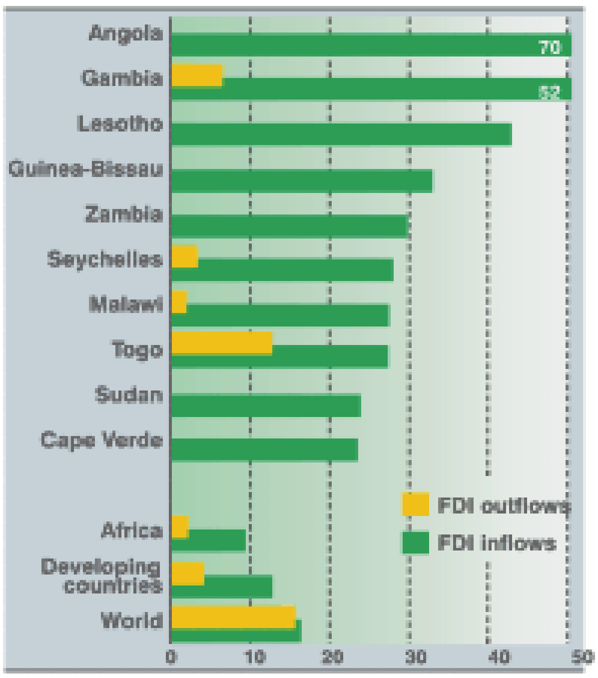
[a] Ranked on the basis of the magnitude of 2001 FDI inflows.

of FDI inflows to gross fixed capital formation in 1998-2000 was higher than for developing countries as a whole (figure III.11 and annex table B.5). Most of these 22 countries are LDCs with relatively small economies, such as Cape Verde, Djibouti, Lesotho and Togo.

There were some interesting trends in FDI inflows within the continent:

- The year 2001 saw a number of remarkable developments regarding FDI flows to *North Africa*: they increased by 83 per cent to $5.3 billion – an unprecedented figure for this subregion. However, as with the developments in Africa in general, the large increase masks diverging trends among individual North African countries. The lion's share of the increase was accounted for by the jump in FDI flows to *Morocco*, from $200 million in 2000 to almost $2.7 billion in 2001. As already mentioned, this increase was due to the sale of a 35 per cent stake in the local telecom operator, Maroc-Telecom, to France's Vivendi Universal as part of that latter company's M&A-based global expansion strategy over the past few years (chapter IV). FDI flows to *Algeria* and *Sudan* also increased, on account of FDI in the gas and petroleum

Figure III.11. Africa: FDI flows as a percentage of gross fixed capital formation, top 10 countries, 1998-2000[a]
(Percentage)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 1998-2000 FDI inflows as a percentage of gross fixed capital formation.

industries. Overall, the share of North Africa in total FDI flows to Africa declined slightly, from 33 per cent to 31 per cent, as the large increase in absolute flows to North Africa was more than offset by an even larger increase in FDI flows to sub-Saharan Africa.

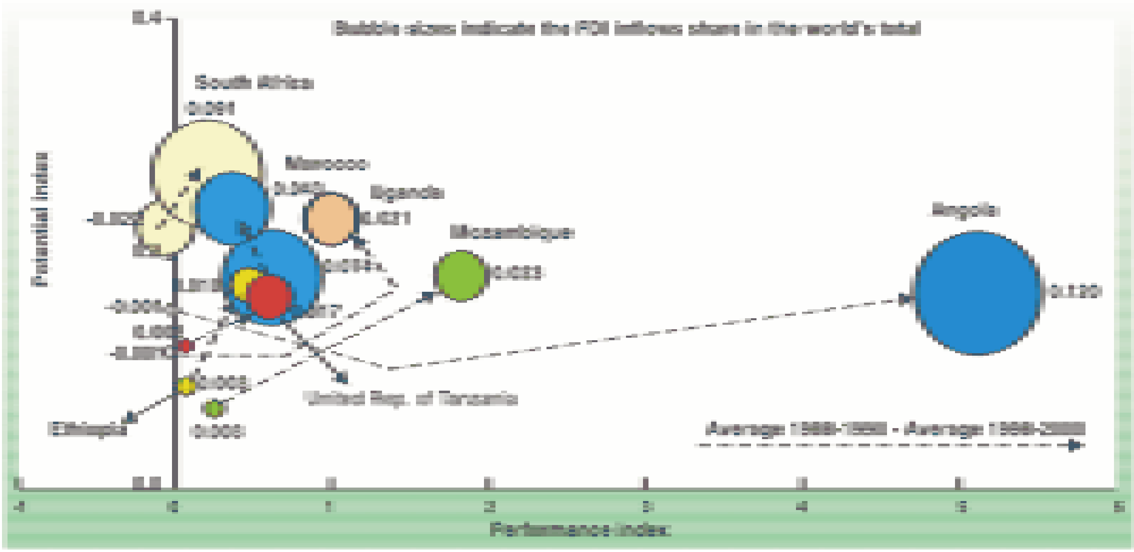
- Flows to *sub-Saharan Africa* surpassed, for the first time ever, the mark of $10 billion, to reach $11.8 billion in 2001. As mentioned earlier, this was largely the result of the Anglo American-De Beers deal. Without that transaction, sub-Saharan Africa as a whole would show little change, as the increase in FDI flows to *South Africa* is almost identical to the increase in FDI flows to the subregion as a whole. There were slightly fewer countries that experienced an increase in FDI inflows (19) that year than those that incurred a decline (21). Behind South Africa, two oil-producing countries – *Angola* and *Nigeria* – ranked second and third in terms of absolute inflows. A considerable gap exists between these three countries (all of which received flows of more than $1 billion) and the other countries of the subregion. The group of the next largest FDI recipients – all of which received more than $200 million, led by *Côte d'Ivoire* with $257 million – also includes three LDCs: *Mozambique*, *Uganda* and *the United Republic of Tanzania*. These three countries have experienced steadily increasing inflows over the past few years, with Mozambique and the United Republic of Tanzania benefiting from their proximity to South Africa. More than two-thirds, or 69 per cent, of total FDI flows to Africa in 2001 were accounted for by sub-Saharan Africa.

- FDI inflows to the 34 African *LDCs* increased by some $600 million (or 16 per cent), to almost $4.2 billion in 2001, but only 19 of them registered an increase in 2001. For Africa as a whole, the growth in FDI inflows does not mean that all countries experienced an increase. Only half of the 34 LDCs registered an increase in 2001. Among these, three (Angola, Mozambique and Sudan) together accounted for the lion's share of the total increase for African LDCs. Angola, with $240 million (in petroleum-related FDI) registered by far the largest jump, and remained, with more than $1.1 billion, the largest FDI recipient among African LDCs. Overall, the share of African LDCs in total FDI flows to the continent fell from more than 40 per cent to just a quarter, largely due to the above-mentioned developments in South Africa; excluding that particular transaction, *grosso modo*, FDI to LDCs was similar to that of non-LDC African countries.

The performance of African countries in attracting FDI, as measured by their rankings on UNCTAD's Inward FDI Performance Index, is mixed. Most of the 36 countries for which that Index could be calculated rank low on it for the period 1998-2000. There is only one African country, Angola, that made it to the top 20 in that period. Angola's ranking is largely due to its rich endowment of offshore petroleum which spurred massive FDI from 1996 onwards. On the other hand, it is also remarkable that only four of the bottom 20 rankings are occupied by African countries – Libyan Arab Jamahiriya, Niger, Rwanda and Sierra Leone. This suggests that, although absolute flows to many African countries remain minimal, in relative terms the countries perform better than the absolute figures would suggest. Moreover, half of the African countries included in the rankings improved their position on the list between 1988-1990 and 1998-2000. These countries are from all of the continent's subregions and at various levels of development, including more advanced countries such as South Africa and LDCs such as the Democratic Republic of the Congo and Uganda (figure III.12).

Turning to UNCTAD's FDI Potential Index, only 7 of the 20 countries with an improved FDI Performance Index ranking saw a parallel increase in their potential: Ethiopia, Mali, Mozambique, Namibia, Sudan, Tunisia and Uganda. All of them have had relatively high GDP growth rates for the period 1990-2000, the minimum being 3.8 per cent. This suggests that improved economic performance attracted more FDI. Also, the share of LDCs in the group of African countries with improved FDI Performance Index values is remarkable: they account for 11 of the 20 countries. Among them are a number of countries that are well-known for their sustained efforts towards greater political and economic stability, such as Mali, Mozambique, the United Republic of Tanzania and Uganda. Others, such as Angola, Cameroon or Congo, might have improved because of renewed possibilities

Figure III.12. The UNCTAD Inward FDI Performance Index and Inward FDI Potential Index for selected countries in Africa, 1988-1990 and 1998-2000



Source: UNCTAD, based on table II.1 and annex table B.1.

for exploiting their natural resource endowments. Moreover, the fact that a good half of the African countries on the list improved their position on the FDI Performance Index squares well with the fact that, since the beginning of the 1990s, FDI flows into Africa have been increasing gradually after a long period of stagnation.

Ranking by the Inward FDI Potential Index does not feature any African country among the top 20 countries, while 11 of the bottom 20 are from the continent. This is not surprising, given that most African countries have mediocre economic growth rates, insufficient infrastructure and a low level of education: all factors critical for obtaining high values on that Index. In general, African countries seem to perform better on the Performance Index than on the Potential Index, so that a fairly large number of them (9) fall into the group of above-potential economies and only one (Egypt) into that of below-potential economies, although the majority (22) rank low on both indices (table II.3).

Most of the FDI flows to Africa come from only a small number of home countries (table III.2), led by the United States, France and the United Kingdom. During the period 1996-2000, the United States alone accounted for more than 37 per cent of total flows from developed countries, France for 18 per cent and the United Kingdom for 13 per cent. Germany and Portugal followed at some distance. Japan has been a relatively small investor (Fujita, 2001a).

Overall, the trend towards a more even distribution of the origins of FDI flows to Africa that seemed to emerge during the mid-1990s (UNCTAD, 1999a) came to a halt during the period 1996-2000. It should be noted, however, that for all but four of

Table III.2. Africa: accumulated FDI flows from major developed countries,[a] 1981-2000

(Millions of dollars)

Country	1981-1985	1986-1990	1991-1995	1996-2000
Australia	-13	-149	-33	-99
Austria	72	33	7	221
Belgium	99	40	-47	242
Canada	27	37	146	626
Denmark	19	24	1	340
Finland	-	38	3	8
France	1 239	1 001	2 066	4 362
Germany	504	332	402	2 475
Italy	455	217	213	678
Japan	350	1 143	201	340
Netherlands	94	153	297	816
New Zealand	-	-	-	-
Norway	99	12	145	-148
Portugal	-	-	96	1 560
Spain	-	-	50	476
Sweden	177	48	4	197
Switzerland	-6	73	452	69
United Kingdom	882	2 193	2 376	3 269
United States	1 866	404	278	9 249

Source: UNCTAD, based on OECD, unpublished data.

[a] The countries listed in the table are the members of the OECD's Development Assistance (DAC) Committee.

19 major developed countries, accumulated FDI flows to Africa were higher in the second half of the 1990s than in the first half. Only two home countries, Australia and Norway, recorded net divestment over the five-year period, 1996-2000.

The bouncing back of the United States to the top position among sources for FDI in Africa is, perhaps, the most remarkable development during 1996-2000. Its FDI flows increased in both North and sub-Saharan Africa. While flows to North Africa recovered from two periods of substantial divestments (-$581 million in the period 1986-1990, and -$454 million in 1991-1996) to more than $3.8 billion in 1996-2000, flows to sub-Saharan Africa recovered from a longer period of relatively low levels ($986 million for the period 1986-1990 and only $106 million in 1991-1996) to almost $5 billion in accumulated flows during 1996-2000.[25] TNCs from the United States were very active in South Africa, often buying back the affiliates they had sold when pulling out of the country during the apartheid era. At the same time, FDI from the United States also went to other sub-Saharan countries. For example, United States TNCs were at the forefront of exploring newly-found oil and natural gas reserves in Angola and along the western coastline of the continent.

Of the developed countries, Portugal became the second largest investor in North Africa after the United States during the period 1996-2000, while France, traditionally the most important source of FDI for that subregion, fell back to third place, despite an increase in flows to $605 million compared to $492 million in the period 1991-1995. However, Portugal's rise is due to one exceptional year (2000) when its outflows amounted to more than $1 billion. Geographic proximity might play a role in Spain being the fourth largest investor in North Africa, while it ranks only tenth for flows to sub-Saharan Africa. However, FDI flows from Spain to North Africa grew more slowly than they did to southern Africa. Spain ranks just after the United Kingdom, from which flows increased significantly in 1996-2000 ($506 million), compared to previous periods, when flows were even negative at times. Significant investments from the United Kingdom in Egypt, including in the retail sector, were among the main drivers behind this development.

FDI flows from almost all EU countries – including France, Germany, the Netherlands, Portugal, Spain, Sweden and the United Kingdom – to sub-Saharan Africa increased from $1 billion per annum in 1991-1995, to $2 billion per annum in 1996-2000. Flows from the same countries to North Africa showed a similar picture. The combined flows from the EU countries to North Africa rose from $814 million to $2.6 billion between the two periods. This trend may have been influenced by the fact that, during the 1990s, North African countries concluded agreements with the EU on the creation of a free trade area. A striking difference between North Africa and sub-Saharan Africa is that countries such as Germany and the Netherlands – major investors in southern Africa – accounted for relatively small amounts of FDI in North Africa during 1996-2000. Overall, however, the home-country distribution of FDI flows to both North and sub-Saharan Africa was somewhat similar during 1996-2000.

Data for FDI flows to Africa from major home countries suggest that the primary sector has remained the most important over the past decade, with a share of 55 per cent in the accumulated FDI to Africa for the period 1996-2000 (table III.3).[26] Oil and petroleum are largely responsible for this performance. Services industries have gained in importance in recent years, although their share (25 per cent) in total FDI flows is much lower than that of the primary sector. In the past two years, however, FDI flows into services were higher or as high as those into the primary sector, especially on account of banking and finance, transportation and

Table III.3. FDI outflows from major investors[a] to Africa, by sector, 1996-2000
(Millions of dollars and per cent)

Sector	1996	1997	1998	1999	2000	Total 1996-2000	Distribution share
Primary sector	3 133	4 369	5 056	2 726	2 029	17 314	54.6
Secondary sector	1 085	1 114	1 233	1 812	1 297	6 541	20.6
Tertiary sector	624	2 155	52	3 108	1 931	7 871	24.8
Total	4 842	7 639	6 341	7 647	5 257	31 726	100.0

Source: UNCTAD, based on data obtained from various central banks and ministries.
[a] France, Germany, Japan, the Netherlands, Switzerland, the United Kingdom and the United States only.

trading. The first two industries benefited, at least partially, from privatization processes as well as from a few cross-border M&As in a small number of African countries. Transportation FDI includes flows into Liberia in connection with flag-of-convenience shipping, which, statistically, is counted as FDI but, *de facto*, has little do with it. As for manufacturing, it was the least important sector for FDI over the past decade. Food products as well as steel and metal products accounted for the largest share of FDI flows into this sector. FDI flows into electrical and electronic equipment, textiles or motor vehicles – all industries that play a prominent role in attracting FDI in other developing regions – were insignificant. It should be noted that even if the amounts of FDI inflows into manufacturing and service industries were often limited, they nonetheless played an important role in some countries in the development of local industries, as in the case, for example, of Botswana (box III.3).

Box III.3. Botswana: the role of FDI in economic restructuring

Botswana stands out as the sole graduate from the category of LDCs, becoming a middle-income country within one generation. Its progress was spearheaded by the discovery of rich deposits of diamonds in 1967. Unlike other developing countries, Botswana has been open to FDI since it gained independence in 1966. It decided to exploit diamonds in a joint venture with foreign investors and avoided nationalizations. FDI, and the Government's handling of the fiscal, social and economic pressures of transformation, were key factors in Botswana's economic success. Somewhat unusually for a developing country, it has managed to create a long-term macroeconomic environment conducive to a sound investment climate.

Botswana's early opening to FDI was rewarded with large inflows in the 1970s. A record annual inflow of $127 million was registered in 1979. Between 1975 and 2000, flows remained quite stable, with five-year annual averages hovering between $50 million (during 1981-1985) and $70 million (in 1986-1990 and 1996-2000), except for the 1991-1995 period when they were negative. Very large negative flows – of $287 million – occurred in 1993 because of losses and subsequent changes in the ownership of a copper-nickel mine. Until the 1990s, Botswana received a disproportionately larger amount of FDI than the other 13 members of the Southern African Development Community (SADC) regional grouping to which it belongs, or than the LDCs as a group (to which it belonged at independence). During the 1990s Botswana lost its position vis-à-vis these countries as they opened up to FDI, among others, through privatization, which Botswana has not yet implemented.

On an annual basis, FDI inflows were lumpy, with peaks determined by investments in three diamond mines and copper and nickel mines. More recently, however, with no shortage of local savings, liberalization of the capital account and a further improvement of Botswana's creditworthiness, the link between large FDI projects and FDI inflows has become weaker, as investors have a choice of financing options typically unavailable in many developing countries. A major $400 million expansion of the Orapa diamond mine during 1998-2000 did not prevent a fall in FDI inflows from $96 million in 1998 to $30 million in 2000.

Foreign firms came to play a significant role in many industries early in Botswana's development effort. In partnership with the Government, they developed the mining sector. FDI also contributed to the development of the manufacturing sector, although this is small (4-5 per cent of GDP). In the services sector, commercial banks have always been foreign-controlled. Other service industries with a strong foreign presence include insurance and business services. Foreign firms are prominent in road transport, wholesale trading and construction. In tourism, of a total of 331 enterprises licensed and operating between March 1997 and February 2001, more than two-thirds were foreign, half of them being joint ventures with local partners.[a] By contrast, agriculture, beef-processing and infrastructure services have always been the domain of local, mainly State-owned firms. Such firms are also visible in financial services. On the other hand, the local private sector has always been rather weak, especially in manufacturing. This poses one of the most formidable challenges to Botswana's development, which has so far been driven mainly by large State-owned and foreign firms.

In terms of qualitative impact, early inflows of FDI strongly boosted export receipts and government revenues which were invested wisely and created the foundation for long-term growth. Concentrated in mining, FDI has had little direct impact on employment. Linkages with the local economy appear weak, one of the reasons being a dearth of local businesses. More importantly, FDI has provided the resources critical for the first phase of the diversification of Botswana's economy, from purely agriculture to include mining. It has also contributed to the second phase of diversification, "beyond diamonds", but this remains an unfinished business and a continuing challenge to the Government.

Source: UNCTAD, forthcoming a.

[a] Information from the Department of Tourism of Botswana.

Obviously, the industrial pattern of FDI flows differs among individual home countries. In the case of the United States, for example, oil and petroleum have accounted for more than 60 per cent of all FDI outflows to Africa since 1996. In the case of the Netherlands, most FDI went into the primary sector, while most FDI from other home countries such as Germany, Japan and the United Kingdom, went into services. TNCs from the United Kingdom were particularly active in banking and finance as well as in trading, and German firms concentrated on construction and real estate. Japanese FDI went mainly into transportation, most of which had to do with flag-of-convenience shipping.

