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FDI from Developing and Transition Economies: Implications for Development

CHAPTER II
REGIONAL TRENDS:
FDI GROWS IN MOST REGIONS

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REGIONAL TRENDS: FDI GROWS IN MOST REGIONS

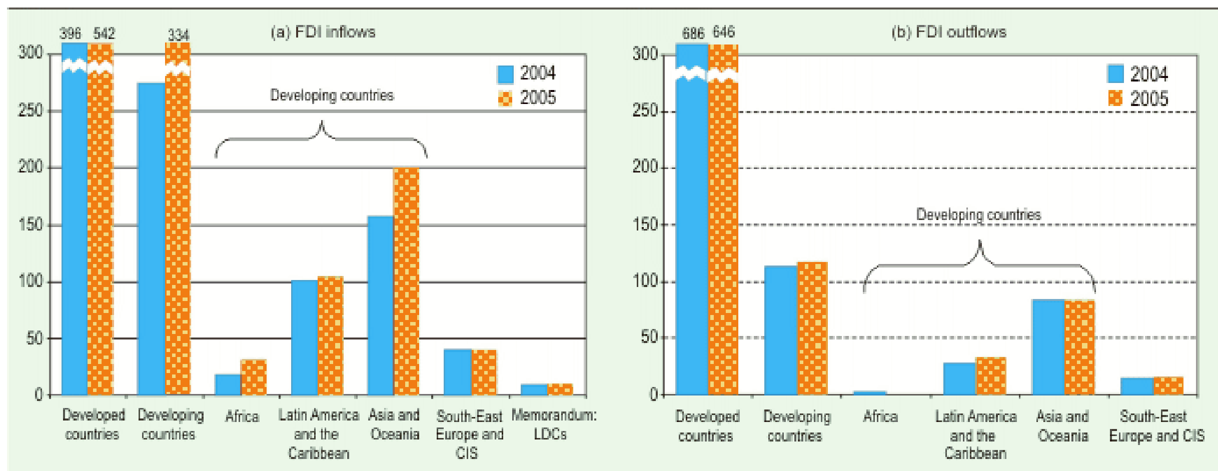
Introduction

FDI inflows grew in nearly all regions in 2005, though unevenly. Developing countries as a whole experienced increases in both inflows and outflows, while developed countries showed increases only in inflows (figure II.1). The slight decline in outflows from the latter largely reflected a fall in the reinvested earnings of United States affiliates abroad (see subsection C.1.a). Inflows to South-East Europe and the CIS[1] remained steady, but outflows from the region rose. FDI flows to the 50 least developed countries (LDCs) as a whole grew by 11% to reach $10 billion, but still remained marginal relative to world flows and total flows to developing countries.

Cross-border M&As were a prime driver of FDI growth in 2005 (chapter I). Their numbers rose worldwide, but the rise was particularly prominent in developing and transition economies. In both developed and developing regions, more than half of all cross-border M&As took place in the services sector (table II.1). Their growth in the primary sector was mainly concentrated in developed countries, while in developing countries there were more cross-border purchases but fewer sales. Not that primary-sector FDI fell in developing countries; it simply occurred through greenfield investment. In general, the relatively small value of M&As in the primary sector in developing countries reflects a restrictive regulatory environment. In South-East Europe and the CIS, cross-border M&As were more evenly distributed between manufacturing and services.

Figure II.1. FDI flows by region, 2004-2005

(Billions of dollars)



Source: UNCTAD, based on annex table B.1 and FDI/TNC database (www.unctad.org/fdistatistics).

Table II.1. Sectoral distribution of cross-border M&As, by group of economies, 2004-2005
(Millions of dollars)

Sector	Year	World	Developed countries	Developing countries	South-East Europe and CIS	Memorandum: LDCs
			Sales			
Total	2004	380 598	315 851	54 700	10 047	506
	2005	716 302	598 350	100 633	17 318	302
Primary	2004	19 414	11 337	6 157	1 920	350
	2005	115 420	110 474	2 858	2 088	42
Manufacturing	2004	120 747	105 202	14 956	589	-
	2005	203 730	171 020	25 963	6 747	-
Services	2004	240 437	199 312	33 587	7 538	156
	2005	397 152	316 856	71 812	8 483	260
			Purchases			
Total [a]	2004	380 598	339 799	39 809	991	250
	2005	716 302	626 339	83 150	6 812	58
Primary	2004	17 471	14 904	2 509	58	-
	2005	105 544	97 876	5 646	2 022	-
Manufacturing	2004	106 795	91 269	15 239	286	-
	2005	148 742	125 604	20 585	2 553	29
Services	2004	256 332	233 624	22 061	647	250
	2005	461 969	402 823	56 909	2 237	29

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics).
[a] Also includes unspecified items.

oil and gas, although there was also investment in services from the United Kingdom, the United States, South Africa, China, Brazil and India. At the same time, however, low skill levels, fragmented markets and a lack of diversification inhibited FDI in manufacturing.

FDI inflows increased in 34 African countries in 2005 and declined in 19. Cross-border M&As are becoming an important mode of entry into the region: their value more than doubled, to reach $10.5 billion in 2005. Most African countries adopted more favourable regulatory frameworks and policies at the national, bilateral and regional levels. Inflows to the region are expected to increase sharply in 2006 against the background of a high volume of new project commitments and renewed M&A activity. However, the region continues to exhibit weaknesses that constrain its ability to attract quality FDI of the kind that would generate broader beneficial effects in its economies. Its outward investors, primarily those from South Africa, expanded their transnationalization through cross-border M&As, although outward FDI from the region as a whole declined in 2005.