The difference in the industrial composition of FDI flows into Africa is largely explained by the different industrial structures of the home countries. The United States, for example, hosts a large number of oil and petroleum companies, while the large banking-related outflows from the United Kingdom to Africa are due to that country's strong financial industry. [27]

Future FDI is also likely to focus on a few countries. Surveys by UNCTAD/AFII/Andersen (UNCTAD, 2001a) and MIGA (MIGA, 2002) suggest that South Africa will remain the main destination, followed quite far behind by Egypt.[28] The former survey also revealed that TNCs prefer to tap African markets by exporting rather than investing. Only about 20 per cent of the respondents saw greenfield FDI as an option, and only 12 per cent considered acquiring an African firm. Both modes of FDI accounted for considerably higher shares in other developing regions. Recent initiatives to grant African manufactures better access to developed-country markets may strengthen manufacturing FDI. The African Growth and Opportunity Act (AGOA) initiative by the United States, and the European Union's "Everything-but-Arms" programme are expected to help in this respect (see Part Three).

AGOA has also had an impact on intra-African FDI and trade. Mauritian garment firms are buying more South African textiles, and South African firms are investing in neighbouring countries. For example, the Transvaal Clothing Corporation (TRALCO) has announced plans to construct a plant in Swaziland (box III.4).[29]

Box III.4. New trade and investment initiatives in sub-Saharan Africa in response to AGOA

According to the 2001 and 2002 Reports of the President of the United States on the Implementation of AGOA (USTR, 2001b, 2002), the adoption of this Act in May 2000 has started to generate new trade and investment responses in a number of beneficiary countries. Reportedly, these have included the following (although it is difficult to ascertain whether they would have taken place in any event):

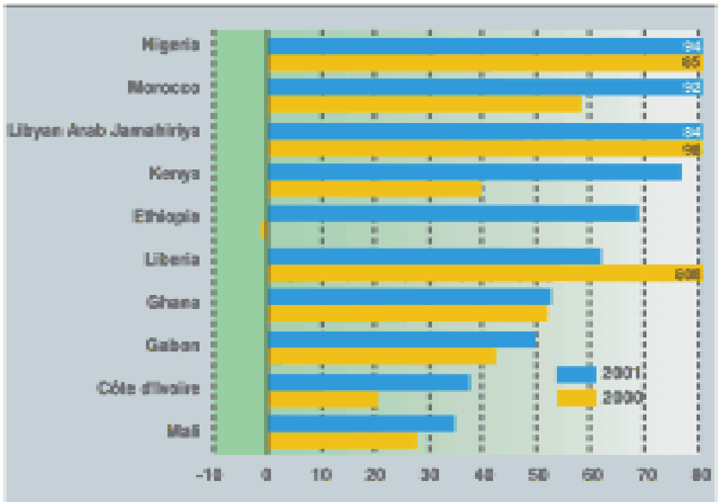
- In Cape Verde, a fish-processing company was acquired by a United States company, and two new investments in the garment industry were announced by Portuguese companies.
- In Ghana, a United States company is investing in a tuna-processing plant.
- In Kenya, the Government has so far announced new investments, and expansions of existing investments, in apparel production, amounting to $13 million and providing over 20,000 new jobs.
- In Malawi, AGOA has led to FDI in two garment factories (by a European company and a Taiwanese company) and the creation of at least 4,350 jobs. Total employment could increase eventually by 10,000, for a total of 20,000 workers.
- In Mauritius, FDI worth $78 million has already taken place. In the near future, there are prospects of Asian and European companies building cotton-yarn spinning mills. In addition, there are reports of substantial new orders from major United States retailers.
- In Senegal, a leading Senegalese apparel and textile company plans to enter into partnership with a United States textile manufacturer and a Malaysian firm to export to the United States, with the potential creation of 1,000 jobs.
- In South Africa, the establishment of a new $100 million clothing facility expected to employ 13,000 workers has been announced by a Malaysian company. South African companies are also receiving new orders from a variety of United States clothing companies and retailers.
- In Namibia, a new investment is planned in the apparel and textile sector of more than $250 million, leading to 8,000 new jobs over the next five years and 18,000 jobs over the next 10 years.
- In the United Republic of Tanzania, reports indicate the expansion of a textile mill in partnership with a United States firm involving 1,000 jobs.

Source: USTR, 2001b, pp. 114-115 and USTR, 2002, pp. 30-31.

While these schemes to provide privileged access to United States and EU markets for African exports may stimulate FDI, a note of caution is in order. The effects of such access may be temporary and confined to activities like apparel, in which there are significant constraints on exports by other developing countries. FDI may flow to African countries to exploit their temporary privileges, despite high costs, and withdraw once the privileges end (or when the ending of the Multi-Fibre Arrangement makes them less important). It is thus vital to use the duration of the privileges to build up local skills, linkages and infrastructure in Africa and make the facilities fully competitive (for details, see Part Three).

Total ***outflows*** from the region stood at -$2.5 billion in 2001, compared with $1.4 billion in 2000. For the first time ever in the past 30 years, FDI flows from Africa were negative. This means that, on a net basis, Africans sold more of their foreign affiliates and repatriated the capital, than they invested abroad. However, the FDI outflows are – as the inflow figures – distorted by the Anglo American-De Beers transaction (figure III.13).[30] Excluding that transaction, FDI outflows from Africa would have been reduced only by some $650-$800 million in 2001. That decline in turn was largely due to a reduction in FDI outflows from Liberia (more than $500 million in 2001). As almost all FDI into Liberia is related to the registering of ships under flag-of-convenience, it has little significance for the overall FDI trends in Africa. For all other African countries, FDI flows were insignificant, not surpassing the $100 million mark even for such a large country as Nigeria.

Figure III.13. Africa: FDI outflows, top 10 countries, 2000 and 2001[a]
(Millions of dollars)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 2001 FDI outflows.

2. Asia and the Pacific

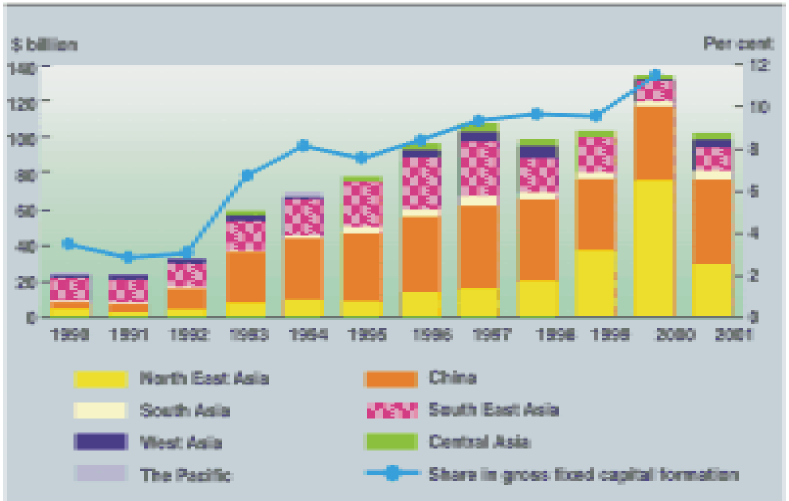
FDI flows to the developing economies of Asia and the Pacific declined from $134 billion in 2000 to $102 billion in 2001. Much of the decline was due to an over 60 per cent drop in flows to Hong Kong, China, which had recorded a massive inflow ($62 billion) in 2000 (*WIR01*, p. 25). If this is discounted, inflows in 2001 were at the peak reached in the previous decade. While they remained stagnant in North-East and South-East Asia, they increased significantly in South and Central Asia (by 32 per cent and 88 per cent, respectively) (figure III.14). The share of developing economies of the Asia-Pacific region in global inflows increased from 9 per cent in 2000 to nearly 14 per cent in 2001. According to the UNCTAD Inward FDI indices, during the past decade, while FDI potential improved in many economies (e.g. Hong Kong (China), Republic of Korea and Taiwan Province of China) FDI performance declined in Malaysia and Singapore (figure III.15 and table II.1).

Within these overall trends, economies performed unevenly in 2001. China regained its position – lost to Hong Kong, China in 2000 – as the largest recipient in both the region and the developing world. India, Kazakhstan, Singapore and Turkey were leading recipients in their respective subregions (figure III.16).

FDI inflows to *China* – the largest recipient among developing countries for most of the past decade – regained their momentum after three years of stagnation, to reach $47 billion in 2001. The momentum continued in the first half of 2002, when inflows increased by 19 per cent over the same period of 2001. The upward trend in FDI is likely to be sustained in the coming years, particularly in the light of the country's accession to the WTO (see *WIR00*, box III.2). Aside from investment by new entrants, reinvested

Figure III.14. FDI inflows and their share in gross fixed capital formation in developing Asia and the Pacific, 1990-2001

(Billions of dollars and percentage)



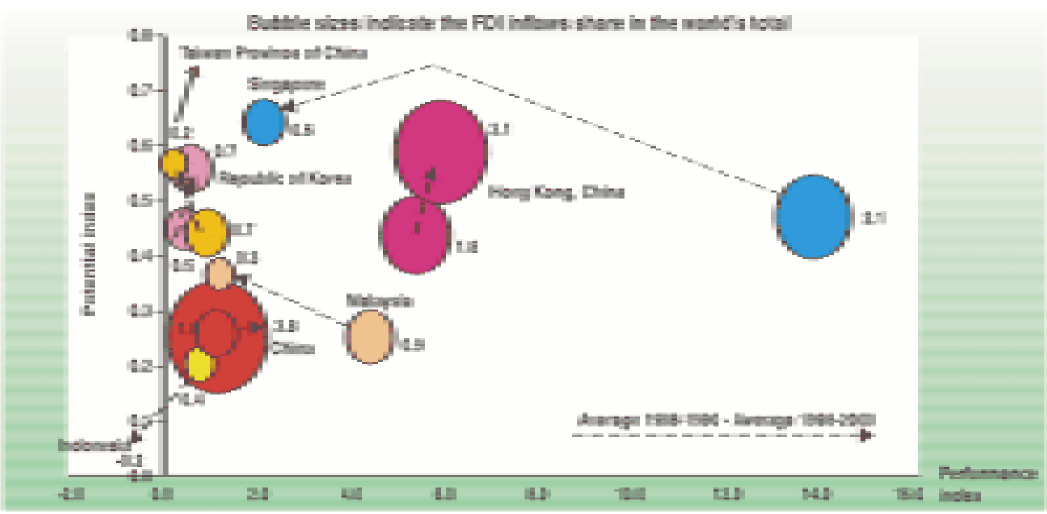
Source: UNCTAD, FDI/TNC database.

Note: North East Asia includes: Hong Kong (China); Korea, Democratic People's Republic of; Korea, Republic; Macau (China); Mongolia; and Taiwan Province of China.
South East Asia includes: Brunei Darussalam; Cambodia; Indonesia; Lao People's Democratic Republic; Malaysia; Myanmar; Philippines; Singapore; Thailand; and Viet Nam.
South Asia includes: Afghanistan; Bangladesh; Bhutan; India; Maldives; Nepal; Pakistan; and Sri Lanka.

earnings of foreign affiliates in China have become an important source of FDI, accounting for about one-third of the total inflows during 2000-2001. FDI continues to play a prominent role in China's economy. For example, foreign affiliates now account for 23 per cent of the total industrial value added, 18 per cent of tax revenues and 48 per cent of total exports (China, MOFTEC, 2001a).

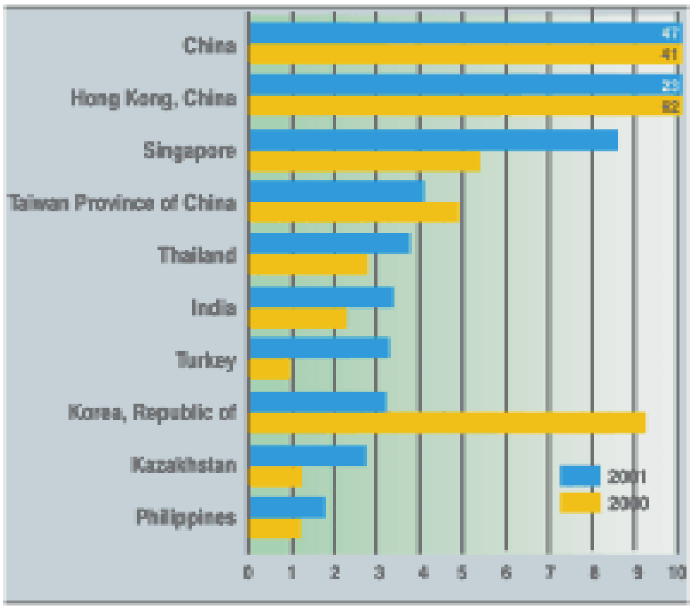
The FDI boom in *North-East Asia* subsided, with inflows falling from $76 billion in 2000 to $30 billion in 2001. The growth of FDI to this subregion in 2000 was largely due to a doubling of inflows to Hong Kong, China, mostly on account of a single large acquisition in telecommunications, valued at $24 billion (*WIR01*, p.25). Nevertheless, the role of the Hong Kong, China, economy as a business hub for the region continued to be strengthened. By 2001, 3,237 TNCs had established regional offices there (including 944 regional headquarters), an 8 per cent increase over the previous year (table III.4). FDI in the *Republic of Korea* fell by two-thirds in 2001, to $3 billion, as the wave of post-financial-crisis M&As tailed off.[31] Inflows to *Taiwan Province of China* in 2001 amounted to $4 billion, thus remaining at historically high levels. Its accession to the WTO has increased its attractiveness for international investment, particularly in the services sector (box III.5). The new regulations governing M&As passed in January 2002 are another factor that will encourage TNC participation in the restructuring of the economy.[32]

Figure III.15. The UNCTAD Inward FDI Performance Index and Inward FDI Potential Index for selected countries in Asia, 1988-1990 and 1998-2000



Source: UNCTAD, based on table II.1 and annex table B.1.

Figure III.16. Developing Asia and the Pacific: FDI inflows, top 10 economies, 2000 and 2001[a]
(Billions of dollars)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 2001 FDI inflows.

Flows to *South-East Asia* stagnated at $13 billion. Part of the reason was continued divestment ($3 billion in 2001) in *Indonesia*, where divestments have exceeded inflows since late 1998. In *Malaysia*, FDI remained stagnant; in response, the Government introduced a number of incentives, including the extension of the reinvestment allowance period from 5 to 15 years, and tax measures to benefit the machinery and equipment industry and manufacturing-related services. Inflows to the *Philippines* rose from $1.2 billion in 2000 to $1.8 billion in 2001. FDI in *Singapore* also increased by 59 per cent to $9 billion, the first time since 1998, but still below the peak of $11 billion reached in 1997. Faced with the erosion of its competitiveness in electronics vis-à-vis other countries in the region, Singapore has designated biomedical sciences as the next pillar of its manufacturing growth, and has been

Table III.4. Regional headquarters established by foreign firms in Hong Kong, China, 2001[a]
(Number)

By home economy[b]		By industry	By regional headquarters	By parent firms	By area of responsibility[b]	
United States	221	Manufacturing:	66	133	China	782
Japan	160	Electronics	63	112	Taiwan Province of China	486
United Kingdom	90	Biotechnology	3	21	Singapore	392
China	70	Services:	750	700	Republic of Korea	356
Germany	56	Construction, architectural, engineering and surveying	44	64	Thailand	329
Netherlands	48	Wholesale, retail and trade-related services	375	255	Malaysia	312
France	43	Tourism, entertainment, restaurants and hotels	18	22	Philippines	311
Switzerland	34	Transportation and related services	61	59	Japan	298
Singapore	25	Telecommunications	21	20	Indonesia	276
Taiwan Province of China	22	Financial services	94	136	Australia	220
Others	180	Business and professional services	81	67	India	216
		Information technology	40	53	Other countries/territories in the region	135
		Media and multi-media	16	24		
		Others	285	354		
Total above	949[c]		1 101[d]	1 187[e]		4 113[f]

Source: Hong Kong Census and Statistics Department, 2002.

[a] As at 1 June.
[b] Ranked in descending order.
[c] The total is higher than the actual number (944) due to the inclusion of joint ventures undertaken by two or more foreign investors.
[d] The total is higher than the actual number (944) due to the fact that some regional headquarters are engaged in more than one line of business.
[e] The total is higher than the actual number (944) due to the fact that some parent firms are engaged in more than one line of business.
[f] The total is higher than the actual number (944) due to the fact that some regional headquarters are responsible for more than one area.

improving infrastructure and targeting high-potential companies in that industry through various investment funds, including venture capital. Leading companies in biotechnology from both Europe and Japan have signed up to relocate to Singapore (EIU, 2002a). FDI in *Thailand* increased by $1 billion to $3.8 billion, but remained lower than its peak level in 1998. TNCs continued to consolidate their regional auto-manufacturing bases in Thailand. Auto and auto component manufacturers such as BMW, Honda, Toyota, Land Rover and Ishikawajima-Harima announced expansion or entry there. *Viet Nam* is entering a new era as host to FDI, strengthened by its bilateral trade agreement with the United States and the prospects of its accession to the WTO. Although FDI commitments in the country rose by a third, to $3 billion in 2001, FDI flows on a balance-of-payments basis remained at the same level as in 2000 ($1.3 billion).

Inflows into *South Asia* reached $4 billion, a 32 per cent increase over the previous year. Of this, $3.4 billion went to *India* (a 47 per cent increase). India, by far the largest recipient in the region, has been

Box III.5. The accession to the WTO of Taiwan Province of China: implications for FDI

Taiwan Province of China joined the WTO (as the Separate Customs Territory of Taiwan, Penhu, Kinmen and Matsu) in January 2002. Fulfilment of its WTO obligations involves substantial trade and investment liberalization, which will have an impact on its inward and outward FDI.

Accession to the WTO has made the economy of the Province more attractive to foreign investors. In services, in which FDI was largely restricted, Taiwan Province of China has committed to liberalizing a number of industries, including business services, communications, distribution, education, financial services, health and social services, and maritime and air transport services. The removal of foreign equity limitations will not only attract new investors, but also enable foreign joint-venture partners to increase their equity shares in existing affiliates. Indeed, after the preliminary liberalization measures taken by the Province in the process of accession to the WTO, FDI flows to the economy during 2000-2001 doubled from their annual average of the 1990s (annex table B.1), mainly boosted by flows to the services sector. The share of the services sector in total inflows increased from an average of 37 per cent during the 1990s to 58 per cent in 2001.

Unlike services, most manufacturing industries in Taiwan Province of China had been largely open to foreign investors and had already attracted a significant amount of FDI. Accession to the WTO may not, therefore, immediately have substantial FDI-generating effects. Indeed, the reduction of import restrictions and the elimination of trade-related investment measures in industries such as automobiles may reduce flows by eroding the incentive for "barrier-hopping" FDI.[a] Nevertheless, over time, freer access to the import of inputs could help improve the cost-quality conditions of manufacturing, and increase the attractiveness of the economy as a site for efficiency-oriented manufacturing FDI.

Accession-related liberalization of trade and investment will probably also accelerate outward investment from the economy. As the domestic market becomes more open, increased competitive pressures in a number of previously protected industries will necessitate restructuring and induce more domestic firms to invest abroad. In fact, in response, partly to the long lobbying of the business community, and partly to the imperatives of the post-accession trading environment, the authorities in Taiwan Province of China have already lifted restrictions on direct investment into the mainland. The $50 million ceiling on individual projects has been removed and approval for investments of less than $20 million has become automatic. Effective January 2002, the authorities also lifted the ban on investments in notebook computers, third-generation mobile phones and consumer electronics products in the mainland.

In sum, accession to the WTO will make the island economy more attractive to FDI. The services sector will replace manufacturing as the engine of growth for inward FDI. In the manufacturing sector, FDI will play a more prominent role in the process of restructuring and consolidation in response to a new and more competitive landscape. As the FDIregime will be gradually liberalized, both inflows and outflows are likely to reach new and higher levels.

Source: UNCTAD.

[a] In the automobile industry, there will be a significant reduction of import tariffs, a phasing out of quotas, as well as the elimination of local-content requirements and tax incentives for domestically-produced automobile engines, chassis and bodies. This may reduce the incentive for some foreign investors to invest directly in domestic subcontractors or may induce them to bring in foreign suppliers.

taking steps to liberalize its FDI regime further. Inflows into other economies in the subregion stagnated or declined, apparently due to perceived instability in the investment environment, particularly after the September 11 event.

West Asia is estimated to have received \$4.1 billion in FDI in 2001, considerably higher than in the previous year. *Turkey* had the largest inflows in the region (roughly \$3 billion). FDI into *Saudi Arabia* also increased, helped by the establishment of the Saudi Arabian General Investment Authority (SAGIA) and the introduction of tax incentives and a law allowing wholly-owned foreign affiliates. The subregion as a whole (the petroleum sector apart) continues to be marginal as a recipient of FDI, though many countries in the region have liberalized their regimes. It has largely missed out on linking up to the international production systems that have driven export growth in East and South-East Asia.[33] There are many countries in the subregion with the cheap labour that can attract export-oriented operations in low- to medium-technology goods (Sadik and Bolbol, 2001), a strategy pursued thus far only by Turkey. Moreover, considering the market size of the region – almost equivalent to that of China as measured by GDP – there is much greater potential for market-seeking FDI than has been realized (box III.6).

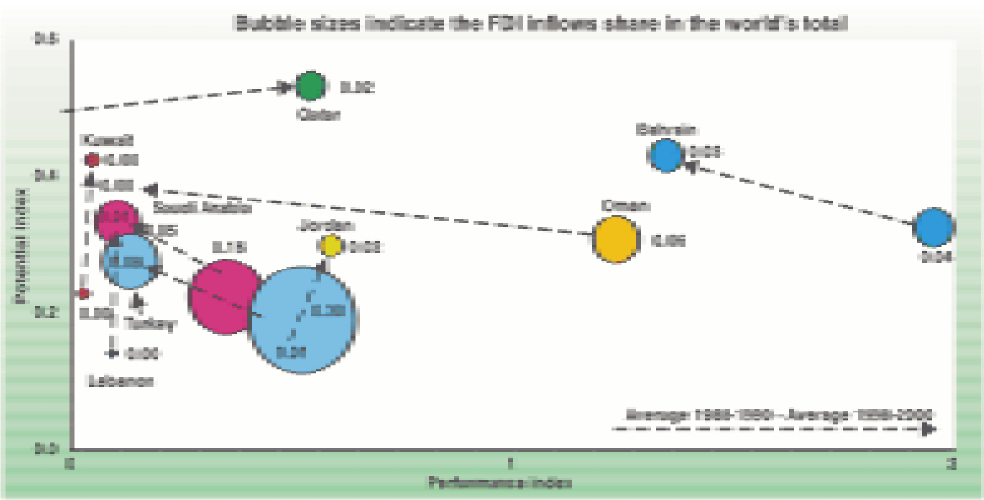
FDI in *Central Asia* rose by 88 per cent in 2001, to \$3.6 billion, driven by the doubling of inflows to *Kazakhstan* (\$2.8 billion). Resource-based activities – particularly in copper and zinc, as well as in oil and gas extraction – absorbed the largest share of inflows (77 per cent). The *Pacific region* remains marginal in terms of FDI inflows, with \$200 million in FDI in 2001. Political instability and poor infrastructure compound the structural constraints of location and

Box III.6. FDI potential in West Asia

Total FDI in West Asia accounted for less than 0.6 per cent of world flows in 2001, one-tenth of its share in world GDP.

The distribution of FDI is uneven in the region, partly reflecting, political instability and risk (Fujita, 2001b). Overall, however, judging from the ratios of FDI to GDP and domestic investment, the role of FDI has declined in West Asian economies over the past 15 years. Turkey, which had the largest inflows in the region (roughly \$3 billion) in 2001 (annex table B.1), is an exception. However, even in Turkey, inflows are not commensurate with the country's potential (tables II.1 and II.3). Among the eight countries in this region for which the UNCTAD Inward FDI Performance Index and Inward FDI Potential Index have been calculated, only Jordan improved its position based on both indices over the past decade (box figure III.6.1).

Box figure III.6.1. The UNCTAD Inward FDI Performance Index and Inward FDI Potential Index for selected countries in West Asia, 1988-1990 and 1998-2000

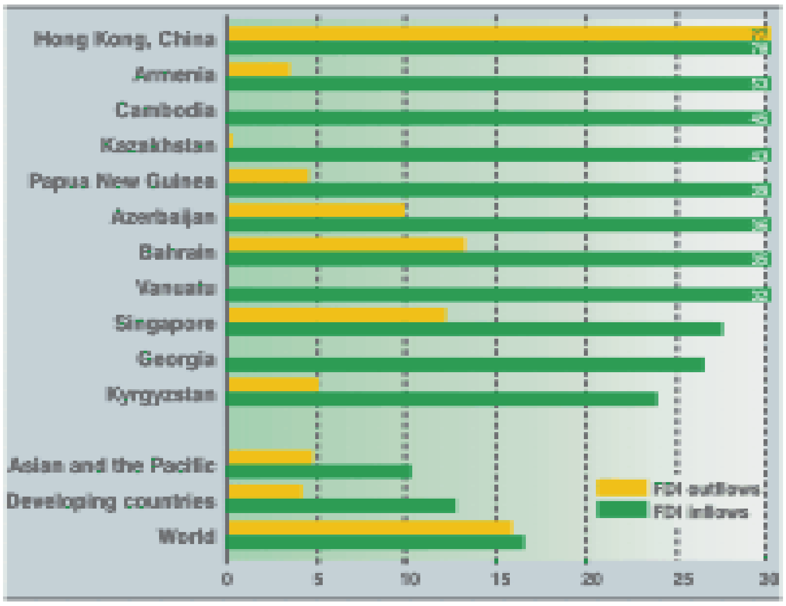


Source: UNCTAD, based on table II.1 and annex table B.1.

Source: UNCTAD.

size in the Pacific island countries. However, in both these subregions, FDI accounted for a significant share of gross fixed capital formation (23 per cent during 1998-2000), far higher than in other developing and developed regions (figure III.17 and annex table B.5).

Figure III.17. Developing Asia and the Pacific: FDI flows as a percentage of gross fixed capital formation, top 10 economies, 1998-2000[a]
(Percentage)



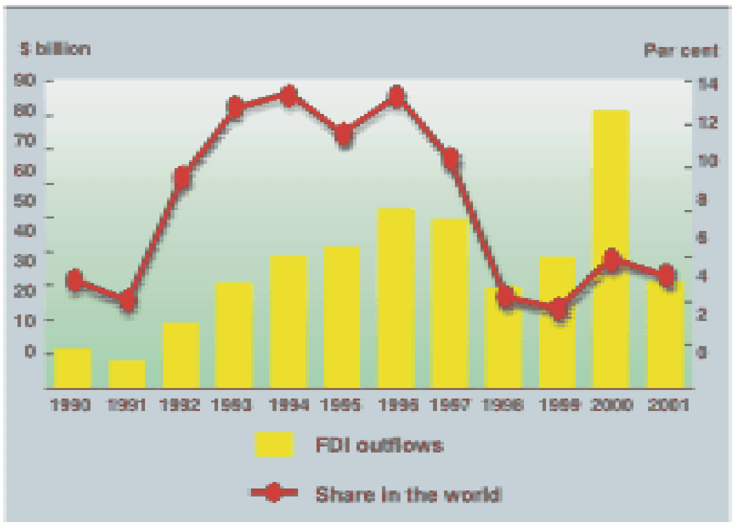
Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 1998-2000 FDI inflows as a percentage of gross fixed capital formation.

Overall, prospects for FDI in the Asia-Pacific region remain bright. Surveys suggest that Asia will continue to be an important location for the expansion of activities within TNCs' international production systems. The UNCTAD/AFII/Andersen survey reported that over half the respondents saw "improved" or "significantly improved" prospects for FDI in the region in the next three to five years (UNCTAD, 2001a). China topped the list in Asia, followed by Indonesia and Thailand. The recent MIGA survey also ranks India, Malaysia and Singapore as favoured destinations. Greenfield investment will become, once again, after the M&A boom during the financial crisis, the preferred option by far for TNC entry into the region (MIGA, 2002).

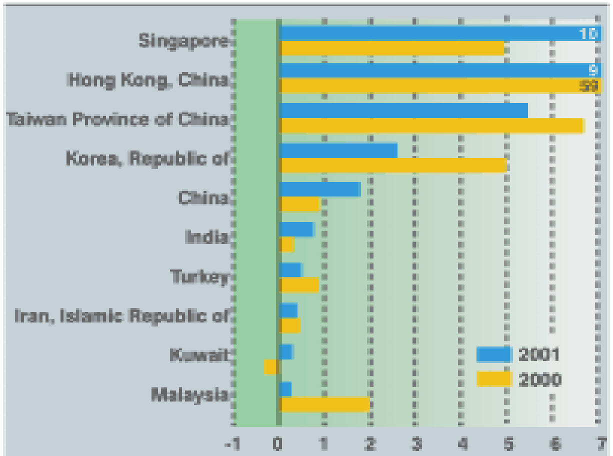
Outward FDI from developing Asia, at about $32 billion in 2001, hit its lowest level since 1998 (figure III.18), mainly because of a massive fall in outflows from the largest traditional investor, *Hong Kong, China*. The territory's outflows in 2001 were only $9 billion, compared to $59 billion in 2000. *Singapore* overtook Hong Kong, China as the region's single largest outward investor (figure III.19). Outflows from Singapore doubled in 2001. This increase was boosted by two major cross-border M&A deals: the acquisition of Cable & Wireless Optus of Australia by SingTel of Singapore ($9 billion) and the acquisition of the Dao Heng Bank Group of Hong Kong, China, by the DBS Group of Singapore ($6 billion) (annex table A.I.2). Indian TNCs accelerated their outward investment, particularly the asset-seeking kind, via cross-border M&As. The value of cross-border acquisitions by Indian firms doubled, to over $2 billion in 2001 (annex table B.8). Indeed, one of the distinctive features of outward FDI from developing Asia is the shift in the mode of entry over the past two years, from greenfield investment to

Figure III.18. Developing Asia and the Pacific: FDI outflows and their share in the world, 1990-2001
(Billions of dollars and percentage)



Source: UNCTAD, FDI/TNC database.

Figure III.19. Developing Asia and the Pacific: FDI outflows, top 10 economies, 2000-2001[a]
(Billions of dollars)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 2001 FDI outflows.

M&As. The latter reached $25 billion in 2001, about 80 per cent of the outflows from the region.[34]

FDI from *Taiwan Province of China* fell by 18 per cent in 2001**.** Much of its investment went to China, as its industries have steadily relocated there. The nature of activities transferred to China has changed over time, from labour-intensive ones in the 1980s to capital-intensive and high-technology (electronics and computer components) ones in the late 1990s. The trend is likely to continue, given the easing of restrictions on FDI from Taiwan Province of China into China and the WTO accession of both economies. Outward FDI from the *Republic of Korea* declined by almost 50 per cent, to about $2.6 billion in 2001. Korean TNCs continued to sell off non-core activities abroad, leading to a reduction in their foreign assets by almost a third between the late 1990s and 2001. Over half of Korean outward FDI stock remains in the manufacturing sector (mainly in electrical and electronics); two-thirds of it is located in Asia and a quarter in North America.[35]

Firms from *China* have been expanding abroad rapidly. The top 12 Chinese TNCs, mainly State-owned enterprises, now control over $30 billion in foreign assets with over 20,000 foreign employees and $33 billion in foreign sales in 2001 (table III.5). Non-State-owned enterprises are now following the State-owned ones abroad, although most of them are small and medium-sized TNCs. Non-State-owned firms now have investments in over 40 countries, not only in Asia but

Table III.5. The 12 largest TNCs from China, ranked by foreign assets, 2001
(Millions of dollars and number of employees)

Ranking by				Assets		Sales		Employment		TNI[a]
Foreign assets	TNI[a]	Corporation	Industry	Foreign	Total	Foreign	Total	Foreign	Total	(Per cent)
1	3	China Ocean Shipping (Group) Company	Transportation	9 382	16 926	2 149	6 757	4 124	74 669	30.9
2	4	China National Offshore Oil Corporation	Petroleum	4 814	8 635	976	3 669	13	24 406	27.5
3	5	China State Construction Engineering Corporation	Construction	3 739	8 099	1 818	5 790	6 833	236 464	26.8
4	1	China National Cereal, Oils and Foodstuff Imp and Exp Corp.	Trade	3 707	5 014	6 446	13 004	359	25 000	41.6
5	12	China National Petroleum Corporation	Petroleum	3 350	83 254	1 600	41 089	4 400	1 167 129	2.8
6	2	China National Chemicals Imp and Exp Corp.	Trade	2 788	4 928	9 148	16 011	350	7 950	39.4
7	9	SHOUGANG Group	Steel and iron	969	6 675	467	4 401	2 086	179 997	8.8
8	6	China National Metals and Minerals Imp and Exp Corp.	Trade	729	2 797	998	4 277	570	7 145	9.1
9	7	China Harbor Engineering Company (Group)	Construction	520	3 271	6 579	17 826	812	70 160	18.0
10	11	Shanghai Baosteel Group Corporation	Steel and iron	383	19 389	1 211	8 643	50	113 896	5.3
11	8	Haier Group Corporation	Refrigerator production	328	3 188	976	7 260	803	31 281	8.8
12	10	ZTE Corporation	Telecommunication equipment	17	1 205	260	1 685	120	12 961	5.9

Source: UNCTAD, FDI/TNC database.

[a] TNI is the abbreviation for "transnationality index". The transnationality index is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

also in other parts of the world. Among the leading non-State-owned TNCs are the Huawei Technologies Corporation (40 foreign affiliates), the Wanxiang Group (9 foreign affiliates) and Zheng Tai Group (7 affiliates) (Zhan and Ge, 2002).

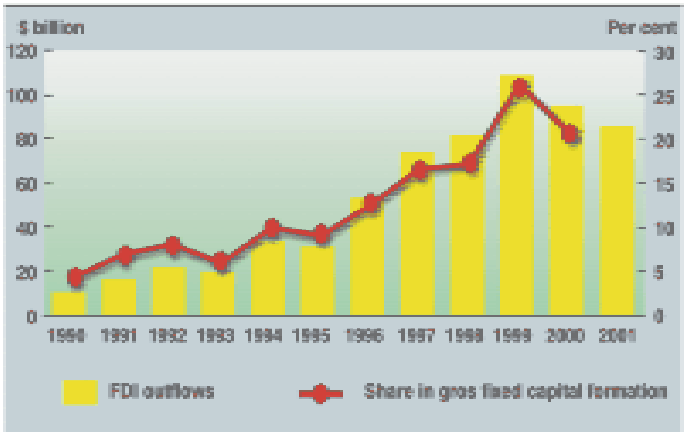
3. Latin America and the Caribbean[36]

FDI into Latin America and the Caribbean declined for the second year in a row. The region received $85 billion in 2001, 11 per cent less than in 2000, which in turn was 13 per cent lower than in 1999 (figure III.20). FDI flows to the telecom industry dropped substantially, as did flows to two of the largest countries (Argentina and Brazil). (See box III.7 on the impact of the Argentine crisis on FDI flows.)

However, *Mexico* doubled its inflows to $25 billion, overtaking *Brazil* to become the largest FDI recipient in the region for the first time since 1995 (figure III.21 and annex table B.1). The increase was driven by the acquisition of Banamex (Banacci) by Citigroup for $12.5 billion – the second largest acquisition in the region ever and the third largest worldwide in 2001 (annex table A.I.2).[37] FDI in *Chile* also rose by 50 per cent, to reach $5.5 billion.

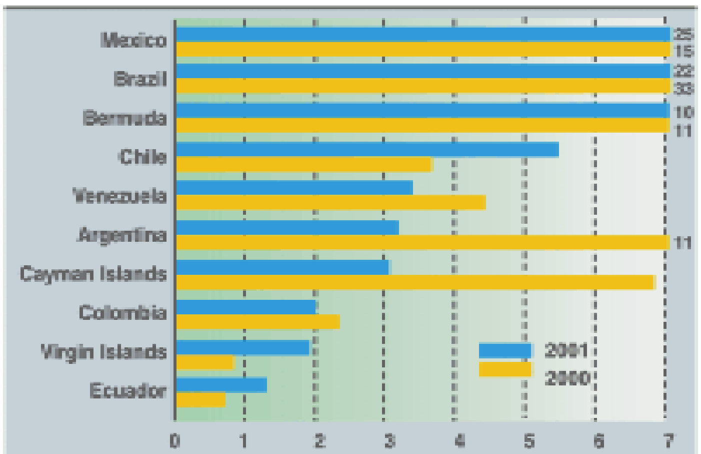
According to UNCTAD's Inward FDI Performance Index, a majority of the economies in Latin America and the Caribbean are attracting shares of global inflows that exceed their shares in global GDP. Of the 24 economies in the region for which the Index has been calculated (chapter II), 16 had values of one or higher. According to the UNCTAD Inward FDI Potential Index, it is the smaller, middle-income economies that have the greatest potential in the region, while those with the lowest GDP per capita have the least. Partly because the FDI Potential Index captures mainly structural factors other than the size of an economy, large economies like Mexico and Brazil rank relatively low on the FDI Potential Index, despite being considered countries with great potential by TNCs interviewed for a recent survey (see below). Some small Caribbean and Central American economies and some countries with important natural resources rank relatively high on performance, despite poor potential. As a percentage of total investment (measured by gross fixed capital formation), countries with important natural resources received the largest flows of FDI during 1998-2000, with Bolivia and Trinidad and Tobago heading the list (figure III.22). It is worth noting that Bolivia's ranking on the FDI Performance Index has improved considerably over the past decade (figure III.23).

Figure III.20. FDI inflows and their share in gross fixed capital formation in Latin America and the Caribbean, 1990-2001
(Billions of dollars and percentage)



Source: UNCTAD, FDI/TNC database.