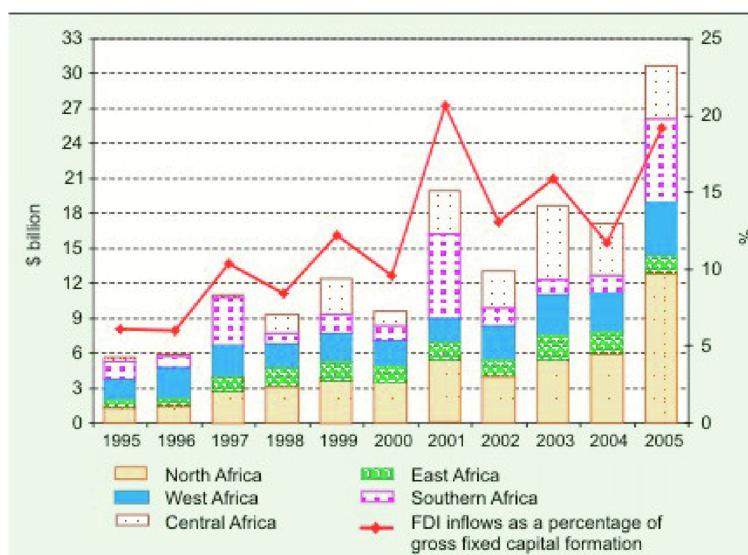
A. Developing countries

In developing countries as a whole, both inflows and outflows rose in 2005, although trends varied by region. Inflows into and outflows from Latin America and the Caribbean and West Asia rose in 2005, while in Africa and East, South and South-East Asia only inflows rose (figure II.1). Increases in West Asia were particularly marked, both inward and outward.

1. Africa

In Africa, rising corporate profits and high commodity prices helped boost inflows in 2005 to a historic high of $31 billion, from $17 billion in 2004 (figure II.2). FDI inflows as a percentage of Africa's gross fixed capital formation also increased, to 19% in 2005. However, the region's share of global FDI remained at around 3%. A large proportion of the 2005 inflows were concentrated in mining, and in particular,

Figure II.2. Africa: FDI inflows and their share in gross fixed capital formation, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

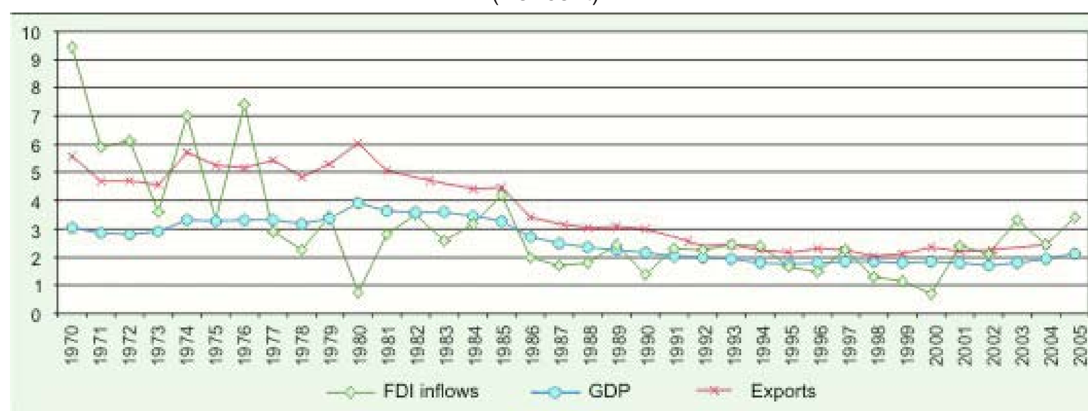
a. Geographical trends

(i) Growth driven by high commodity prices

Total FDI inflows into Africa surged to reach $31 billion in 2005, representing a historic growth rate of 78%. This was higher than the global FDI growth rate of 29% and that of developing economies as a whole. It was primarily the consequence of a boom in the global commodity market, which led to large inflows into the primary sector, although inflows into the services sector also rose. Nonetheless, Africa's current share in global FDI remains much lower than it used to be in the 1970s and early 1980s, even though in the past three years that share has once more surpassed the region's share in global GDP and exports (figure II.3). The decline in Africa's share in global FDI over the past two decades reflects its slow progress in increasing production capacity and diversification, and creating larger regional markets. As a result, Africa's per capita inflows were only $34 in 2005, compared with $64 for developing economies as a whole.

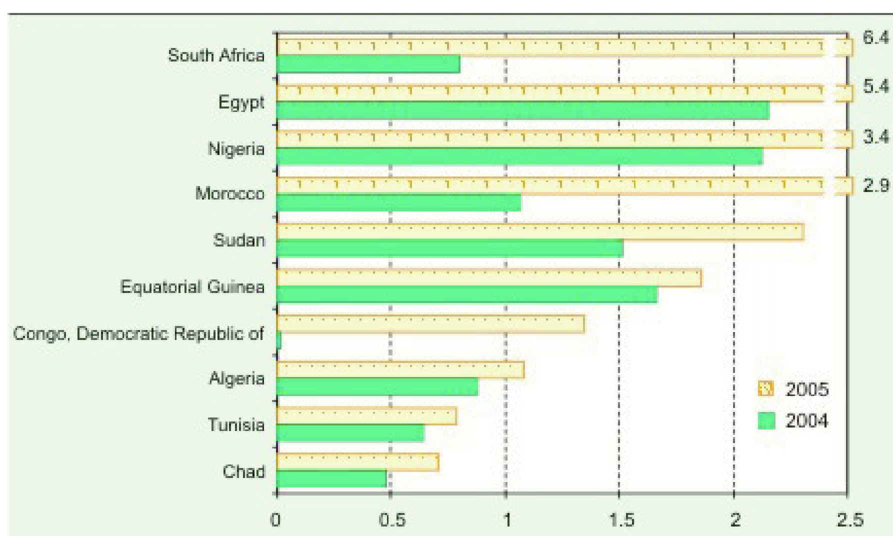
FDI in Africa has traditionally been geographically and industrially concentrated, and 2005 was no exception; five countries (South Africa, Egypt, Nigeria, Morocco and Sudan – in descending order of value of FDI) accounted for 66% of the region's inflows (figure II.4 and table II.2). South Africa registered the largest inflows, with a sharp increase to $6.4 billion from only $0.8 billion in 2004, or about 21% of the region's total. This was mainly due to the acquisition of Amalgamated Bank of South Africa (ABSA) by Barclays Bank (United Kingdom) for $5 billion (see annex table A.I.7 and discussion below). Among other leading recipients in 2005 were Chad, Equatorial Guinea and Sudan, along with Algeria, the Democratic Republic of the Congo and Tunisia, many of them oil and gas-producing countries. Inflows to the Democratic

Figure II.3. Shares of Africa in world FDI inflows, world GDP and world exports, 1970-2005
(Per cent)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) for FDI and UNCTAD Secretariat for GDP and exports.

Figure II.4. Africa: FDI inflows, top 10 economies,[a] 2004-2005
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked on the basis of the magnitude of the 2005 FDI inflows.

Table II.2. Africa: country distribution of FDI flows, by range,[a] 2005

Range	Inflows	Outflows
Over $3.0 billion	South Africa, Egypt and Nigeria	..
$2-2.9 billion	Morocco and Sudan	..
$1-1.9 billion	Equatorial Guinea, Democratic Republic of the Congo and Algeria	..
$0.5 to 0.9 billion	Tunisia and Chad	..
$0.2 to 0.4 billion	United Republic of Tanzania, Congo, Namibia, Botswana, Gabon, Libyan Arab Jamahiriya, Zambia, Uganda and Ethiopia	Nigeria
Less than $0.1 billion	Liberia, Côte d' Ivoire, Mali, Ghana, Mauritania, Mozambique, Guinea, Zimbabwe, Seychelles, Senegal, Togo, Madagascar, Lesotho, Sierra Leone, Gambia, Somalia, Mauritius, Djibouti, Kenya, Benin, Burkina Faso, Cape Verde, Cameroon, Niger, Eritrea, Guinea-Bissau, Rwanda, Sao Tome and Principe, Central African Republic, Malawi, Comoros, Burundi, Swaziland and Angola	Liberia, Morocco, Libyan Arab Jamahiriya, Egypt, South Africa, Botswana, Mauritius, Senegal, Angola, Algeria, Swaziland, Gambia, Tunisia, Kenya, Seychelles, Niger, Mali, Zimbabwe, Ghana, Rwanda, Benin, Lesotho, Burkina Faso, Guinea-Bissau, Côte d' Ivoire, Togo, Namibia and Gabon

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Countries are listed according to the magnitude of FDI.

Republic of the Congo and South Africa were the most diversified and went into energy, machinery and mining, as well as into banking, which received the largest share.

The countries that received the least FDI in Africa were mostly LDCs (table II.2), including oil-producing Angola, which witnessed a drastic decline in its FDI inflows in 2005. Many of them have limited natural resources, lack the capacity to engage in significant manufacturing, and, as a result, are among the least integrated into the global production system. Some have also experienced political instability or civil war in the recent past, which has destroyed much of their already limited production capacity.

The key source countries of FDI inflows to Africa have remained the same for some years, but investment from China and other Asian economies (box II.1) increased, especially in the oil and telecom industries. In contrast to other regions, greenfield FDI projects in Africa increased in 2005 (annex table A.I.1).[2] A number of greenfield projects originated from EU member countries, but projects by firms from Asia also grew. The rise in greenfield FDI projects by Chinese investors, among others, is noteworthy: CNOOC is engaged in projects in Algeria, Nigeria, South Africa and Sudan, with about $280 million or 7% of its total outward FDI invested in Africa in 2005 (see also box II.1).[3] The driving force of Chinese FDI has been growing domestic demand for raw materials. The value of Asia-Africa cross-border M&As rose significantly as well (table II.3; and annex table B.7 for the number of deals).

The five subregions of Africa showed considerable variation in FDI inflows in 2005:

North Africa.[4] FDI inflows into the subregion more than doubled in 2005 to $13 billion, accounting for 42% of total inflows to Africa. Egypt, Morocco, Sudan, Algeria and Tunisia, in that order, received the largest inflows in 2005. The surge in inflows to Egypt ($5.4 billion) was mainly because of a strong rise in investment in the petroleum industry, along with the privatization programme. In Morocco and Tunisia, it was largely privatizations that led to the increase.[5] Asian FDI flows to Sudan, principally from China, India, Kuwait and Malaysia, grew considerably in 2005. For example, a consortium comprising Petronas of Malaysia, the Oil and Natural Gas Corporation (ONGC) of India and the Sudanese State-owned Sudapet invested $0.4 billion in the development of an oilfield (see also box II.1).[6]

West Africa.[7] FDI inflows into West Africa increased by 40%, to $4.5 billion in 2005 from $3.2 billion in 2004, representing 15% of Africa's total. This increase was dominated, as usual, by inflows to Nigeria, which received 70% of the subregion's total and 11% of Africa's total – with oil accounting for some 80% of the inflows. TNCs mostly from France (Total), the United Kingdom (BP) and the United States (ChevronTexaco) invested in projects to develop undersea oilfields off the coast of Nigeria. FDI in Mauritania also increased 23-fold, again mainly as a result of increased activity in the oil industry. In Sierra Leone, Sierra-Com (Israel) invested $3 million – a significant amount for this country – for high-speed broadband wireless Internet and Voice over Internet Protocol (VoIP) communications.[8]

Central Africa.[9] With inflows of $4.6 billion in 2005, the same amount as in 2004, this subregion accounted for 15% of Africa's inflows, attracting FDI into the primary as well as the service sector,

Box II.1. Asian FDI in Africa

In the past decade, TNCs from developing Asia have begun to show an interest in investing in Africa. India and Malaysia are the leading Asian investors there, followed by the Republic of Korea, China and Taiwan Province of China (box table II.1.1); Pakistan is another FDI source, although its investment is relatively small. Among African host economies, South Africa is a large recipient of Asian FDI, but Mauritius receives the most FDI from India and Malaysia. However, Asian investments in Africa remain dwarfed by those from more traditional sources such as the United Kingdom (with a total FDI stock of $30 billion in 2003), the United States ($19.0 billion), Germany ($5.5 billion) and France ($4.4 billion). Among developed countries, Japan has relatively little FDI in Africa ($2 billion).