Figure III.21. Latin America and the Caribbean: FDI inflows, top 10 economies, 2000 and 2001[a]
(Billions of dollars and percentage)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 2001 FDI inflows.

Box III.7. FDI and the economic crisis in Argentina

FDI played an important role in Argentina's economy in the 1990s. The ratio of FDI to gross fixed capital formation rose, and its level in the period 1998-2000 was comparable to that of Brazil and Mexico (annex table B.5). Flows rose steadily, peaking in 1999, partly on account of the acquisition of the oil company YPF by Repsol of Spain (box figure III.7.1). The share of foreign affiliates in the sales of the 1,000 largest firms in Argentina increased from 34 per cent in 1990 to 68 per cent in 2000.[a]

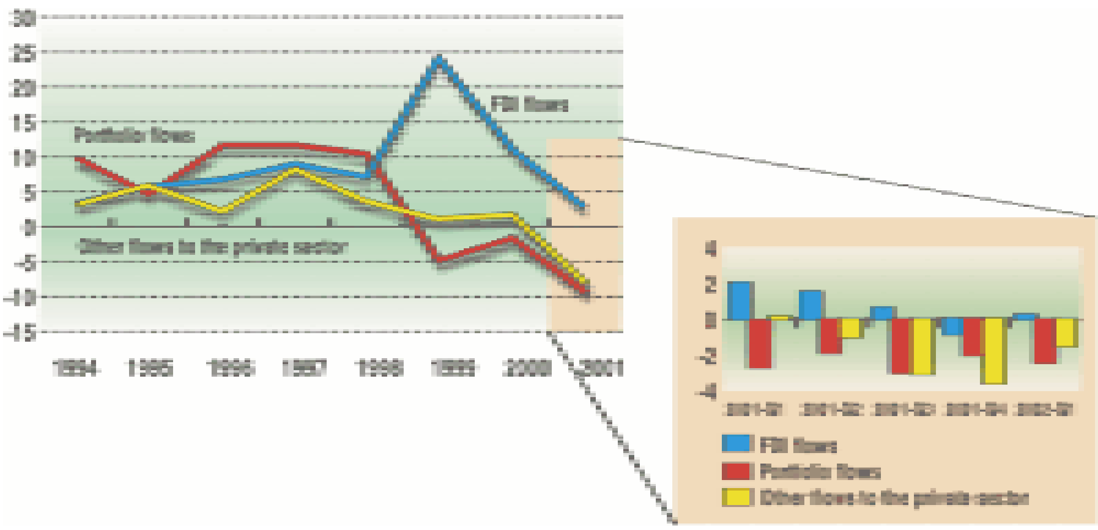
In 1999, the country began to slide into recession and suffer from high levels of country risk and growing uncertainty about the future of the currency convertibility scheme that had been in place since 1991. Nevertheless, FDI inflows in 2000 were the second highest since 1992. However, portfolio flows (partly linked to M&As) had already turned negative in 1999 (box figure III.7.1).[b] The deepening crisis finally affected FDI inflows in 2001 and they fell (by 70 per cent) to the level of the early 1990s; they are expected to fall further in 2002. Total investment in foreign affiliates declined by 30 per cent in 2001, reaching its lowest level since 1996, and it is expected to fall another 50 per cent in 2002.[c] That compares with a fall in total domestic investment of 16 per cent in 2001, and an expected fall of nearly 50 per cent in 2002.[d]

As with East Asia in 1997-1998 (*WIR98*), the fall in foreign currency prices of domestic assets, and the fact that many domestic firms are heavily indebted and have limited access to liquidity (due, among other reasons, to the breakdown in the domestic financial system), may lead to acquisitions by foreign firms. The depreciation also increases the attractiveness of the country for export-oriented FDI. As yet, however, there are no signs of this occurring on a substantial scale. In fact, some firms with significant investments in the 1990s – for example, France Télécom and HSBC – have announced that they will not make more investments in Argentina in the near future, and have even suggested that they might withdraw entirely.[e] Some smaller firms – such as the German autoparts maker, Kautex, and the United States grain trader, Tradigrain – have abandoned their operations in the country.[f] Campofrio, a Spanish meat-processing and packaging firm, has put its Argentine affiliate on sale.[g]

Argentina's economy has now gone through three years of deep recession. In 2001, domestic GDP was more than 8 per cent below the 1998 level and a further fall of at least another 15 per cent is expected in 2002 (IMF, 2002). The Convertibility Scheme was abandoned early in 2002 and, by the end of June 2002, the peso had been devalued vis-à-vis the dollar to almost a quarter of its value six months earlier. Bank deposits have been frozen, giving rise to public demonstrations against the banking system and eroding the trust of Argentine citizens in local banks.

Box figure III.7.1. Financial flows to Argentina 1994-2001

(Billions of dollars)



Source: UNCTAD, based on data from Argentina, Ministerio de Economia.

/...

Box III.7. FDI and the economic crisis in Argentina (continued)

It is too early to tell how these developments will affect FDI inflows and TNC operations in the country. The impact will depend on a number of factors:

- *The effect of the devaluation on the relative prices of Argentine exports.* So far the devaluation of the peso has not had a major inflationary impact on domestic prices. Consumer prices are estimated to have increased by 20 per cent between January and April 2002, and possible further increases of 30-40 per cent are envisaged during 2002.[h] If price rises continue to be modest, a significant devaluation of the real exchange rate could be achieved, not only making imports more expensive (and hence creating new opportunities for local firms) but also turning Argentina into an attractive location for export-oriented FDI. In fact, some foreign firms have already announced plans to increase exports from their Argentine affiliates. For example, Accenture plans to export information services from Argentina, to compete with those from India and the Philippines.[i] Others are reconsidering the planned closure of production lines. For example, Fiat Iveco was to close its truck production facilities in Argentina and import those vehicles from Brazil, but is now reconsidering this decision.[j] However, export increases may take some time to occur. Furthermore, the possibility of a resumption of high inflation reversing the real-exchange-rate decline (and the consequent improvement in export competitiveness) cannot be disregarded.

- *The extent to which market-seeking FDI takes advantage of the "bargain prices" of domestic assets resulting from the crisis and the devaluation.* Banks and other portfolio investors in Argentine firms – including so-called "vulture funds" – as well as TNCs, with or without foreign affiliates in the country, could acquire stock in indebted firms that cannot meet their obligations but have a promising future. For instance, some Brazilian firms interested in expanding their operations abroad have already expressed their interest in acquiring Argentine firms.[k] However, no major acquisitions of firms in distress in manufacturing and/or services have been made so far, with the exception of the acquisition by Ambev, the Brazilian brewing group, of a 36 per cent voting stake in Quilmes, Argentina's largest brewer. The acquisition of the cash-strapped Quilmes was mainly motivated by the objective of integrating the activities of the two firms in order to consolidate their dominating positions in Latin America's Southern Cone; both of them had already invested in countries such as Bolivia, Chile, Paraguay, Uruguay and Venezuela.

- *The depth and duration of the recession.* The recession has created significant idle capacity in most industries, particularly in firms that have not been able to increase their exports to compensate for the fall in domestic demand. For instance, the production of cars, which is dominated by TNCs, nearly halved between 1998 and 2001. Foreign affiliates have suffered major losses in recent years, especially in banking, telecom services, supermarkets and oil refining. As a result, many TNCs are adopting a "wait and see" attitude.[l] Although only a small number have reacted by pulling out of the country,[m] few, if any, are committing further funds to the affiliates they already have or to new projects in the country.

- *Attitudes and policies with respect to inward FDI.* A significant proportion of Argentine citizens seem to believe that the country has been "sold out" to foreign investors. One factor explaining the present widespread mistrust of foreign investors is the large increase in rates for services after privatization in utilities such as telecommunications.[n] According to polls by the Argentine market research firm Graciela Romer & Asociados, while 60 per cent of the citizens surveyed agreed that utilities should be privatized in February 1992, that figure fell to 23 per cent in December 2001 (Graciela Romer & Associates, 2002). A recent poll by Gallup and two Argentine market research firms also showed that 55 per cent of Argentine citizens do not trust privatized firms. The financial crisis that led to the freezing of bank accounts and to the conversion of dollar-denominated deposits into peso-denominated ones at a rate significantly below the market rate of exchange led most Argentines (70 per cent of those surveyed by the Argentine market research firm Hugo Haime y Asociados) to believe that foreign-owned banks had "taken their deposits away". Although foreign banks did not make the decision either on the freezing of the deposits or on their conversion to pesos, their headquarters generally have been reluctant to provide funds to keep their local branches afloat. (Argentina's central bank was forced to suspend the operations of the Argentine affiliate of ScotiaBank for that reason.)

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According to the UNCTAD/AFII/ Andersen survey, FDI prospects for Latin America and the Caribbean over the next three years are likely to improve, although not as much as in East Asia or Central and Eastern Europe (UNCTAD, 2001a). One quarter of the respondents – a higher share of respondents than in any other developing region – considered M&As the most favoured form of expansion into the region. This survey and the similar one conducted by MIGA (MIGA, 2002) concluded that, in the near future, FDI in the region will continue to be concentrated in Brazil, Mexico and, to a lesser extent, Chile.[38] By sector, the MIGA survey shows that Brazil is attracting interest in both manufacturing and services, while Mexico is considered a top destination only for manufacturing, and Chile and Argentina only for services.

Most of the slowdown of FDI inflows to Latin America and the Caribbean can be attributed to a decline in Spanish FDI (figure III.24), which in 1999 and 2000 financed large M&As in services, very often involving privatizations (*WIR00*, p. 59). In general, FDI inflows through privatizations have slowed down in the region, particularly in Brazil, where they had reached $8.7 billion in 1999

Box III.7. FDI and the economic crisis in Argentina (concluded)

Apart from the change in attitudes towards foreign investors that may or may not be reflected in FDI policies, a number of measures have been taken, or are being discussed (including with the industries involved), that directly affect many TNCs in the country, such as a bankruptcy law, restrictions on banking activities, the freezing and conversion to pesos of utility tariffs, and a windfall tax on oil exports.

The crisis may also have negative effects for Argentine firms that made significant outward investments during the 1990s, especially for those that have relied heavily on foreign credit. In fact, IMPSAT, a firm that had expanded to many Latin American countries to provide telecom services, was not able to make a scheduled bond interest payment in December 2001 (the bond had been issued in the United States market) and has recently agreed to a plan through which its creditors will become the firm's main stockholders. Affiliates of IMPSAT have also had problems in meeting their debt obligations.[p]

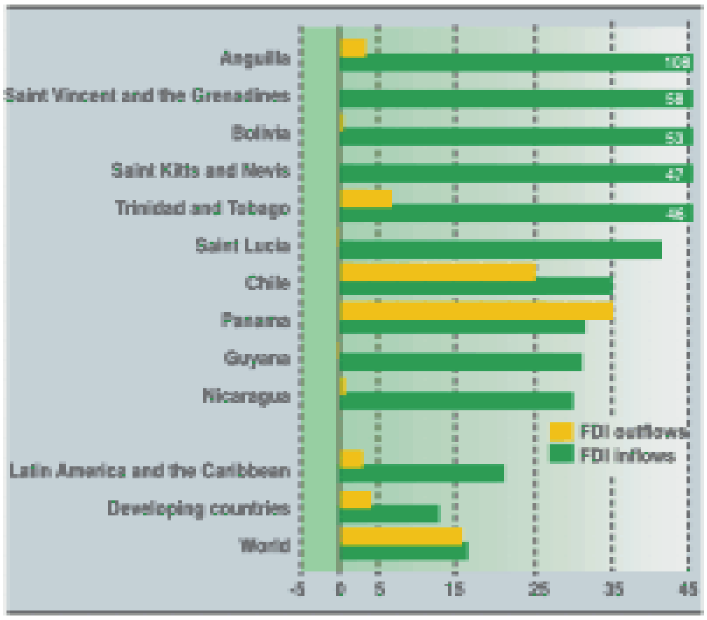
To sum up, there is considerable uncertainty, affecting FDI in Argentina at present, as regards both economic factors and policy with respect to inward FDI and the large public service industries that have been privatized with TNC participation. However, should Argentina's economic situation improve, with a resumption of growth, a significant real peso devaluation, and an environment of institutional stability, foreign investors may well be induced to invest again in this country that is rich in natural resources and human capital. Furthermore, if the Southern Common Market (MERCOSUR) is able to make progress again, that will become an additional factor to induce FDI back into Argentina.

Source: Chudnovsky and López.

a Estimates based on data from *Prensa Economica*, October 1991 and October 2001; and *Mercado*, August 1991 and July 2001.
b A similar contrast between the behaviour of FDI and portfolio capital was observed during the Asian and Mexican crises in 1997-1998 and 1994-1995, respectively (see *WIR98*).
c According to data from the Centro de Estudios para la Produccion of the Secretariat of Industry. The data show the total amount of real investments in foreign affiliates, irrespective of the source of financing of those investments.
d *Latin America Concensus Forecasts*, 17 June 2002.
e France Télécom's Chairperson said that the company was likely to exit Telecom Argentina (*Business News Americas*, 22 March 2002). HSBC's chairperson said that the bank's policy "is to invest for the long term, but it is entirely possible that political events in Argentina could cause us to reassess this policy" (*Financial Times,* 5 March 2002).
f *La Nación*, 7 March and 9 March 2002.
g *La Nación*, 12 April 2002.
h *Latin America Consensus Forecasts*, ibid.
i *La Nación*, 31 March 2002.
j *La Nación*, 12 March 2002.
k *La Nación*, 15 March 2002.
l For instance, the president of Volkswagen's Brazilian operations said that while VW's plant in Buenos Aires is viable – in March its chief financial officer had said that the firm was to close down the factory – the company will make no more investments for the time being (*AFX Europe*, 2 May 2002).
m For example, two foreign banks, Bank of Nova Scotia (Canada) and Credit Agricole (France), pulled out of the country in 2002. The former has suspended the activities of its Argentine affiliate, Scotia Bank Quilmes, for lack of liquidity and has put it up for sale. The Government has taken control of the local affiliates of Credit Agricole after the parent company decided to abandon them (*El Pais*, 21 May 2002).
n Although there has been an improvement in the availability and quality of public services after privatization, at present most citizens appear to favour a re-nationalization of those services.
o *Página 12*, 24 March 2002.
p *Clarín*, 12 March 2002.

Figure III.22. Latin America and the Caribbean: FDI flows as a percentage of gross fixed capital formation, top 10 economies, 1998-2000[a]

(Percentage)



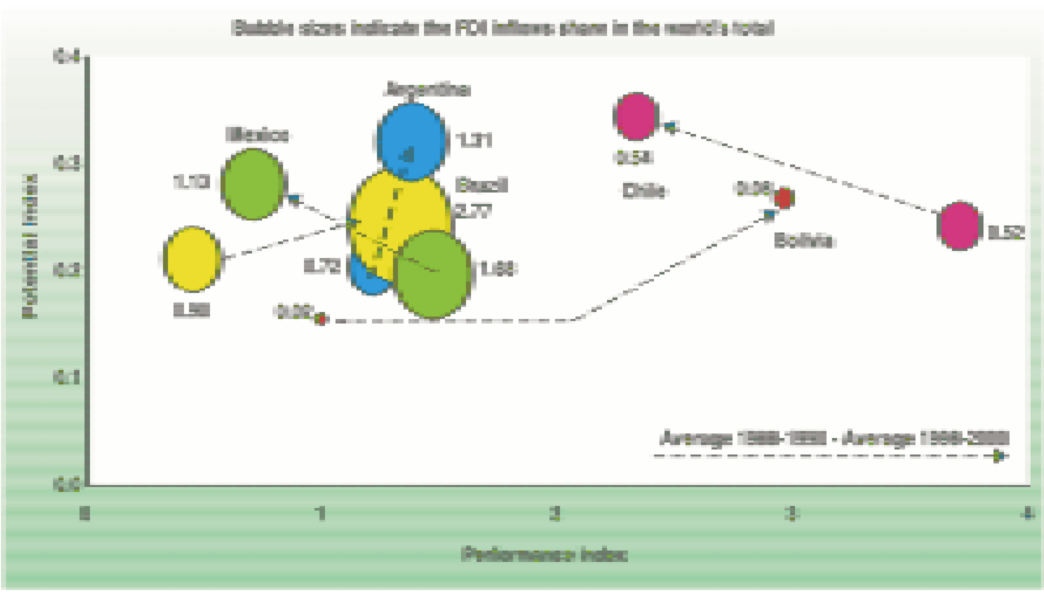
Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 1998-2000 FDI inflows as a percentage of gross fixed capital formation.

and $7 billion in 2000, but were only $1 billion in 2001 (figure III.25); they are unlikely to resume their high levels of the past in the near future. Some other countries, such as Argentina and Chile, have already completed most of their privatization programmes, while others such as Ecuador, Paraguay or Uruguay are finding it politically difficult to sell State-owned enterprises.

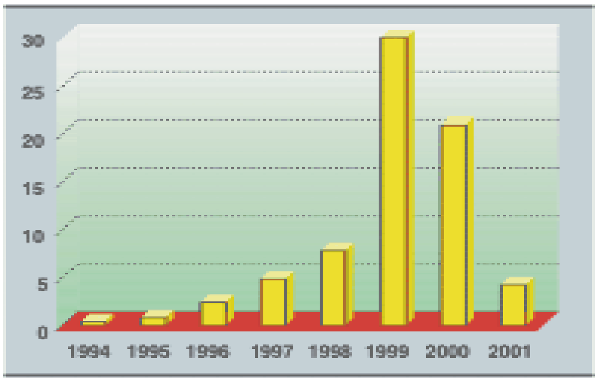
The sectoral breakdown of inward FDI to the region changed in 2001 from the pattern observed in previous years. FDI into the services sector in Mexico rose to almost two-thirds of total inflows, from an average of 23 per cent in the period 1994-2000, driven by large acquisitions in banking (box III.8) and telecommunications. In contrast, Brazil saw a decline in FDI in services, especially telecom and financial services, which had attracted large M&As by foreign firms in 1999 and 2000,[39] and an increase in the manufacturing sector, which has been attracting substantially larger FDI inflows since the devaluation of its currency in 1998 (figure III.26). In Brazil's electricity industry, FDI halved in 2001 despite the urgent need for investment in power generation,[40] mainly because of disagreements about the regulatory framework governing the industry.[41]

Figure III.23. The UNCTAD Inward FDI Performance Index and Inward FDI Potential Index for selected countries in Latin America, 1988-1990 and 1998-2000



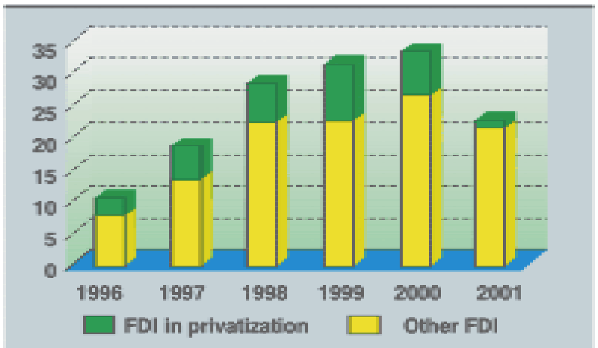
Source: UNCTAD, based on table II.1 and annex table B.1.