Box table II.1.1. FDI in Africa from selected Asian developing economies, 1990-2004
(Millions of dollars)

Year	China[a]	India[a]	Malaysia	Pakistan	Republic of Korea	Taiwan Province of China[a]
			Flows			
1990	..	..	..	5.0	24.1	13.0
1991	1.5	..	1.1	4.2	15.9	4.5
1992	7.7	..	12.6	8.2	27.7	16.9
1993	14.5	..	6.6	7.0	28.7	0.4
1994	28.0	..	36.2	5.5	111.1	18.7
1995	17.7	..	72.3	6.9	38.4	28.8
1996	-	..	496.0	5.8	8.1	20.9
1997	-	..	147.5	5.5	87.7	-
1998	-	..	77.5	4.4	81.2	36.2
1999	42.3	..	223.9	3.9	19.9	41.3
2000	85.0	243.3	80.0	4.3	23.8	7.0
2001	24.5	184.8	46.8	4.1	14.3	6.1
2002	30.1	883.4	661.1	2.1	- 6.5	17.4
2003	60.8	338.4	..	..	..	..
2004	..	22.1	..	..	..	..
			Stocks			
1990	49.2	296.6 [b]	1.1 [c]	84.9	45.2	25.9
2002	588 [d]	1968.6 [e]	1 615.8	93.1	511.6	224.0

Source: UNCTAD, based on UNCTAD forthcoming a.

[a] Based on approval data.
[b] 1996.
[c] 1991.
[d] 2003.
[e] 2004, cumulative flows from 1996.

By mode of entry, there were 47 greenfield FDI projects and 11 cross-border M&A deals from South, East and South-East Asia in 2005. Among the greenfield projects, China had 16 new investments, followed by India with 12. Altogether, South, East and South-East Asia accounted for more than 10% of all greenfield investment in Africa in 2005. As regards cross-border M&As, Malaysian companies such as Petronas and Telkom Malaysia have been the most active over the past two decades, accounting for more than 24% of the deals during the period 1987-2005 (box table II.1.2). The largest recent acquisition by an Asian firm was the $1.8 billion purchase of LNG (Egypt) by Petronas (Malaysia) in 2003.

With the increase in Asian FDI flows to Africa has come a new aid-investment nexus between Asian countries and their African partners. China, for instance, plans to increase contributions to its African Human Resources Development Fund by 33% and to provide training to 10,000 African personnel by 2008.[a] India is also stepping up aid to Africa: Indian technicians have been running training schemes to build up small companies in Ghana, Kenya, Nigeria, Senegal, Uganda, the United Republic of Tanzania and Zimbabwe. The Republic of Korea and others are also increasing aid to Africa alongside their commercial expansion. Ultimately, the rise of FDI from Asia to Africa is unlikely to have much of an affect on the relationship between Africa and its traditional sources of FDI (the industrialized countries) *in the short term*. However, Asia's increasing volume of FDI is helping to diversify Africa's options, and to the extent that investment and the associated aid help to create stronger domestic production capacity, it may influence Africa's economic relations with the world generally, particularly in trade.

Box table II.1.2. Cross-border M&As in Africa by firms from selected developing Asian economies, 1987-2005
(Cumulative number of deals)

Host/home economy	China	Hong Kong, China	India	Malaysia	Pakistan	Republic of Korea	Singapore	Others	Asia total
Egypt	-	-	3	2	-	2	1	8	**16**
Ghana	-	-	-	2	-	-	-	-	**2**
Madagascar	-	-	-	1	-	-	-	1	**2**
Mauritius	-	-	1	3	-	-	7	3	**14**
Morocco	-	-	-	-	-	2	-	4	**6**
South Africa	-	5	3	12	1	1	3	5	**30**
Sudan	1	1	3	1	-	2	-	2	**10**
Uganda	1	-	-	1	-	-	-	-	**2**
United Republic of Tanzania	1	-	-	-	-	1	-	-	**2**
Zambia	-	-	3	-	-	-	-	-	**3**
Others	-	-	2	3	-	-	1	11	**17**
Africa total	**3**	**6**	**15**	**25**	**1**	**8**	**12**	**34**	**104**

Source: UNCTAD, based on UNCTAD forthcoming a.

Source: UNCTAD, based on UNCTAD forthcoming a.

[a] *Jeune Afrique*. "The African report: an insight into Africa, an outlook on the world", Number 2, March 2006.

Table II.3. Africa: distribution of cross-border M&As, by home/host region, 2004-2005
(Millions of dollars)

	Sales		Purchases	
Home/host region	2004	2005	2004	2005
World	4 595	10 509	2 718	15 505
Developed countries	2 571	9 564	727	13 331
European Union	2 418	8 906	488	12 994
United States	40	184	-	29
Japan	-	44	-	-
Developing economies	2 024	476	1 991	2 152
Africa	1 849	360	1 849	360
Latin America and the Caribbean	-	-	-	-
Asia and Oceania	175	116	141	1 792
Asia	175	116	141	1 792
West Asia	-	5	-	-
South, East and South-East Asia	175	111	141	1 792
South-East Europe and CIS	-	469	-	22

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

including infrastructure. Equatorial Guinea, the Democratic Republic of the Congo, and, to a lesser extent, Chad and Congo, were the major host countries in 2005. In addition to FDI flows into the oil industry (for instance, the United States firm Chevron-Texaco), there were significant flows into infrastructure development. In the Democratic Republic of the Congo, a large share of the inflows were from other developing countries, mostly South Africa and developing Asia (e.g. China). ESKOM of South Africa invested in the Grand-Inga Dams project, one of the largest FDI projects under way in Africa today. Angola's inflows plummeted to $24 million in 2005 from $1.4 billion in 2004. A large part of this can be attributed to the purchasing of assets of foreign companies in the oil projects of Angola's national oil company – Sonangol – which now has significant interests in a total of 30 oil blocks. Nevertheless, Angola did attract some FDI in banking in 2005: Banco Comercial Angolano, a private bank, undertook a 50% capital expansion jointly with the South African bank, ABSA.[10]

East Africa.[11] FDI inflows into this subregion fell to $1.7 billion from $1.9 billion in 2004, and represented 5% of the inflows to Africa. East Africa attracted the lowest FDI inflows of all the subregions. It comprises mostly resource-poor countries, many of which have recently experienced political instability. In 2005, six of these countries (including the subregion's main recipients: Ethiopia, Kenya, Madagascar and Mozambique) registered a decline in their FDI inflows. On the other hand, Uganda benefited from continuing macroeconomic and political stability to become one of the FDI front-runners in the subregion, with inflows rising by 16%, to $258 million in 2005. Small and medium-sized TNCs from other African countries, in particular Egypt, Kenya, Mauritius and South Africa, have been attracted to Uganda. Some FDI inflows in telecom services were also registered in Kenya and Madagascar.

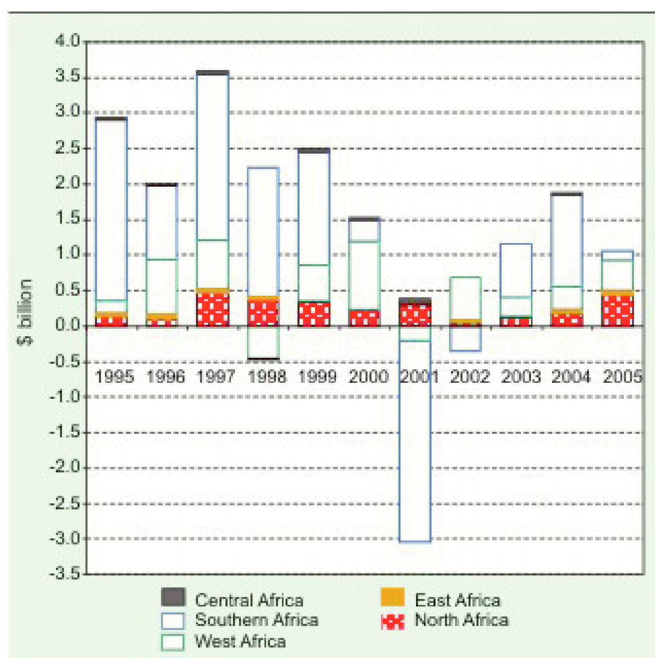
Southern Africa.[12] This subregion experienced the most impressive FDI inflows, in terms of both growth and sectoral diversity, in 2005. Inflows rose to $7.1 billion from $1.5 billion in 2004, with investment taking place in particular in banking, telecommunications and mining industries. The increase lifted the subregion from its lowest ranking among African subregions in 2004 to the second highest in 2005, accounting for 23% of African inflows. Inflows to Southern Africa were dominated by the above-mentioned major cross-border acquisition of the South African bank, ABSA, by an international banking group led by Barclays Bank of the United Kingdom. Foreign companies, particularly banks, have repurchased operations in South Africa (sold at the end of the apartheid regime) as well as in its neighbouring countries (e.g. Namibia). Diamond and nickel mines that had lain dormant in many Southern African countries, such as Lesotho, Namibia and South Africa (because of high extractive costs and low demand), also attracted new FDI as the prices of these commodities skyrocketed in 2005.

(ii) Outward FDI: down in 2005

Despite the increased transnationalization of TNCs from Africa through cross-border M&As in 2005, FDI outflows from the region declined sharply, by 44%, to $1.1 billion from $1.9 billion (figure II.5).

A major cause of the decline was the slump in outward FDI from South Africa, which had accounted for 72% of the region's outward FDI in 2004 ($1.34 billion). South Africa's outward FDI dropped by 95% in 2005, to only $0.07 billion. In addition, some of the country's TNCs now have their primary listings on stock markets outside the country, as illustrated by SABMiller that moved its primary listing to London. The outward

Figure II.5. Africa: FDI outflows, by subregion, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

investments of such companies are no longer registered as investments from South Africa.[13]

FDI outflows from Africa were a minuscule proportion of global outflows – 0.1% – and only 0.9% of developing-country outflows.[14] The top six home countries of outward FDI from Africa in 2005 were Nigeria, Liberia, Morocco, the Libyan Arab Jamahiriya, Egypt and South Africa, in that order, accounting for 81% of the region's outflows (annex table B.1).

While data on cross-border M&As are not directly comparable with FDI data (*WIR00*), the significant rise in the value of M&A purchases by TNCs from the region in 2005 is worth noting: at $15.5 billion in 2005 it is almost six times the level attained in 2004 (table II.4 and annex table B.4). This increase is, however, explained largely by one deal: the acquisition of Wind Telecomunicazioni (Italy) by Orascom Telecom through Weather Investments (Egypt) for $12.8 billion (annex table A.I.7).[15] Available data show that greenfield FDI rose in 2005, mainly as a result of an increase in projects in Africa and Asia, especially West Asia. The number of greenfield projects in these two regions increased more than 50% in 2005.

b. Sectoral trends: FDI up in the primary sector

FDI inflows to Africa in 2005 were, once again, tilted towards primary production (mainly oil), even though significant increases also occurred in the services sector, particularly in banking. Inflows to the manufacturing sector, particularly the textile and apparel industry, declined following the end of quotas established under the Multi-Fibre Arrangement (MFA).

The *primary* sector – particularly the oil and gas industry – continued to attract FDI to Africa. In 2005, the share of petroleum in FDI inflows to the oil-producing countries in the list of the top 10 recipients in Africa (figure II.4) remained high: Algeria, 55%, Egypt, 37%, Nigeria, 80%, and Sudan, 90%.[16] Available information on greenfield FDI projects suggests a near-doubling of such projects in the sector. While these numbers are only a small fraction of all greenfield projects in the continent, the value of the investments involved is usually very large. However, while 2004 was characterized by high-value M&As in the primary sector (87% of total value), 2005 marked a pause with only 9% of total M&As by value (table II.4).