Figure III.24. Spanish FDI in Brazil, Argentina, Chile and Mexico, 1994-2001
(Billions of dollars)



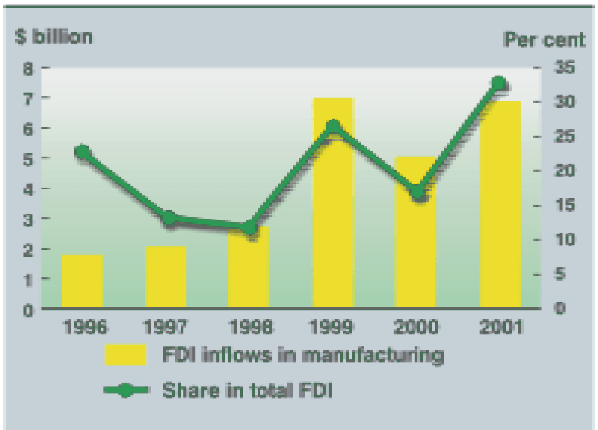
Source: UNCTAD, based on data from Secretaría de Economía (Mexico), Central Bank of Brazil, Dirección General de Cuentas Internacionales, Ministerio de Economía (Argentina) and Comité de Inversiones (Chile).

Figure III.25. FDI in privatization in Brazil, 1996-2001
(Billions of dollars)



Source: UNCTAD, based on data from the Central Bank of Brazil.

Figure III.26. FDI inflows in the manufacturing sector in Brazil, 1996-2001
(Billions of dollars and percentage)



Source: UNCTAD, based on data from the Central Bank of Brazil.

Box III.8. Mexico: FDI in financial services

In recent years, the share of financial services in Mexico's total inflows has grown significantly. In 2001, the industry experienced the single largest foreign investment ever made in Mexico: the acquisition of Banamex (the most important bank in Mexico) by the United States financial group, Citicorp, for nearly $12.5 billion. This acquisition boosted the share of financial services in Mexico's inflows, from 32 per cent in 2000 to 58 per cent in 2001. These shares contrast with the average share for financial services of 10 per cent during 1994-1999.

The increasing interest of foreign investors in the financial services industry has been one of the important characteristics of FDI in Mexico only in recent years, even though the opening up of the industry to FDI started in 1994 as a result of the negotiations on NAFTA and the subsequent liberalization and deregulation, between 1996 and 1999, of Mexico's legal framework for regulating financial services. The Foreign Investment Law of 1993 originally limited FDI participation in holding companies for financial groups and commercial banks to 30 per cent. In 1996, the law was revised, allowing participation of up to 49 per cent. A further revision in 1999 allowed majority foreign ownership. However, the participation of foreign financial institutions in such activities in Mexico is subject to the provisions of a bilateral or an international agreement regulating the establishment of affiliates in the country and conditional on obtaining the relevant authorizations.

Another factor behind the growth of FDI in financial services was the difficult situation faced by Mexican financial intermediaries as a result of the financial and balance-of-payments crisis in 1995. This resulted in an urgent need for quick capitalization.

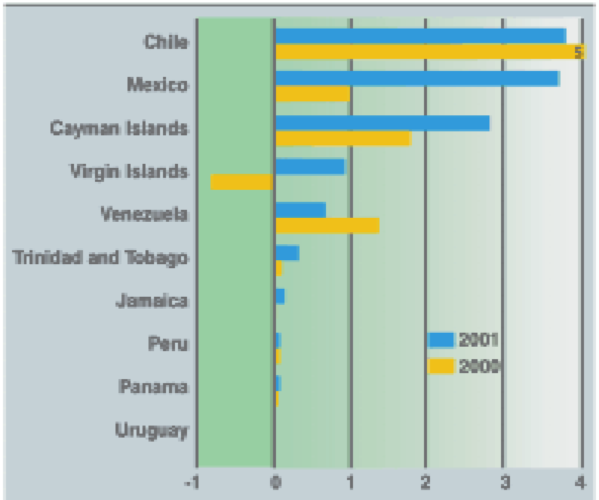
Facilitated by the changes in law, Mexico's financial services industry attracted investments by a number of foreign financial groups between 1994 and 2001, including Citicorp (Citibank) of the United States in 1994; Bank Bilbao-Vizcaya of Spain in 1995; Bank of Montreal of Canada in 1996; Banco Santander of Spain in 1997; Bank Bilbao-Vizcaya of Spain again in 2000; and Citicorp of the United States, in the previously mentioned acquisition in 2001. In view of the financial and technological strengths of these institutions, their presence has the potential to translate into major improvements in Mexican financial services with the consequent benefits for users of greater availability of credit, attractive rates and security of savings.

Source: García.

The recession in the United States directly affected manufacturing in Mexico and the Caribbean basin, particularly in *maquila* enterprises exporting to the United States.[42] In Mexico, FDI inflows in the manufacturing sector declined by $4 billion in 2001. FDI into resource-based activities was especially important in the Andean countries. *Bolivia* received $647 million in FDI, half of it in oil and gas extraction; *Ecuador* received $1.3 billion, 85 per cent of which was in petroleum; and *Venezuela* attracted $3.4 billion in total inflows, 24 per cent lower than in 2000, amid concerns over political and economic stability.[43]

Most FDI ***outflows*** from Latin American countries remain within the region. *Chile* continued to be the largest investor abroad with $3.8 billion in outflows in 2001 (figure III.27), followed by *Mexico* with $3.7 billion. Mexican companies continue to expand into the United States; for example, the food group, Bimbo, acquired Orowit in the United States for $610 million in January 2002.

Figure III.27. Latin America and the Caribbean: FDI outflows, top 10 economies, 2000 and 2001[a]
(Billions of dollars)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 2001 FDI outflows.

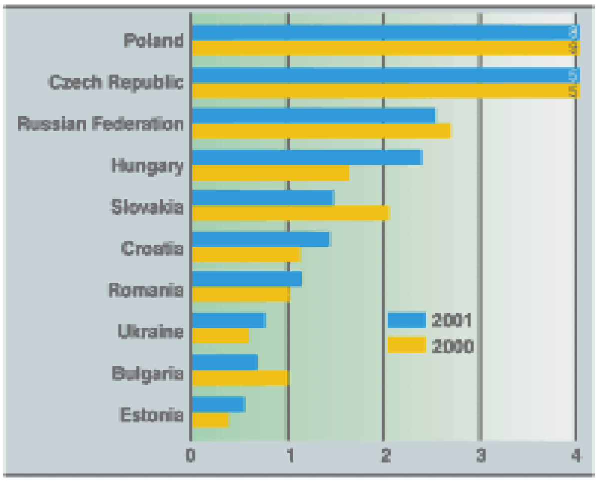
C. Central and Eastern Europe

In 2001, ***FDI flows*** to and from Central and Eastern Europe (CEE) remained at levels comparable to those of the previous year. In fact, while global FDI inflows declined by more than 40 per cent – and this slowdown affected all regions except Africa – flows into CEE grew by two per cent in 2001. They rose in 14 of the region's 19 countries, and its share of world inflows rose from 2 per cent in 2000 to 3.7 per cent in 2001. This suggests that CEE is viewed as a stable and promising region for FDI, its overall economic growth having been less affected by the global slowdown in 2001 than that of any other region. The survey by UNCTAD/AFII/Andersen (UNCTAD, 2001a) found that two-thirds of the respondents expected CEE to have improved or significantly improved prospects for FDI in the next three to five years. This is the highest proportion of positive responses for all regions in the world covered by the survey.

FDI continues to be highly concentrated by country. Five countries (Poland, the Czech Republic, the Russian Federation, Hungary and Slovakia) accounted for three-quarters of the region's inflows in 2001. Of these, all but Slovakia have dominated FDI inflows to CEE since the early 1990s. The UNCTAD/AFII/Andersen survey found that Poland, Hungary, the Czech Republic and the Russian Federation (in that order) were the favoured locations for four-fifths of respondents (UNCTAD, 2001a). The survey by MIGA (MIGA, 2002) drew similar conclusions: Poland was the most popular location, followed by the Czech Republic, Hungary and the Russian Federation. The concentration of FDI is expected to continue in the near future.

Poland, the region's leading recipient since 1996, suffered a decline in 2001 (figure III.28). The reasons lie in the Polish economy: privatization is coming to an end and macroeconomic problems have surfaced. The Government has launched a new and extended incentive scheme to attract fresh investors (box III.9), similar in many respects to schemes already in place in Hungary and the Czech Republic (*WIR98*, p. 289). FDI in the *Czech Republic*, the region's second-largest FDI recipient since 1998, declined moderately – by one per cent – in 2001. Inflows were led by some major greenfield investments, including a major venture by Toyota (Japan) and PSA (France) for the manufacture of automobiles (box III.10). This opens up opportunities for the Czech auto-supplier industry to diversify beyond inputs for Volkswagen/Skoda, so far the only large car producer in the country.

Figure III.28. Central and Eastern Europe: FDI inflows, top 10 countries, 2000 and 2001[a]
(Billions of dollars)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 2001 FDI inflows.

Box III.9. The new system of incentives for investors in Poland

In May 2002, a new law on financial support for investment entered into force in Poland. It stipulates the principles and forms of such financial support, applicable to both foreign and domestic investors. Investments benefiting from the scheme should meet one of the following conditions:

- The value of the new investment is at least %10 million;
- The value of the new investment is at least %500,000, results in the development and modernization of an existing business, and maintains at least 100 jobs (or 50 jobs if the investment is made in one of the priority locations) for at least five years;
- As a result of the investment, at least 20 new jobs are created for at least five years;
- The investment involves technological innovation, making it possible to manufacture modern and competitive goods or services; or
- The investment introduces modern, environmentally-friendly technologies.

Financial support to new investments can take a number of forms.

For investors, these are (individually or together):

- A subsidy determined as a percentage of the value of a new investment, but not exceeding 50 per cent of the maximum amount of public assistance provided for a given location;

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Box III.9. The new system of incentives for investors in Poland (concluded)

- A subsidy not exceeding the value of %4,000 per job for the creation of new employment; and
- A subsidy of up to %1,150 per employee for the training of the workers hired.

For the host communities, these include:

- Assistance in the creation or improvement of the physical infrastructure to support the investment made by the investor.

The details of financial support to individual projects are spelt out in agreements concluded between the Ministry of the Economy and the investor, or the investor and the host community. Each agreement lays down the obligations of the investor and/or the community, in particular the location and value of the investment, the timetable of the project, the number of persons employed and training courses. The agreement also determines the amount and timing of the financial support, and the circumstances under which assistance is to be repaid by the investor. Cumulative assistance provided to an individual enterprise under various titles cannot exceed the stipulated ceiling on allowable State aid.

Source: UNCTAD, based on information provided by the Ministry of Economy of Poland.

Box III.10. Toyota/PSA's investment in the Czech Republic

Toyota and PSA have agreed jointly to develop and produce small cars in the Czech Republic, aiming at a low-price niche. The joint-venture partners had visited and pre-selected various industrial sites in the Czech Republic, Hungary and Poland in the second half of 2001 before settling on Kolin in the Czech Republic. The plant they have started building will be the biggest greenfield investment in the Czech Republic since the start of the country's transition to a market system. Total investment, including research, development and start-up costs, will be about $1.5 billion. The Kolin car plant is scheduled to start producing in 2005. Once operational, it is expected to employ 3,000 people and produce some 300,000 cars per year. An additional 7,000 jobs are expected to be created in service and supply firms.

The Czech Republic has succeeded in attracting this project partly by virtue of its geographical position within Europe, skilled engineers, relatively developed infrastructure and advantageous labour costs, as well as its competitive system of incentives introduced in 1998 (*WIR98*, p. 289). The authorities in

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Box III.10. Toyota/PSA's investment in the Czech Republic (concluded)

the Czech Republic hope that with the entry of Toyota and PSA the country will become the car assembly centre and automotive supply hub for countries poised to enter the EU. Toyota and PSA would also introduce competition in a market so far largely dominated by the incumbent local producer, Skoda Auto (an affiliate of Volkswagen), which employs 24,000 people in the Czech Republic, produces 7 per cent of GDP and 10 per cent of national exports. For the large supplier network currently serving mainly Skoda Auto (more than half of the world's 50 leading suppliers have facilities in the Czech Republic) or exporting to the European continent, the Toyota/PSA plant may offer a new supply outlet. Local suppliers, however, would have to compete with other suppliers in Western Europe. Both PSA and Toyota have substantial, non-labour-intensive, advanced supplier networks around their plants in Western Europe, consisting of firms not yet present in the Czech Republic. However, these suppliers may not transfer any business to the Czech Republic unless the orders exceed their current capacities in Western Europe.

Source: UNCTAD, based on CzechInvest, 2002; Carey, 2002; and Anderson, 2002.

FDI inflows to the *Russian Federation* declined for the second year in succession in 2001, despite the attractiveness of that country's natural resources and high GDP growth, reflecting continued difficulties in the domestic business environment. In *Hungary*, robust GDP growth spurred a surge of FDI (by about 40 per cent), the highest inward FDI flow since its privatization programme ended in 1998. Most of the inflows to Hungary took place in the form of associated FDI, including investments by suppliers to foreign affiliates in the automotive and electronics industries (Ernst & Young, 2002). In *Slovakia*, FDI inflows declined somewhat after a privatization-related peak in 2000. Slovakia's inflows in 2001 were, nevertheless, the second highest since the start of that country's transition to a market economy.

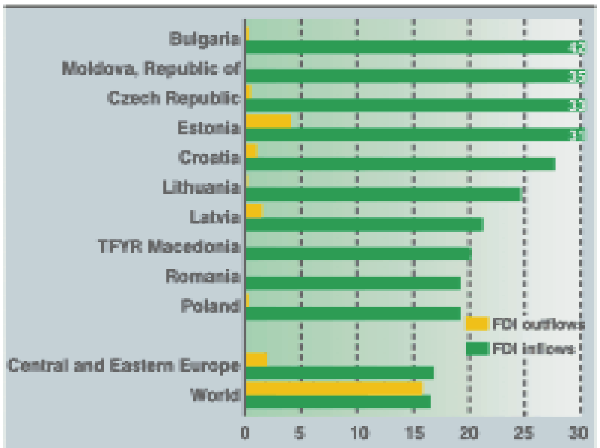
Most of the other countries in the region saw their FDI inflows grow in 2001, helped by stability and above-average growth rates in the region,[44] as well as ongoing privatization in some latecomer countries and some industries. *Slovenia*, for example, opened such key industries as telecommunications and banks to foreign investors in 2001. Some of the highest FDI growth in the region, however, reflects the very low levels in 2000, for some countries (*Yugoslavia, the Former Yugoslav Republic of Macedonia, Belarus, Bosnia* and *Herzegovina*). On the other hand, notable exceptions to the FDI growth trend were observed in *Bulgaria* and *Latvia*.

Parallel with the surge of FDI inflows, their share in the gross fixed capital formation of the region reached high levels by the end of the 1990s, exceeding 25 per cent in 1999. This increase was particularly high in 1996-1999 (annex figure B.5). In terms of FDI inflows relative to gross fixed capital formation Bulgaria, Croatia, the Czech Republic, Estonia, Lithuania, Latvia and the Republic of Moldova were the regional leaders in 1998-2000 (figure III.29). These high ratios reflect the small size of the national economies, due either to small populations (e.g. the Baltic states) or very low GDP levels per capita (e.g. Bulgaria and the Republic of Moldova). The Czech Republic is a notable exception, its high ratio reflecting mainly the high inflows it has received.

The steady performance of many CEE countries in attracting inward FDI in 2001 means that the majority of these countries

Figure III.29. Central and Eastern Europe: FDI flows as a percentage of gross fixed capital formation, top 10 countries, 1998-2000[a]

(Percentage)



Source: UNCTAD, FDI/TNC database.

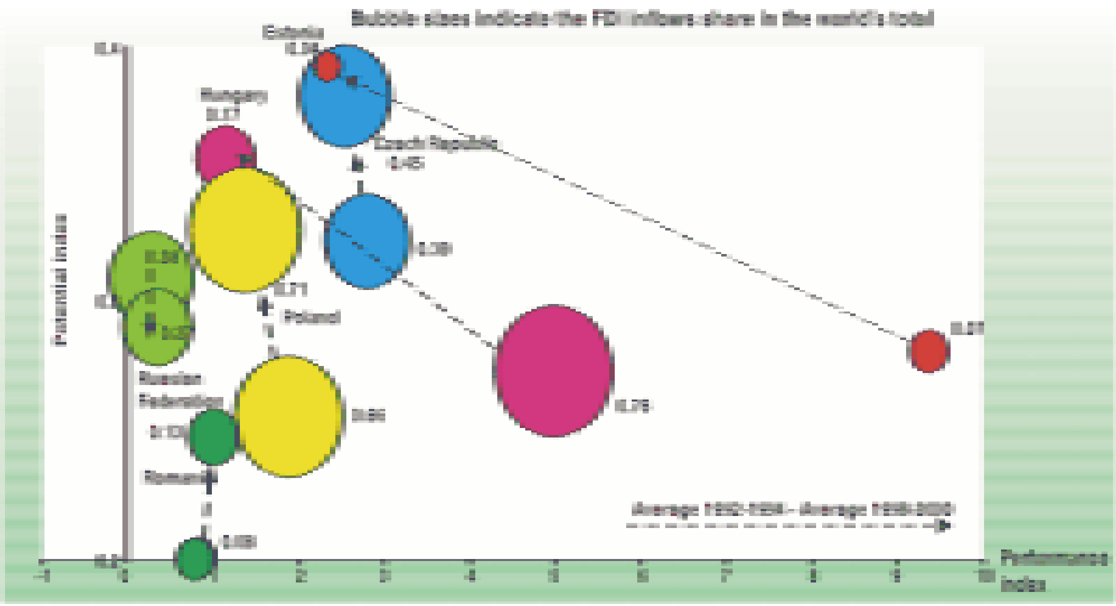
[a] Ranked on the basis of the magnitude of 1998-2000 FDI inflows as a percentage of gross fixed capital formation.

continue to keep their position as high-potential, high-performance recipients of FDI (chapter II), while others, such as Slovenia, may be poised to move out of their present positions into that group. Of the 17 CEE countries covered by UNCTAD's Inward FDI Performance and Inward FDI Potential indices, nine countries were already front-runners in the early phase of transition (1992-1994), combining high FDI potential with high FDI performance.[45] With the exception of the Republic of Moldova, these countries combined a favourable geographical location (closeness to Western European markets) with good initial conditions for transition (EBRD, 2000). Three countries were below-potential recipients (low performance despite high potential),[46] and two countries (Romania and the Former Yugoslav Republic of Macedonia) were under-performers (low potential combined with low performance). With the exception of Slovenia, the two latter groups were characterized by greater geographical distance from Western European markets and difficult initial conditions for transition (EBRD, 2000).