Manufacturing activities did not feature prominently in FDI inflows into Africa in 2005. For example, cross-border M&As in this sector accounted for only $1.7 billion, or 16% of the total value of cross-border M&As. In recent years, countries such as Kenya, Lesotho, Mauritius and Uganda had begun to receive FDI in their textile and apparel industry, in part under the African Growth and Opportunity Act (AGOA), but the trend changed following the end of MFA quotas in 2005. A number of TNCs in that industry in Africa have been relocating. In Mauritius, there was a 30% decline in the volume of garments manufactured in 2005 following the departure of some Hong Kong (China) companies.[17] In Lesotho, six textile firms closed, leaving 6,650 garment workers jobless.[18] This shows that the value of preferential market access is limited when domestic production capabilities are inadequate. Barring a few countries such as Egypt and South Africa (box II.2), most African countries lack linkages between foreign TNCs and local enterprises, and their efforts to promote regional integration have been too limited to allow economies of scale. As a result, they are

Table II.4. Africa: distribution of cross-border M&As of African countries, by sector/industry, 2004-2005
(Millions of dollars)

Sector/industry	Sales 2004	Sales 2005	Purchases 2004	Purchases 2005
Total	4 595	10 509	2 718	15 505
Primary	3 994	908	1 680	249
Mining, quarrying and petroleum	3 994	908	1 680	249
Manufacturing	68	1 676	529	35
of which:				
Food, beverages and tobacco	46	17	-	3
Wood and wood products	-	120	452	-
Non-metallic mineral products	-	967	-	29
Metals and metal products	-	12	-	3
Machinery and equipment	4	545	-	-
Electrical and electronic equipment	-	-	74	-
Tertiary	533	7 925	509	15 221
of which:				
Electricity, gas and water	19	58	-	-
Construction	-	-	58	48
Trade	44	312	60	47
Hotels and restaurants	33	32	-	-
Transport, storage and communications	331	1 534	317	1 307
Finance	65	5 398	74	13 787
Business services	25	4	-	31
Health and social services	-	587	-	-

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

unable to participate competitively in the international production networks of TNCs.

An important aspect of FDI flows into *services* in 2005 was a shift in their composition, from investment driven by privatization to investment into private entities. Cross-border M&As in services, for instance, surged to $8 billion in 2005 from $0.5 billion in 2004 (table II.4), taking place mostly in finance (68% of the deals, mainly in South Africa), followed by transport, storage and communications (19%). One example was the acquisition by Barclays Bank (the United Kingdom) of 60% of ABSA. Barclays also acquired a substantial stake in Bank Windhoek of Namibia as a result of this takeover. The State Bank of India acquired a 51% stake in Mauritius-based Indian Ocean International Bank Ltd as part of its overseas expansion policy – particularly into the rest of Africa. Other transactions included acquisitions in Angola and Nigeria by banks from Brazil and the United States.

c. Policy developments

In 2005, African countries continued to liberalize their investment environments. Of the 53 regulatory changes observed by UNCTAD in Africa, four fifths (42) were favourable to FDI, while 11 made the environment less favourable. Mirroring global trends in extractive industries, some countries either increased taxes or imposed new restrictions on access to natural resources.

The trend towards privatization continued across Africa. Algeria, Angola, Comoros, Congo, Côte d'Ivoire, Kenya, the Libyan Arab Jamahiriya, Mauritius, Morocco, Nigeria, Sierra Leone and Tunisia either privatized specific sectors or introduced plans to enhance cross-sectoral liberalization. The industries affected included utilities, telecommunications and tourism. Some programmes attracted TNCs from developing countries. In Angola, the privatization agency approved Telecom Namibia's bid to become the first private operator of Angola's fixed-line network. Egypt has pursued a policy aimed at opening up its markets in activities where it has a clear advantage (e.g. tourism) as well as in some manufacturing (box II.3).

Another set of favourable changes concerns attempts to improve the investment climate. Mirroring international trends, a number of African countries, such as Egypt, Ghana, Senegal and South Africa, have reformed their tax systems, often reducing corporate income taxes. Some have eased operational conditions for TNCs. For example, Egypt is facilitating the entry and residence of foreigners.

Recognizing that an investor-friendly admission phase has a beneficial effect on the subsequent relationship between host and investor, some countries such as Ghana and Mali have reformed their admission procedures by introducing one-stop shops. Other governments have acted to remove some of the key constraints on attracting and benefiting from FDI. For example, South Africa has introduced a Skills Support Programme (SSP) to enhance the supply of skilled labour (box II.4). Similar measures could be usefully adopted by other African countries seeking FDI in high-value processing.

In Africa, as in other regions, 2005 also saw policy changes which made the regulatory framework less favourable to FDI in the extractive

Box II.2. South Africa: from import substitution to export orientation in the automotive industry

The automotive industry has become a dynamic export platform in South Africa as a result of increased FDI. The increase in inflows to the industry was partly due to government policies, particularly the Motor Industry Development Programme (MIDP) in 1995, which sought to give car assemblers greater flexibility in their sourcing and to encourage a shift towards exports. The MIDP abolished local content requirements and introduced a faster tariff phase-down than required by South Africa's WTO obligations. Under the programme, exporters, including foreign firms, also benefit from various concessions, mainly duty reductions on imports.

The foreign automotive firms present in South Africa include, among others, General Motors, Toyota, Volkswagen, Ford, and Nissan. Recent foreign investors include auto components manufacturers such as Mario (Italy), Woco Group (Germany), Leonie AG (Germany), Almec Spa (Italy), AMD Group (United States) and Saffil Ltd (United Kingdom). As a result of FDI, the production of cars and light commercial vehicles grew from 315,000 in 1995 to about 500,000 in 2005, while exports more than doubled, from approximately 60,000 to 140,000. The capital expenditure of affiliates of automotive TNCs (i.e. for investment in production and export facilities, and supporting infrastructure) also more than doubled between 2000 (1.5 billion rand or $236 million) and 2005 (3.6 billion rand or $566 million).