At the end of the millennium, the number of front-runners remained the same: nine. The composition of this group was fairly stable: only Bulgaria joined it as a newcomer, while the Republic of Moldova moved out into the group of above-potential economies. The above-potential group lost Albania but gained, besides the Republic of Moldova, Romania and the Former Yugoslav Republic of Macedonia. The fact that most of the newcomers are south-east European countries indicates a gradual shift in the geography of FDI towards that subregion. At the other end of the spectrum, the group of below-potential economies was reduced to three: Belarus, the Russian Federation and Slovenia.

A more detailed analysis of UNCTAD's indices of Inward FDI Performance and Potential for six key countries (the Czech Republic, Estonia, Hungary, Poland, Romania and the Russian Federation) (figure III.30) highlights a tendency among all but the Russian Federation towards greater FDI potential over the 1990s. FDI performance shows more divergence. For Estonia and Hungary – countries that took an early lead in attracting privatization-related FDI – the Index fell somewhat as their privatization programmes were nearing completion. In contrast, the performance of Romania, one of the late-privatizing countries, improved by 1998-2000. In the Russian Federation, where privatization with FDI did not take off, the weak performance of 1992-1994 further deteriorated in 1998-2000.

Figure III.30. The UNCTAD Inward FDI Performance Index and Inward FDI Potential Index for selected countries in Central and Eastern Europe, 1992-1994 and 1998-2000

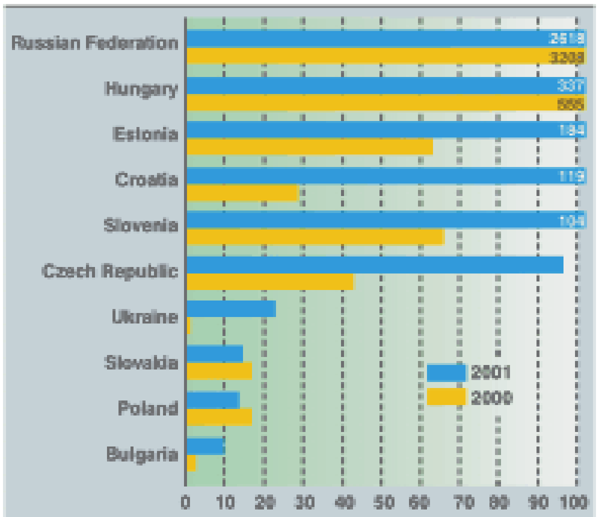


Source: UNCTAD, based on table II.1 and annex table B.1.

Note: As most of the countries in Central and Eastern Europe did not exist before 1992, the period of the FDI Performance Index is adjusted for 1992-1994.

Judging from registered values, FDI ***outflows*** from CEE declined by 12 per cent in 2001 (figure III.31). The region's share in world FDI outflows for that year was three-fifths of 1 per cent, up slightly from three-tenths of 1 per cent in 2000. The *Russian Federation*, which accounts for almost four-fifths of the FDI from the region, recorded a decrease in outflows in 2001, despite the investment abroad of windfall gains from high oil and gas prices enjoyed by the leading Russian firms.[47] YUKOS, the third largest Russian oil and gas company, acquired the Anglo-Norwegian engineering firm, Kvaerner, as well as a stake in a Slovak pipeline and an oilfield in Kazakhstan. FDI outflows from *Hungary* declined slightly, too, despite the conclusion of a major telecom acquisition by Hungary's MATAV in the Former Yugoslav Republic of Macedonia. A number of other countries (Estonia, Croatia and Slovenia) had strong growth in outward FDI, although from a very low base. Most of these new investments from the smaller countries are directed to neighbouring countries (box III.11; *WIR01*, pp. 37 and 252). In some countries such as Estonia, Hungary and Poland, an important part of outward FDI is carried out by foreign affiliates (e.g. Deutsche Telekom-owned MATAV). Relative to gross fixed capital formation, it is only in Estonia, Hungary and the Russian Federation that the ratio exceeds 3 per cent (figure III.29).

Figure III.31. Central and Eastern Europe: FDI outflows, top 10 economies, 2000 and 2001[a]
(Millions of dollars)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 2001 FDI outflows.

Box III.11. The wave of outward FDI from Slovenia

From 1993 to 2001, Slovenia's outward FDI stock more than tripled, from $281 million to $898 million, displaying one of the highest growth rates in CEE. The geography of outward FDI, too, changed. Before independence in 1991, driven by "system-escape" motivations (the need to circumvent the restrictions of the socialist economy), most of the outward FDI of Slovene companies had been directed at developed markets (Svetlicic, Rojec and Lebar, 1994). After 1993, Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia and Yugoslavia, began rapidly to gain importance, with Slovenia becoming one of the most important hubs for investment flows into the reconstruction of south-eastern Europe. Since 1994, according to data from the Bank of Slovenia, all these other countries together account for two-thirds of Slovenia's total outward stock.

This pattern of outward FDI from Slovenia is driven both by pull factors, such as rapid changes in the international environment (especially in south-eastern Europe), and push factors, such as the small domestic market. Indeed, the disintegration of former Yugoslavia, and the temporary loss of its market, pushed Slovene firms to go international in order to survive. Internationalization was largely helped by the traditionally strong ownership advantages of Slovene firms. Most of them had their origins in large and old, but restructured and privatized, companies, although some new and smaller firms also started investing abroad in the 1990s. The fact that "old" firms, which had already started to internationalize in the 1960s and 1970s, are the most transnationalized demonstrates that such early internationalization proved to be instrumental in the subsequent tide of outward FDI. These firms appear to have gained self-confidence from their early experience, which helped them prepare themselves for more demanding forms of international competition. Case studies also demonstrate that these firms have successfully combined knowledge of foreign markets with their own R&D efforts (Jaklic and Svetlicic, 2002). They typically have above-average and fast-growing R&D expenditures and high-skilled labour intensity. Outward investors represent less than 2 per cent of the total corporate sector in terms of number of firms; they, nevertheless, provide 30 per cent of employment and produce 40 per cent of exports (Jaklic and Svetlicic, 2002).

The internationalization of Slovene firms is driven mainly by market-seeking and first-mover motives. Apart from technological

/...

Box III.11. The wave of outward FDI from Slovenia (concluded)

advantages, they possess specific know-how about how to do business in the other countries of former Yugoslavia. Slovenian firms can easily re-establish their previous business networks and build on the fact that their products and brand names are well known there. They are also aware that such advantages risk erosion over time if they do not move (back) into those markets fast enough. In turn, labour-cost motives have played only a minimal role in the expansion of Slovene firms into countries of former Yugoslavia. This may be because so far few of them have located manufacturing capacities there. Their affiliates focus, instead, on downstream services such as marketing and distribution.

For many Slovene firms, other countries formerly part of Yugoslavia serve as a springboard for wider transnationalization. The average outward investing Slovene firm has 4.4 affiliates, a number already slightly higher than that of firms in a number of those countries. The most transnationalized firms have over 20 affiliates worldwide.

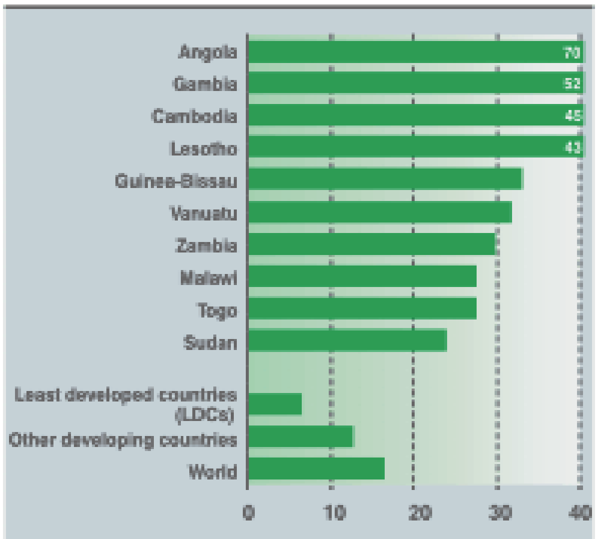
One of the most important lessons from the Slovene case concerns the way firms from that county have used internationalization as an instrument to get out of a situation that combined the loss of previous markets with the crisis of transition. Internationalization has proved to be more useful as a leverage for survival than seeking protection from the Government.

Source: UNCTAD, based on Jaklic and Svetlicic 2002, and Svetlicic et al., 1994.

D. The least developed countries[48]

FDI inflows to the 49 least developed countries (LDCs) are small in absolute terms. (It should be noted that no systematic data exist on non-equity linkages between domestic firms in LDCs and TNCs.) Nevertheless, they often make a contribution to local capital formation. The share of FDI flows in gross domestic capital formation during 1998-2000 averaged 7 per cent for LDCs as a group, compared to 13 per cent for all other developing countries (figure III.32), and it is significantly higher in a number of countries within the LDC group. FDI in the LDCs rose from an annual average of $0.6 billion during 1986-1990 to an annual average of $3.7 billion during 1996-2000. If the group of LDCs is split into major oil-exporting countries (Angola, Equatorial Guinea, the Sudan and Yemen) and other LDCs, the picture changes. In the first group, FDI inflows rose from an annual average of $49 million during 1986-1990 to an annual average of $1.2 billion during 1996-2000, and to $1.6 billion in 2001. The share of the four oil exporters rose from less than 10 per cent during 1986-1990 to some 40 per cent by 2001. The respective figures for the other LDCs are $0.6 billion, $2.5 billion and $2.3 billion.

Figure III.32. LDCs: FDI inflows as a percentage of gross fixed capital formation, top 10 countries, 1998-2000[a]
(Percentage)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 1998-2000 FDI inflows as a percentage of gross fixed capital formation.

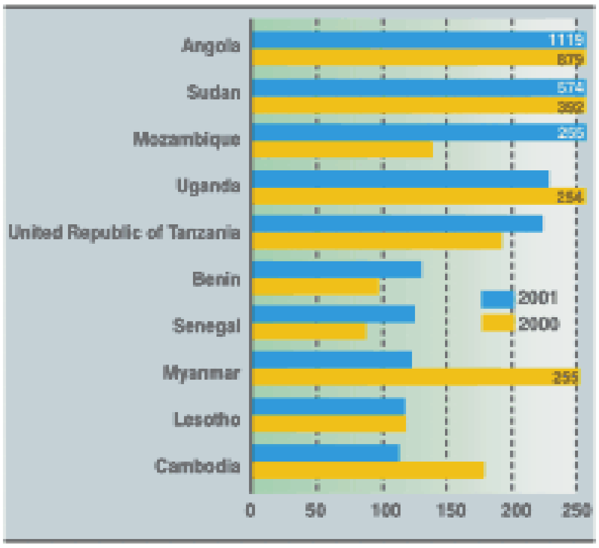
In 2001, despite the general slowdown, FDI in LDCs as a group rose slightly to $3.8 billion, mainly on account of increased flows to Angola (figure III.33), but it was lower than its peak of 1999 ($5.4 billion). Overall, however, the share of LDCs in total FDI flows to developing countries has declined over time, from 2.3 per cent in 1986-1990 to 1.8 per cent during 1996-2000, although it rose slightly in 2001 (figure III.34).

These average figures hide large variations. For example, 16 of the 49 LDCs attracted more FDI relative to gross domestic capital formation than the average developing country (figure III.32 and annex table B.5).

FDI in 21 LDCs grew faster than 20 per cent per annum, and in another seven at between 10 and 20 per cent (table III.6). Individual performance differed greatly over the period 1986-2001 (or the period for which the data are available): Burundi, at one extreme, saw a decline of 22 per cent, while Uganda, at the other, saw an increase of 99 per cent. In Sierra Leone and Yemen, divestment has exceeded new FDI for the past several years. In contrast, FDI has increased rapidly in countries such as Bangladesh, Equatorial Guinea, Ethiopia, Lesotho, Mozambique, Myanmar, the Sudan, and the United Republic of Tanzania. In particular, the United Republic of Tanzania experienced a dynamic growth in FDI inflows in the 1990s (box III.12). Angola was the largest recipient among LDCs in most of the years during 1986-2001, attracting FDI inflows almost equal to those of Peru in 2001.

Clearly, some LDCs have the potential to attract more FDI. According to UNCTAD's Inward FDI Performance and Potential Indices, eight out of the 25 LDCs for which these indices are constructed are above-potential economies, with a higher rank for performance than for capacity (figure III.35). Of these, several (e.g. Angola, Mozambique, Uganda and Zambia) are resource-rich countries. However, 17 of the 25 LDCs rank as under-

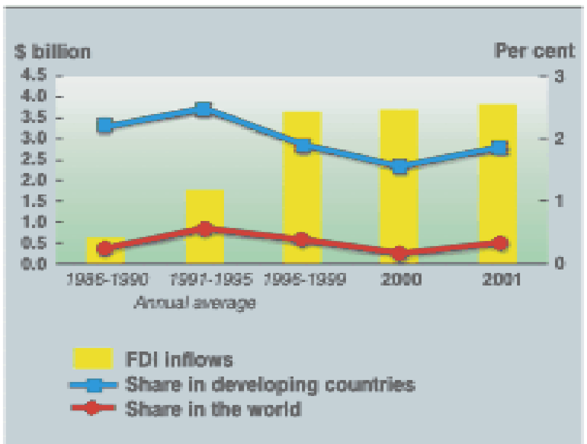
Figure III.33. LDCs: FDI inflows, top 10 countries, 2000 and 2001[a]
(Millions of dollars)



Source: UNCTAD, FDI/TNC database.

[a] Ranked on the basis of the magnitude of 2001 FDI inflows.

Figure III.34. LDCs: FDI inflows and their share in the world inflows and developing-county inflows, 1986-2001[a]
(Billions of dollars and percentage)



Source: UNCTAD, FDI/TNC database.

Table III.6. Annual average FDI growth rates in LDCs, 1986-2001
(Per cent)

Growth rates		Country
More than 20%	Angola	Lesotho
	Bangladesh	Malawi[a]
	Benin	Mali[c]
	Burkina Faso	Mozambique
	Cape Verde[a]	São Tomé and Principe[d]
	Djibouti	Senegal[c]
	Equatorial Guinea	Sudan[a]
	Ethiopia[b]	Togo
	Gambia[a]	Uganda[c]
	Guinea-Bissau	United Republic of Tanzania[c]
	Lao People's Democratic Republic[c]	
10-19.9%	Afghanistan[a]	Madagascar
	Chad	Maldives
	Congo, Democratic Republic of	Myanmar[e]
	Kiribati	
0-9.9%	Cambodia	Samoa[a]
	Guinea	Vanuatu
	Nepal	Zambia
Decline	Bhutan[b]	Niger
	Burundi	Rwanda
	Central African Republic	Sierra Leone[a]
	Comoros[a]	Solomon Islands
	Eritrea[d]	Somalia
	Haiti	Tuvalu[f]
	Liberia	Yemen
	Mauritania	

Source: UNCTAD, FDI/TNC database.

[a] Annual average growth rate from 1987-2001.
[b] Annual average growth rate from 1990-2001.
[c] Annual average growth rate from 1988-2001.
[d] Annual average growth rate from 1996-2001.
[e] Annual average growth rate from 1989-2001.
[f] Annual average growth rate from 1994-2001.

performers in the UNCTAD indices. None falls into the category of front-runner or below-potential economies. Between 1988-1990 and 1998-2000, the Performance Index improved significantly for such LDCs as Angola, Mozambique and the Sudan, while it deteriorated for Niger, Rwanda, and Sierra Leone (table II.1). FDI potential improved in Mozambique and Yemen, but performance declined in the latter (figure III.36).

Box III.12. The United Republic of Tanzania: harnessing FDI for development

The United Republic of Tanzania is a new entrant in the FDI field. Its efforts to harness FDI to its development process date back nominally to 1985, when the country decided to initiate the process of transition from a centrally-planned to a market-based economy. However, it was only in the second half of the 1990s – when the economic situation improved, the privatization programme began in earnest, market-oriented reforms reached a critical mass, and sound foundations for an enabling framework for FDI (including especially the Tanzania Mining Act, considered "the best of its kind") were put in place – that foreign investors responded. During 1995-2000, the United Republic of Tanzania received a total of $1 billion in FDI, compared to $90 million during the preceding six years (annex table B.1). This is a remarkable performance for a country that was receiving hardly any FDI just 10 years ago.

The acceleration of inflows between 1992 and 1996 considerably improved the country's FDI performance relative to other LDCs which have also worked hard to receive more FDI but, with a few exceptions, have not been very successful. The United Republic of Tanzania has, furthermore, improved its position vis-à-vis neighbouring countries. Overall, during 1995-2000, it received inflows comparable to those of Uganda ($1.1 billion) and Mozambique ($0.9 billion), both included by *WIR98* among the seven front-runners in Africa in FDI performance. After 1996, however, although growing in absolute terms, annual inflows into the United Republic of Tanzania did not keep pace with the inflows into LDCs, sub-Saharan Africa or neighbouring countries (except for poorly-performing Kenya), and Tanzania lost some of the gains of the mid-1990s.

The largest sector for FDI in the United Republic of Tanzania is mining, and the largest single industry is gold. At the end of 1998, cumulative FDI in mining was estimated at $370 million. This suggests a share of mining in cumulative FDI inflows of above 50 per cent. Judging from data on *total investments* in major foreign affiliates, most of which were established during 1997-2000, the sectoral composition of the largest projects is: mining (65 per cent), services (19 per cent), and manufacturing (16 per cent). The largest source of FDI in the country is the United Kingdom, followed by the United States, Ghana and South Africa.

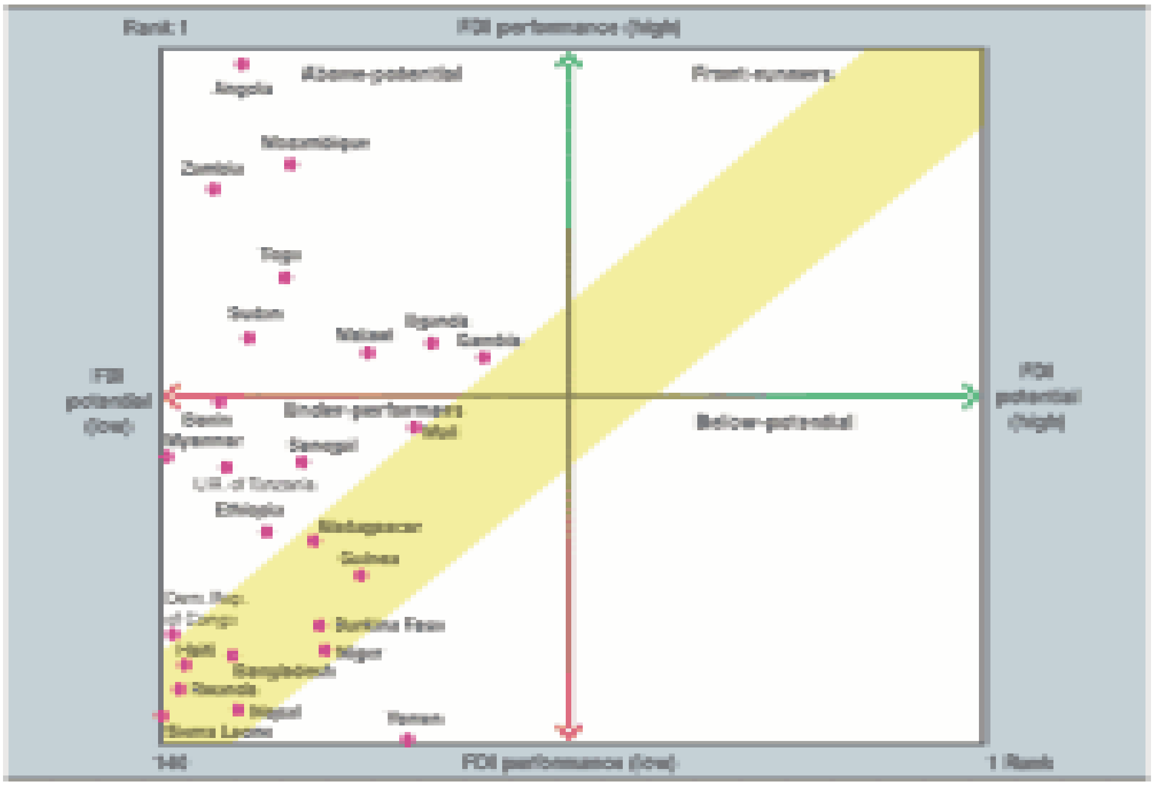
As FDI inflows have increased, the qualitative impact of FDI on the economy has also become noticeable, especially in the industries in which FDI is concentrated. In mining, FDI has served as an engine of growth and has helped increase gold exports. In banking, it has contributed to the modernization of the industry. Foreign investors have restructured privatized enterprises, boosting their competitiveness. They have typically contributed to the transfer of technology and skills. Although the impact is strongest in the industries in which FDI is concentrated, it has implications for the entire economy. Noticeable overall impacts of FDI include a contribution to the inflow of external resources (15 per cent in 1998); a change from a negative to a positive contribution to the balance of payments; the contribution of foreign affiliates to overall exports and inflows of hard currency from tourism; an increased share of FDI in capital formation, and thus growth; and the diversification of the economy away from agriculture towards mining and services.

These positive impacts – which hardly existed until the mid-1990s go some way towards achieving the country's FDI objectives. The objectives are, among others, "to increase the share of foreign direct investment in total external resource inflows" and "to invest in export areas in which Tanzania has comparative advantage". (Tanzania Planning Commission, 1996, pp. 16-17). However, the scale of these impacts is still small and a number of desired impacts are not occurring (such as linkages to the local economy or the encouragement of local science and technology capacities).[a] Thus, after initial successes with FDI, the challenge for the United Republic of Tanzania is now to push FDI to new frontiers, to attract higher levels of FDI inflows than those received in the second half of the 1990s, and to increase the scale and scope of the benefits of these inflows to its economy.

Source: UNCTAD, 2002c.

[a] These objectives were stated in the Planning Commission's 1996 National Investment Promotion Policy document.

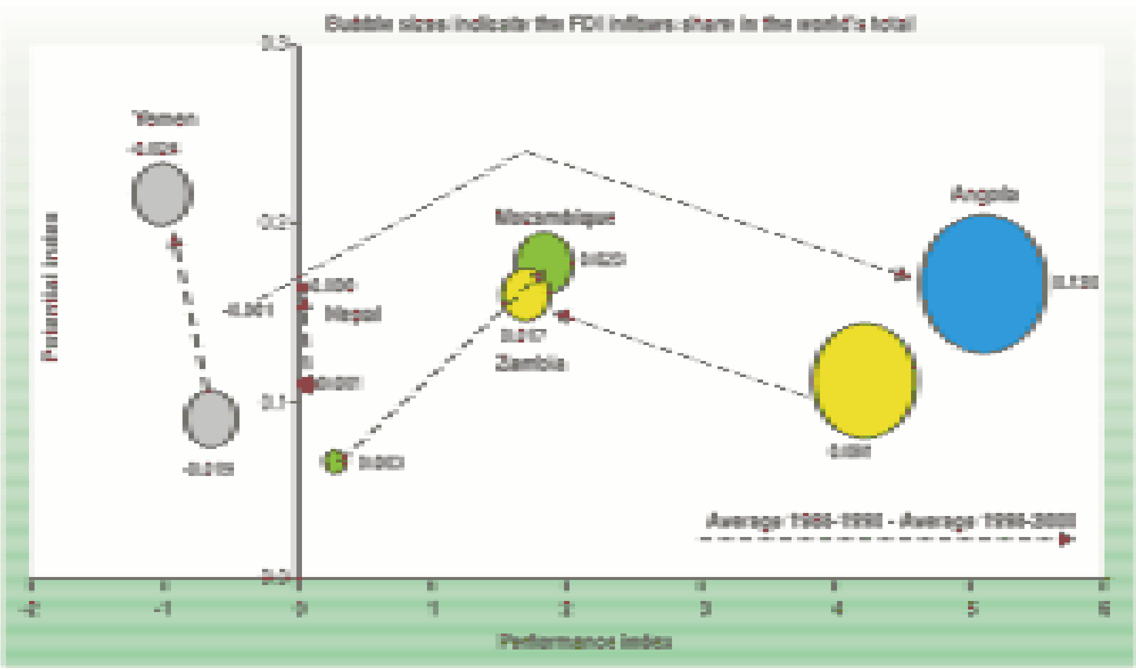
Figure III.35. LDC rankings based on the UNCTAD Inward FDI Performance and Potential Indices, 1998-2000



Source: UNCTAD.

Note: The width of the band is 20 ranks around the 45 degree line.

Figure III.36. The UNCTAD Inward FDI Performance Index and Inward FDI Potential Index for selected LDCs, 1988-1990 and 1998-2000

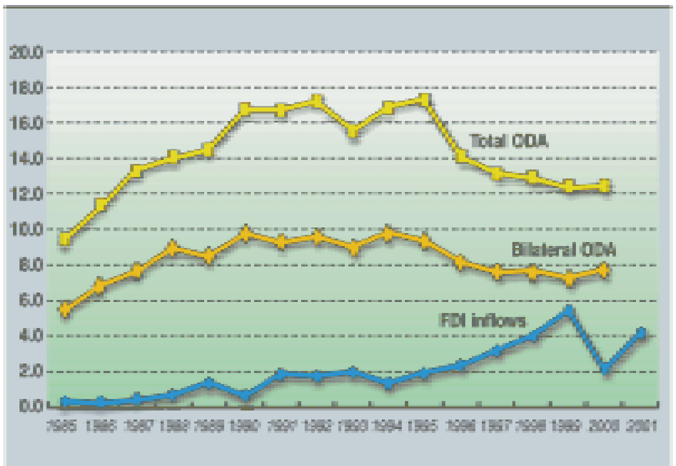


Source: UNCTAD, based on table II.1 and annex table B.1.

The structure of external financial flows to LDCs changed in the 1990s. Official development assistance (ODA) remained the largest component,[49] but declined in absolute and relative terms between 1995 and 2000. LDCs as a whole received $12.5 billion in bilateral and multilateral ODA in net terms in 2000, compared to $16.8 billion in 1990. The amount of bilateral ODA declined from $9.9 billion to $7.7 billion during this period (figure III.37). FDI, on the other hand, became more prominent: in 28 LDCs FDI increased, while bilateral ODA decreased during the 1990s (table III.7). But only in seven LDCs (Angola, Equatorial Guinea, the Gambia, Lesotho, Myanmar, the Sudan and Togo), did FDI inflows exceed bilateral ODA in 2000 and three of them are major oil exporters. Thus most LDCs must rely on ODA as their major source of finance.

FDI flows into LDCs are also highly concentrated, though the share of the top five recipients is lower now than it was in the late 1980s. In the period 1986-1990, the top five recipient countries accounted for 78 per cent of FDI inflows; by 1996-2001, their share had declined to 55 per cent.[50] The bulk of FDI in LDCs (more than 90 per cent) is through greenfield investments. Only a few (notably the United Republic of Tanzania and Zambia) have recorded M&As of any significance since 1987 (figure III.38). Some deals have not involved local firms but only foreign affiliates. For example, the second largest M&A in LDCs so far has been the $260 million acquisition of Texaco Inc-Yetagun Natural in Myanmar[51] by Premier Oil Plc from the United Kingdom in 1997 (annex table A.III.1).

Figure III.37. FDI inflows and ODA flows to LDCs, 1985-2001
(Billions of dollars)



Source: UNCTAD, FDI/TNC database and OECD Development Assistance Committee, International Development Statistics, online databases.

Table III.7. Growth trends [a] in FDI and bilateral ODA flows, 1990-2000

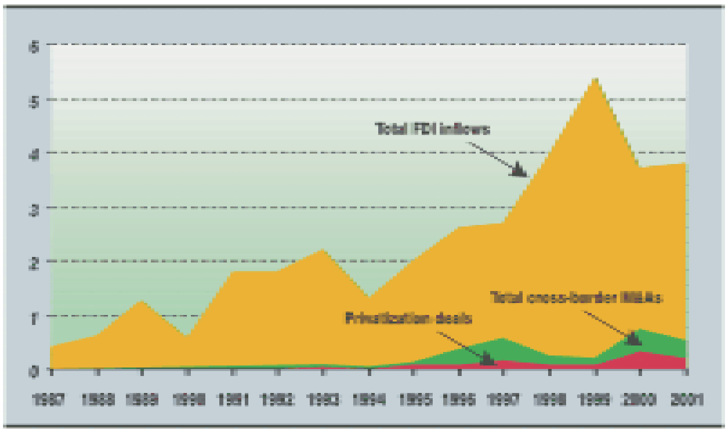
	FDI (-)	FDI (+)
ODA (+)	Benin Bhutan Eritrea Sierra Leone	Angola Cambodia Haiti Lao People's Democratic Republic Madagascar Malawi Maldives Uganda
ODA (-)	Liberia Mauritania Niger Rwanda Samoa Solomon Islands Somalia Tuvalu Yemen Djibouti	Afghanistan Bangladesh Burkina Faso Burundi Cape Verde Central African Republic Chad Comoros Democratic Republic of the Congo Equatorial Guinea Ethiopia Gambia Guinea Guinea-Bissau Kiribati Lesotho Mali Mozambique Myanmar Nepal Sao Tome and Principe Senegal Sudan Togo United Republic of Tanzania Vanuatu Zambia

Source: UNCTAD, FDI/TNC database and OECD Development Assistance Committee, International Development Statistics, online databases.

[a] Calculated as the slope of the linear regression for FDI and ODA flows between 1990 and 2000.

The limited extent of M&As in LDCs partly reflects the nature of their privatization programmes. Many LDCs have now enacted new

Figure III.38. FDI inflows, cross-border M&A sales and privatizations in LDCs, 1987-2001
(Billions of dollars)



Source: UNCTAD, FDI/TNC database and cross-border M&A database.

Note: Cross-border M&As (as well as privatizations) include purchases financed via both domestic and international capital markets that are not categorized as FDI. Furthermore, M&A data are expressed as the total transaction amounts of particular deals at the time of closure of the deals. Therefore, there is no direct relationship between FDI and cross-border M&As.

or revised legislation allowing foreign investors to participate in privatization. Examples are Mauritania, Nepal, the United Republic of Tanzania, Uganda and Zambia (UNCTAD, 2000c; UNCTAD and ICC, 2001; United States, Commercial Services, 1999, 2001a,b,c).

Owing to proximity and history, TNCs from Western Europe have been more active in African LDCs than those from the United States and Japan (UNCTAD, 1999a). Japanese FDI to African LDCs has mainly been motivated for tax reasons: "flag-of-convenience" investment in shipping in Liberia accounts for some three-fourths of all Japanese FDI in Africa. In the Asian LDCs, in contrast, there is considerable intraregional FDI. Firms from Malaysia, Singapore and Thailand are major investors in Cambodia, the Lao People's Democratic Republic and Myanmar. Malaysia accounted for more than one-third of the FDI stock in Cambodia in 1997, Thailand for 35 per cent of the FDI stock in the Lao People's Democratic Republic in 1999, and Singapore and Thailand together for 39 per cent of the FDI stock in Myanmar in 1998.

There is limited information on the *sectoral breakdown* of FDI in LDCs. Countries for which data are available[52] show a broad industry distribution. In the Solomon Islands, for example, most FDI goes into the fisheries industry. In the Lao People's Democratic Republic, FDI has gone mainly into agricultural production. The petroleum sector dominates FDI in a few LDCs, including Angola. While manufacturing is the largest sector for FDI in Cambodia and Uganda, the services sector accounts for the largest share of inward FDI stock in Cape Verde and Nepal. In Ethiopia, the largest recipient is the hotel industry.

The largest foreign affiliates in LDCs are spread across host countries and industries. Large financial affiliates are rare in LDCs; with the exception of a few resource-based companies, most foreign affiliates are small by international standards (annex table A.III.2). The geographical breakdown of the largest foreign affiliates in LDCs by home country shows the dominance of investors from France, Japan and the United Kingdom.

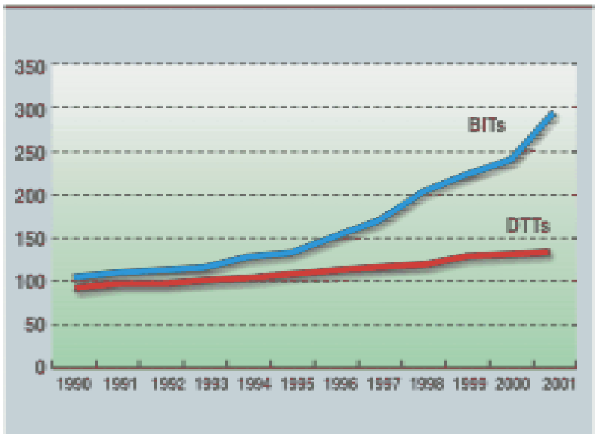
LDCs have improved their investment climate at the national, bilateral and multilateral levels. At the *national* level, most of them now have legislation in place offering a range of guarantees to foreign investors. Many LDCs have liberalized FDI regulations, and no longer discriminate between foreign and domestic investors. They allow profit repatriation and protection against expropriation, and offer incentives and stronger standards of treatment to foreign investors. Indeed, all the changes made in 2001 to the national regulatory frameworks in LDCs[53] were in the direction of liberalization.

At the *bilateral* level, by the end of 2001, 41 LDCs had concluded 292 bilateral investment treaties (BITs) for the protection and promotion of foreign investment, of which 126 were in the 1990s (figure III.39). There were 138 BITs with developed countries (36 during the 1990s) and BITs with other developing countries grew rapidly, from 10 at the end of the 1980s to 126 by the end of 2001. LDCs have also begun to conclude BITs among themselves: 17 had been concluded by the end of 2001.

In addition, 33 LDCs had entered into 138 double taxation treaties (DTTs) by the end of 2001 (39 during the 1990s, figure III.39). Of these, 90 were with developed countries, 41 with other developing countries, 4 with countries of Central and Eastern Europe and 3 between LDCs themselves. The pace of concluding DTTs has not picked up in recent years, in contrast with BITs (figure III.39).

LDCs are participating more in *multilateral agreements* having a bearing on investment (table III.8). As of June 2002, 20 LDCs had acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and 37 LDCs had ratified or signed the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. The ICSID Convention provides access to its arbitration mechanism for investment disputes. There are now 34 LDCs that are full members of the Multilateral Investment Guarantee Agreement (MIGA), and six are in the process of fulfilling membership requirements. In addition, 30 of the LDCs have become members of the WTO. They are thus parties to the three main agreements bearing on investment: the Agreement on Trade-related Investment Measures (TRIMs), the General Agreement on Trade in Services (GATS) and the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS). Another 11 have observer status in the WTO. This brings LDCs in line with international principles and standards on trade, investment and intellectual property rights protection, while allowing them to enjoy special treatment by reason of their development status (UNCTAD, 2000d).

Figure III.39. BITs and DTTs concluded by LDCs, 1990-2001
(Cumulative number)



Source: UNCTAD, on the basis of the country tables and UNCTAD BITs and DTTs databases.

LDCs have been promoting inward FDI more actively: 38 countries had established investment promotion agencies (IPAs) by June 2002. Some, like Madagascar and the Sudan, have introduced "one-stop windows" to simplify procedures and facilitate the entry of foreign investors. And 28 LDCs have joined the World Association of Investment Promotion Agencies (WAIPA), which promotes cooperation among IPAs on a regional and global scale, to share experiences and help IPAs with technical assistance and training (table III.9; WAIPA, 2001).

International organizations like UNCTAD help countries to attract FDI and harness it to their development objectives. UNCTAD undertakes in-depth Investment Policy Reviews to help improve national FDI regimes (box III.13). It also assists LDCs in negotiating BITs and DTTs, and has facilitated 42 such agreements (box III.14). Jointly with the International Chamber of Commerce (ICC), UNCTAD has also been producing investment guides for LDCs, to ensure that reliable information on investment opportunities and conditions reaches potential investors (box III.15).

A growing number of LDCs recognize the role that FDI can play in providing inputs other than finance: the skills, knowledge, technology and access to international markets it offers to promote growth and reduce poverty. Many LDCs have improved their investment regimes but this has not proved sufficient to attract enough FDI. While FDI to LDCs has increased, it has not kept pace with the flows to other developing countries. Private capital inflows have been increasing more slowly than official flows have been declining, which means that LDCs' access to foreign savings has been declining. Moreover, the sustainability of recent increases in FDI flows to LDCs remains a matter of concern.

Efforts are needed to ensure that FDI flows to LDCs not only continue to grow, but are also upgraded to increase their developmental impact. The international community can play a role here, by ensuring that investment opportunities are communicated to corporate executives and by helping LDCs enhance their attractiveness to investors. And, in particular, ODA flows to LDCs need to increase, as FDI is not a substitute for ODA; the characteristics and functions of both are different. Complementarities between the two types

Table III.8. LDC signatories to main international investment-related instruments, as of June 2002

Country	CREFAA[a]	ICSID[b]	MIGA[c]	TRIMs[d]	GATS[e]	TRIPs[f]
Afghanistan		√	g			
Angola			√	√	√	√
Bangladesh	√	√	√	√	√	√
Benin	√	√	√	√	√	√
Bhutan				h	h	h
Burkina Faso	√	√	√	√	√	√
Burundi		√	√	√	√	√
Cambodia	√	i	√	h	h	h
Cape Verde			√	h	h	h
Central African Republic	√	√	√	√	√	√
Chad		√	√	√	√	√
Comoros		√				
Democratic Republic of the Congo		√	√	√	√	√
Djibouti	√			√	√	√
Equatorial Guinea			√			
Eritrea			√			
Ethiopia		i	√	h	h	h
Gambia		√	√	√	√	√
Guinea	√	√	√	√	√	√
Guinea Bissau		i	g	√	√	√
Haiti	√	i	√	√	√	√
Kiribati						
Lao People's Democratic Republic	√		√	h	h	h
Lesotho	√	√	√	√	√	√
Liberia		√	g			
Madagascar	√	√	√	√	√	√
Malawi		√	√	√	√	√
Maldives				√	√	√
Mali	√	√	√	√	√	√
Mauritania	√	√	√	√	√	√
Mozambique	√	√	√	√	√	√
Myanmar				√	√	√
Nepal	√	√	√	h	h	h
Niger	√	√	g	√	√	√
Rwanda		√	g	√	√	√
Samoa		√	√	h	h	h
Sao Tome and Principe		i		h	h	h
Senegal	√	√	√	√	√	√
Sierra Leone		√	√	√	√	√
Solomon Islands		√	g	√	√	√
Somalia		√				
Sudan		√	√	h	h	h
Togo		√	√	√	√	√
Tuvalu						
Uganda	√	√	√	√	√	√
United Republic of Tanzania	√	√	√	√	√	√
Vanuatu			√	h	h	h
Yemen		i	√	h	h	h
Zambia	√	√	√	√	√	√

Source: UNCTAD.