South Africa is now emerging as a hub for the production of right-hand-drive vehicles and other models for export. Other exports include components such as leather seat covers, silencers and exhaust pipes and catalytic converters. Prospects point to growth, as many other large automotive TNCs such as General Motors, Toyota, DaimlerChrysler and Nissan have announced their intention to export models from South Africa to Europe, North America and Asia.

As a result of these investments, South Africa's automotive industry now offers a global export platform that combines low production costs and a high degree of manufacturing flexibility. The country also benefits from accumulated expertise in various automotive technologies, including the ability to design components that can cope with the high temperatures and dust levels in Africa. Finally, it offers easier access to the Southern hemisphere and African markets.

Source: UNCTAD, based on UNCTAD forthcoming b, Naidu and Lutchman 2004, Meyn 2004, Barnes 1999, Barnes and Lorentzen 2003, and www.southafrica.info/.

Box II.3. Egypt: National Suppliers Development Programme to boost manufacturing

As the Egyptian economy has shifted over the past decade towards a more market-based model, the Government of Egypt has taken various measures to increase inward FDI, so as to help Egyptian industries become, or remain, globally competitive. In the manufacturing sector in particular, Egyptian producers, like many other African producers, risk becoming marginalized even in their own markets. Recognizing this, the Government of Egypt has teamed up with the private sector in an initiative known as the National Suppliers Development (NSD) Programme (box figure II.3.1) to boost manufacturing growth and stimulate job creation. Through this initiative, the Government provides active support to companies, including TNCs, to improve the quality and cost of Egyptian goods and to tailor them to the demands of a globalized world economy.

One hundred TNCs and leading exporters in Egypt have been asked to select up to 20 local suppliers for receiving technical assistance by international consultants to identify efficiency and quality shortfalls, after which they will be able to access bank loans through the NSD Programme to make the necessary improvements. In return, exporters who benefit from the programme agree to expose their Egyptian suppliers to global markets. The NSD Programme has started to yield some results. General Motors, which owns Egypt's largest vehicle assembly plant, has helped pioneer projects under the Programme. Other TNCs involved include DaimlerChrysler, Americana, Cadbury and Hero. The Government of Egypt hopes that the NSD Programme will also make Egypt attractive to more TNCs. Indeed, leading private-equity firms are considering investing in Egyptian suppliers that benefit from the Programme.

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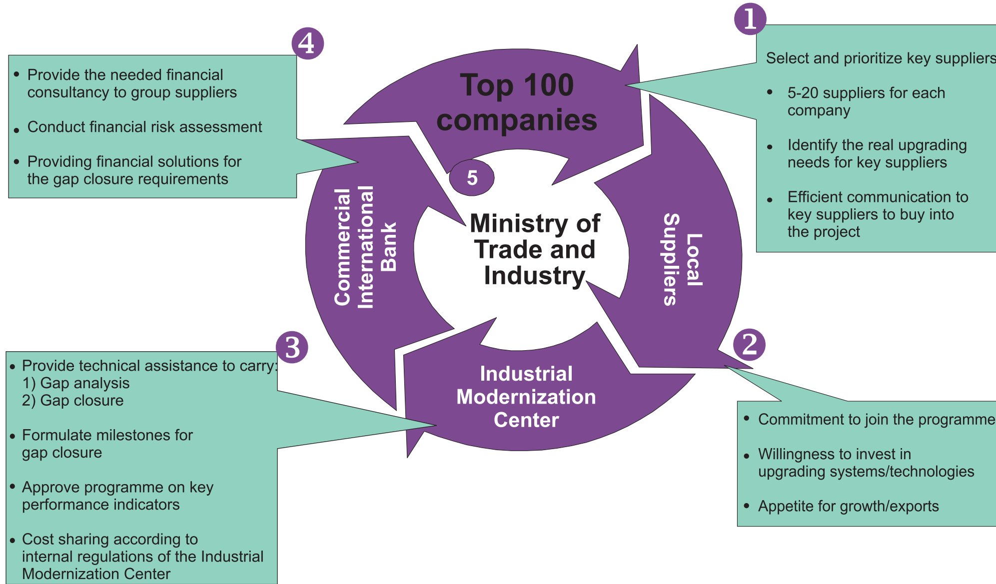
Box II.3. Egypt: National Suppliers Development Programme to boost manufacturing (concluded)

Box figure II.3.1. How does the NSD programme work?



Source: Official communications from the Government of Egypt.

Source: UNCTAD, based on information from the Industrial Modernisation Center and "Egypt's private sector in scheme to boost manufacturing" *Financial Times*, 21 October, 2005, p. 5.

industries. The Central African Republic, for example, introduced an indefinite suspension of the issuance of new gold and diamond mining permits and banned foreigners from entering mining zones. Zimbabwe continued its indigenization programme by requiring all foreign-owned mining companies to sell a 30% stake to local businesses within a 10-year period.

At the bilateral level, African countries concluded a total of 583 BITs and 298 DTTs during the period 1980-2005. Twelve countries (Algeria, Egypt, Ethiopia, Ghana, Mauritius, Morocco,

Box II.4. South Africa: Skills Support Programme

In South Africa, the Government has developed several programmes aimed at improving competitive activities in all sectors. Since the shortage of skilled labour is a serious constraint on attaining such competitiveness through inward FDI, the Skills Support Programme (SSP) was introduced in 2005, complementing the previously existing Skills Incentive Programme (SIP) and Small and Medium Enterprises Development Programme (SMEDP).

SSP seeks to encourage greater investment in training, including the introduction of new advanced skills. It provides a cash grant for new projects or the expansion of existing projects, including FDI projects, for up to three years. There are no restrictions on the type of training to be provided. A maximum of 50% of the training costs will be granted to companies whose training programmes are approved. A variety of training activities qualify, including upgrading instructor competence, training in-house assessors, preparing materials and designing programmes. Companies that have qualified for SIP or SMEDP can also qualify for the SSP. Investors, including foreign direct investors, engaged in manufacturing, high-value agricultural projects, agro-processing, aquaculture, biotechnology, tourism, information and communications technology, recycling, and culture industries are eligible.