[a] Convention on the Recognition and Enforcement of Foreign Arbitral Awards.
[b] Convention on the Settlement of Investment Disputes between States and Nationals of other States.
[c] Convention Establishing the Multilateral Investment Guarantee Agency.
[d] Agreement on Trade-related Investment Measures.
[e] General Agreement on Trade in Services.
[f] Agreement on Trade-related Aspects of Intellectual Property Rights.
[g] Countries in the process of fulfilling membership requirements of MIGA.
[h] Observer status in the WTO.
[i] Signed but not ratified.

Table III.9. Existence of investment promotion agencies in LDCs, as of June 2002

Country	IPA	Member of WAIPA
Afghanistan		
Angola	√	√
Bangladesh	√	√
Benin	√	√
Bhutan		
Burkina Faso		
Burundi		
Cambodia	√	
Cape Verde	√	√
Central African Republic	√	
Chad	√	
Comoros		
Democratic Republic of Congo	√	√
Djibouti	√	√
Equatorial Guinea		
Eritrea	√	
Ethiopia	√	√
Gambia	√	√
Guinea	√	√
Guinea-Bissau		
Haiti	√	√
Kiribati	√	√
Lao People’s Democratic Republic	√	
Lesotho	√	√
Liberia	√	
Madagascar	√	
Malawi	√	√
Maldives	√	√
Mali	√	√
Mauritania	√	√
Mozambique	√	
Myanmar	√	
Nepal	√	√
Niger	√	√
Rwanda		
Samoa	√	√
Sao Tome and Principe		
Senegal	√	√
Sierra Leone	√	√
Solomon Islands	√	√
Somalia		
Sudan	√	√
Togo	√	
Tuvalu		
Uganda	√	√
United Republic of Tanzania	√	√
Vanuatu	√	√
Yemen	√	√
Zambia	√	√

Source: UNCTAD, information obtained from WAIPA.

of capital flows need to expand in order to maximize their developmental impact. A number of the measures proposed in the LDC Programme of Action, adopted in May 2001 at the Third United Nations Conference on the Least Developed Countries (UNCTAD, 2002b), are of relevance in this respect and should be actively pursued.

Box III.13. UNCTAD’s Investment Policy Reviews

Many LDCs have significantly liberalized their FDI regimes, and Governments are keen to know how well their reforms are working: How much new FDI is coming in and is it of the right kind? Does its impact on the national economy conform with the stated objectives? What more should be done to improve the quantity and quality of inflows? With the dismantling of traditional monitoring systems, policy-makers are often unable to assess the impact of investment measures. UNCTAD’s Investment Policy Reviews (IPRs) are intended to fill this void.

IPRs are undertaken by UNCTAD upon requests by Governments. They have been completed for three LDCs (Ethiopia, Uganda and the United Republic of Tanzania) and five other countries (Ecuador, Egypt, Mauritius, Peru and Uzbekistan). As of July 2002, IPRs were in progress in Botswana, Lesotho, Ghana and Nepal. Other LDCs that have requested IPRs include Benin, Cambodia, Mauritania and Mozambique.

The IPRs are funded primarily through extra-budgetary resources. More specifically, individual country projects are funded on a cost-sharing basis by the United Nations Development Programme (UNDP), donor Governments, host Governments and, as appropriate, the local and transnational private sectors (by sponsoring individual workshops or providing in-kind support, such as technical studies or industry experts).

The IPRs are conducted by UNCTAD staff and international and national experts, with inputs from the Government and the private sector. The reviews are discussed in workshops involving public officials and other stakeholders. They are also considered by UNCTAD’s Commission on Investment, Technology and Related Financial Issues. The final texts are widely disseminated.

The IPRs have a common format. There are three sections: the country’s objectives and competitive position in attracting FDI; the FDI policy framework and administrative procedures; and policy options. The reviews examine how policies affect FDI flows. Since investor response is based on both policy and non-policy factors, a key feature of the reviews is to survey actual investors on how they perceive current investment conditions and opportunities. Potential investors are also surveyed.

Overall, the IPRs assess a country’s potential in attracting FDI and the effectiveness

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Box III.13. UNCTAD's Investment Policy Reviews (concluded)

of policies in leveraging the competitive strengths of a country. They provide policy recommendations that are concise, practical and geared to implementation by decision-makers. They also include proposals for coherent technical assistance and follow-up. A few countries have already implemented or are in the process of implementing the recommended actions. Mauritius, for example, is finalizing a review of its fiscal incentives regime.

Source: UNCTAD.

Box III.14. BIT negotiations with a focus on LDCs

UNCTAD assists LDCs in the area of BITs by facilitating negotiations between partner countries. Two negotiating events took place in 2001. In the first event, 18 countries (10 LDCs, 6 developing and 2 developed countries) participated in the bilateral negotiations. They were Belgium, Benin, Burkina Faso, Burundi, Cameroon, Chad, Comoros, Egypt, Ghana, Guinea, Madagascar, Malaysia, Mali, Mauritania, Mauritius, South Africa, Switzerland and Zambia. A total of 42 BITs were finalized and initialled, 9 treaties were negotiated, and 22 agreements were signed during the Third United Nations Conference on LDCs in Brussels, in May 2001. Another round for LDCs (Cambodia, Eritrea, Malawi, Mozambique, Uganda and Zambia) was organized to negotiate with Belgium-Luxembourg, France, the Netherlands and Sweden in October 2001. As a result, 13 BITs were concluded. These negotiating events provide LDCs with the opportunity not only to conclude treaties, but also to exchange experiences and compare negotiating approaches.

Source: UNCTAD.

Box III.15. Opportunities and conditions in LDCs: the UNCTAD - ICC Investment Guides

The project on "investment guides and capacity-building for least developed countries" is a collaborative venture by UNCTAD and the International Chamber of Commerce (ICC). Its objective is to bring together parties with complementary interests: firms seeking opportunities and countries seeking investors. This is not always a straightforward exercise, since firms are driven by strategic considerations as much as by locational advantages, and countries have economic and social objectives that transcend attracting foreign investment.

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Box III.15. Opportunities and conditions in LDCs: the UNCTAD - ICC Investment Guides (concluded)

The UNCTAD-ICC guides are intended to serve two purposes at once: to furnish potential investors with an assessment tool and to furnish Governments with a marketing tool. Apart from being clearly structured and attractively presented, these third-party guides offer the critical advantage of credibility. This is underscored by a short concluding chapter that summarizes the perceptions of the private sector already established in the country of its strengths and weaknesses as an investment location.

As of May 2002, guides had been produced for Bangladesh, Ethiopia, Mali, Mozambique and Uganda, and work had started for Cambodia and Nepal. The guides are available on the UNCTAD website and the ipanet.net website of the Multilateral Investment Guarantee Agency (MIGA).

Source: UNCTAD.

Notes

1 The acquisition of VoiceStream Wireless Corp. by Deutsche Telekom for $29.4 billion was the largest cross-border M&A deal undertaken in 2001 (annex table A.I.2). Cross-border M&As were also important in commercial lending, food industries, banking, insurance, publishing and electronic security.

2 About 200 leading TNCs were surveyed in July-August 2001 (MIGA, 2002) and were revisited a month after September 11. Similar results were obtained through a survey among 129 TNCs conducted by UNCTAD, Invest in France Agency (AFII) and Andersen, in summer 2001 and updated by telephone interviews in November 2001, according to which the United States emerged as the preferred investment location among developed countries (see UNCTAD, 2001a for the results of this survey). These surveys revealed that the investment plans of the majority of respondents were unaffected by the events of September 11 (box I.1).

3 Of Banamex by Citigroup for $12.5 billion (annex table A.I.2).

4 The largest foreign affiliates in services (excluding finance and insurance) in the EU are linked to firms within the region. The exception is Ireland, where the major foreign affiliates in IT-related services are United States-owned (UNCTAD, forthcoming b).

5 Increases in FDI inflows have continued in 2002, fuelled by announcements of large-scale M&As, such as the acquisition of the agrochemical unit of Aventis by Bayer (Germany) for a reported $6.7 billion. "Bayer confirms CropScience purchase", *Financial Times*, 3 October 2001.

6 Including the acquisition of Aqua Spring by Perrier Vittel of Nestlé, as well as FDI in telecoms and utilities.

7 During 2001, 86 foreign investment projects assisted by the Netherlands Foreign Investment Agency (NFIA) were attracted into the country, originating mainly from the United States as in previous years and despite the recession. The majority of investments were IT activities, although investment in manufacturing also took place. While the majority of projects were greenfield investments, there were some follow-up investments as well. Twenty-two European headquarters, 28 European distribution centres, several call centres and shared-services centres, and two new R&D establishments were located in the Netherlands in 2001 (NFIA, 2002).

8 Cross-border M&A transactions completed in 2001 fell by 62 per cent in value from the previous year's record high, totalling $24.4 billion in 2001. This was unsurprising, since the lion's share of FDI flows traditionally originates in the United States (United Kingdom, National Statistics, 2002).

9 The FDI inflows and outflows of Belgium and Luxembourg were very modest in 2001 compared with the previous year. The exceptionally high amounts in 2000, however, became evident only after the data were significantly revised to reflect the value of transactions related to a cross-border M&A deal, as the transaction and the related value were determined and reflected in the balance-of-payments statistics only retroactively. On the basis of the revised data, Belgium and Luxembourg became the second largest FDI recipient (behind the United States) and the second largest outward investor worldwide (behind the United Kingdom) in 2000.

10 Against the background of the largest ever cross-border M&A transaction, the takeover of Mannesmann by VodafoneAirTouch for some $200 billion in 2000, Germany's inflows in 2001 are still above the annual average of the 1995-1998 period.

11 French TNCs have invested significantly in the United States recently. Vivendi, a former utility company, had acquired media companies for some $50 billion between mid-2000 and end-2001 (*Financial Times*, 21 December 2001). Furthermore, outflows in 2000 were significantly influenced by France Télécom's acquisition of Orange Plc of the United Kingdom. Large cross-border M&As in 2001 include the acquisition of full ownership of Axa Financial Inc. of the United States and Blue Circle Industries in the United Kingdom (annex table A.I.2).

12 This looks less dramatic when one takes into consideration the exceptionally large outflows generated by the acquisition of Mannesmann by VodafoneAirTouch in 2000, as mentioned earlier.

13 Including acquisitions of telephone operators in the Mexican market such as Norcel, Cedetel, Bajacel, Movitel, for a total reported value of 2.1 billion euro. In 2002, Telefónica acquired a majority stake in the Mexican mobile operator, Pegasus. "Telefónica avanza en la negociación para adquirir la firma mexicana Pegaso", *El País*, 13 February 2001.

14 Cross-border M&As by Italian TNCs included the acquisition of LASMO (United Kingdom) by ENI and Euralux (Luxembourg) by Mediobanca for $4.0 billion and $1.1 billion, respectively.

15 The Government of Iceland has systematically made its business environment more attractive for FDI through a series of tax cuts. The country's corporate income tax of 18 per cent is now among the lowest in Europe. Furthermore, a 5 per cent corporate income tax is applied to companies registered in Iceland as International Trading Companies and engaged in export activities. The country's attractiveness for FDI, in spite of its small size, is reflected in its high ranking based on the UNCTAD FDI Potential Index, though this potential is not matched in terms of actual FDI performance according to the UNCTAD Inward FDI Performance Index (table II.1).

16 According to data on plant and equipment investment compiled by *Nihon Keizai Shimbun*, domestic investment declined by 3.3 per cent in all industries. It is expected to decline further in 2002 by 12.9 per cent. *Nihon Keizai Shimbun*, 7 April 2002.

17 Investment in the United States was dominated by such M&As as the $9.8 billion acquisition of AT&T Wireless by NTT Docomo and the $2.3 billion investment in Lucent Technologies by Furukawa Electric.

18 Japanese TNCs also expanded existing manufacturing facilities in Europe, and some 70 per cent of Japanese manufacturing affiliates in Western Europe were considering expanding their facilities in 2001-2002 (JETRO, 2001).

19 On a notification basis, as reported by the Ministry of Finance, FDI inflows did not decline in 2000. This was essentially due to large divestments during that year that were recorded in FDI inflows on a balance-of-payments basis, but not on a notification basis. Similarly, in 2001, the decline in FDI inflows on the latter basis was small.

20 For example, VodafoneAirTouch invested in Japan Telecom to become the latter's largest shareholder. In insurance, United States firms, such as AIG and Prudential, acquired Japanese firms in 2001.

21 They are Solectron (United States), Flextronics International (Singapore), Celestica (Canada), SCI Systems (United States) and Jabil Circuit (United States). See chapter V for a further analysis of contract manufacturers.

22 The acquisition was not financed only by FDI.

23 Against the background of the acquisition of Seagram by Vivendi (France) in 2000, which accounted for more than half of Canada's total inflows.

24 According to the South African Reserve Bank, "these inflows were largely a consequence of the cancellation of the cross-shareholding between the Anglo-American Corporation, which is the non-resident company, and the De Beers Mining Company" (SARB, Quarterly Bulleting, September 2001, p. 23). Therefore the increase in FDI inflows to South Africa was accompanied by a simultaneous decline in FDI outflows from South Africa.

25 Data from United States Department of Commerce. Apart from outflows from the United States to North and sub-Saharan Africa, another $48 million went to the continent without further specification of their precise regional destination.

26 FDI outflow data to Africa are available for France, Germany, the Netherlands, Switzerland, the United Kingdom and the United States. For Switzerland, information is available only at the sectoral level, while all other countries report their figures by individual industry.

27 Due to the unavailability of relevant data, this sectoral analysis does not include FDI outflows from a number of other significant home countries for FDI in Africa, and in particular, from Asia. Although the figures in table III.3 include the most important home countries and represent approximately 75 per cent of all FDI flows from OECD-DAC member countries during 1996-2000, the absence of data for certain home countries might bias the results in certain respects. A good example is FDI to telecommunications which is insignificant for the home countries included in table III.3, but which accounted for a large share in privatization-related FDI in Africa during the 1990s. Much of the FDI in this industry was undertaken by Asian companies (in particular from Malaysia) or from other African countries, including South Africa. Nonetheless, overall, the figures provided here give a fair picture of the recent trends in the sectoral composition of FDI flows into Africa.

28 Some respondents to the UNCTAD/AFII/Andersen survey also mentioned Nigeria and Angola as interesting locations (UNCTAD, 2001a). The MIGA survey mentioned Mozambique, Côte d'Ivoire, Morocco, Nigeria, Mali, Mauritius, Senegal, Ghana and Kenya, in that order (MIGA, 2002).

29 DeloitteToucheTohmatsu, *USA-RSA Business Spotlight*, 27 February 2002.

30 While the swap of Anglo American and De Beers shares might have contributed to additional FDI outflows from South Africa, instead, the complex deal led to a large-scale repatriation of capital to South Africa. This is partly due to the fact that some key shareholders in De Beers who also held Anglo American shares sold part of their interest in Anglo American and repatriated the capital to South Africa.

31 In 2002, General Motors Corp. announced a $400 million deal to take over three auto plants from Daewoo Motors Co., and Lehman Brothers signed a tentative deal to invest $1 billion in Woori Finance Holding.

32 *Taipei Times*, 18 January 2002.

33 Foreign firms are already actively involved in infrastructure development (in particular water and power plants) planned in many parts of this region, though they do not bring in much FDI because of the special financing schemes normally used for infrastructure projects (e.g. build-operate-transfer or project finance).

34 Assuming that every dollar of cross-border M&As, as reported in annex table B.8, is translated into FDI flows.

35 http://koreaexim.go.kr/osis/osismain.html

36 For an in-depth examination of FDI issues relating to Latin America and the Caribbean, see ECLAC, 2002.

37 Two other important deals in Mexico were the acquisition of the insurance company SCA by ING from the Netherlands for $800 million, and the acquisition by Vodafone of a 34 per cent stake in Iusacell for $1 billion.

38 Both surveys, conducted before the debt default and devaluation of December 2001, had ranked the FDI prospects for Argentina also relatively high.

39 Two large telecom operators, Telefónica (Spain) and Portugal Telecom, decided not to increase their local stakes in the Brazilian telecom industry because of perceived adverse market conditions (EIU, *Business Latin America,* 8 February 2002).

40 EIU, *Business Latin America*, 4 February 2002.

41 Differences between investors (both foreign and local) and regulators related mainly to the restrictive terms of natural gas sales by the State-owned Petrobras and the way the national power grid apportioned electricity across the system. EIU, *Business Latin America*, 4 February 2002.

42 Exports by the *maquila* sector in Mexico fell by 3.3 per cent in 2001 (Mexico, Secretaría de Economía, 2001). EPZ exports also fell in Costa Rica (27 per cent) and the Dominican Republic (2 per cent).

43 Prospects for new FDI in oil have been fading since the Government of Venezuela raised royalties in November 2001 from 16.6 per cent to 30 per cent. Another deterrent to foreign investors is the new rule that the State oil monopoly, Petróleos de Venezuela (PDVSA), must hold a majority stake in new joint ventures.

44 In 2001, the real GDP of CEE grew by 2.9 per cent, compared with 2.3 per cent for the developing countries and 0.9 per cent ‑for the developed countries (UNDESA and UNCTAD, 2002, pp. 41-46).

45 Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Republic of Moldova and Slovakia. Albania also fell in the above-potential category as it had high performance despite low potential.

46 Belarus, the Russian Federation and Slovenia.

47 The registered outflows of the Russian Federation do not include capital flight, estimated to exceed $20 billion per year.

48 This section updates the Overview of UNCTAD, 2001c. For an up-to-date analysis of the economic situation of LDCs, see UNCTAD, 2002b.

49 In developing countries taken as a whole, however, FDI became the largest component of net resource flows (see chapter I.A).

50 In 1986-1990, these were Angola, Lesotho, Liberia, Myanmar and Zambia; in 1996-2001, these were Angola, Cambodia, Lesotho, Myanmar and the Sudan.

51 The ultimate parent firm of the acquired company in this transaction is Texaco Inc. of the United States.

52 Bangladesh, Cambodia, Cape Verde, Ethiopia, Lao People's Democratic Republic, Myanmar, Nepal, Solomon Islands and Uganda.

53 There were eight changes in six countries (Burkina Faso, the Democratic Republic of the Congo, Eritrea, Sierra Leone, the Sudan and the United Republic of Tanzania) in 2001.