Source: UNCTAD, based on the South Africa Skills Support Programme, "Incentives and development finance", 2005, (www.info.gov.za).

Mozambique, Nigeria, South Africa, Tunisia and Zimbabwe) concluded more than 20 BITs each, mostly with partners from the EU, followed by those in South-East Asia. Seven countries (Algeria, Egypt, Mauritius, Morocco, South Africa, Tunisia and Zimbabwe) concluded more than 12 DTTs each. The number of BITs and DTTs between African countries is expected to increase in the near future under the New Partnership for Africa's Development (NEPAD) initiative. However, caution is advisable against a proliferation of BITs, DTTs, free trade agreements (FTAs) and regional trade agreements (RTAs). African countries have already subscribed to a large number of regional integration schemes (over 200 in 2005),[19] which have created an overlapping multiplicity of agreements.

At the international level, the AGOA initiative continued to bolster trade and investment in Africa, influencing the strategies of foreign investors in a number of industries. An exception (mentioned above) was the textiles and apparel industry, which saw the departure of a number of TNCs following the termination of MFA quotas. This further weakened the drive to promote industrialization in Africa through international trade. It also emphasized the fact that Africa's industrial progress requires competitive production capacity, in addition to better market access (e.g. through AGOA and EBA) and more welcoming regulatory frameworks.

d. Prospects

Prospects for growth in FDI inflows into Africa in 2006 are good: for example, cross-border M&As tripled in the first half of 2006 over those in the same period in 2005, according to UNCTAD's estimates. Rapidly rising global commodity prices will once again be pivotal to this increase, particularly in the oil industry, including in investment from developing countries (box II.5).[20] However, the regional picture is not uniformly upbeat across sectors, countries and subregions. Inflows may continue to be low in low-income economies that lack natural resources.

Box II.5. Prospects for FDI rise as TNCs from developing countries invest in oil in Africa

The buoyant global demand for oil and the resulting rise in profits have resulted in unprecedented FDI in petroleum exploration, extraction and related activities in Africa by TNCs from developing countries. Major examples include the following:

North Africa. In Sudan, the presence of TNCs from countries such as China, India and Malaysia increased. In 2005, Petronas of Malaysia agreed to build a refinery on the Red Sea in Sudan and undertake exploration work onshore. ONGC Videsh of India also continued the expansion of its operations in Sudan, ranging from the exploration of more oil blocks to oil refining. The company financed the construction of a 741-km-long pipeline, which would link Sudan's biggest refinery, Gaili Refinery, north of Khartoum, to Port Sudan on the Red Sea. ONGC Videsh also made further investments in upgrading and modernizing yet another refinery in Port Sudan, so as to handle larger transport capacities of petroleum goods for export.

West Africa. In January 2006, CNOOC (China) was planning to buy a 45% stake in the oilfield, Oil Mining License 130, an undeveloped deepwater project off the Nigerian coast operated by Total (France), for $2.3 billion. In another development, Asia Petroleum Limited (Pakistan) is investing $5 billion in Nigeria to set up a joint venture comprising CPL (Nigeria), Korean Electric Corporation (Republic of Korea) and Medico (Indonesia). In Nigeria, Equator Exploration (United Kingdom) acquired a 30% production-sharing stake in offshore deepwater blocks, with the Korean National Oil Corporation taking another 60% and local companies taking the balance.

Central Africa. In Angola, TNCs from countries other than the United States and EU members (whose TNCs already control approximately 70% of the oil assets), including those from developing countries, are increasingly joining the competition to increase their petroleum reserves. Chinese companies are already in competition there[a] while companies from Brazil, India, Thailand, the Republic of Korea and others have shown an interest in investing in the country.

Southern Africa. In 2006, Petronas of Malaysia won its bid for offshore exploration of oil and gas blocks in Mozambique's Rovuma basin.

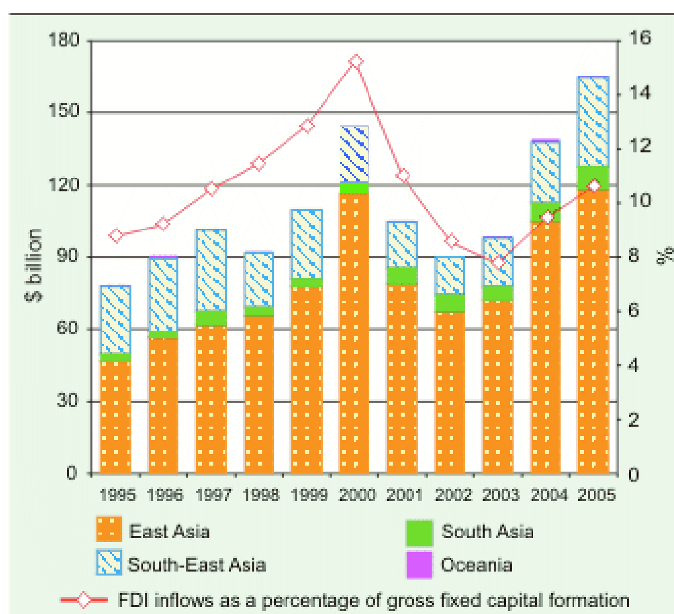
Source: UNCTAD, based on EIU *Viewswire* (various issues).

[a] This can be explained by China's rapid industrialization, which has led to a surge in the country's demand for oil as well as such commodities as iron ore, coal and copper.

In Central Africa, as well as North and West Africa, FDI inflows are expected to grow again in 2006 largely as a result of increased investment in the primary sector in countries such as Angola, Algeria, the Democratic Republic of the Congo, Egypt, the Libyan Arab Jamahiriya, Nigeria and Sudan, and in infrastructure in some cases. In Southern Africa, FDI inflows could decline slightly, as South Africa's inflows will probably return to a normal level after the one-off mega deal between ABSA and Barclays in 2005.

Growth in FDI outflows from Africa is expected to resume in 2006. TNCs from Egypt (services), Mauritius (sugar, textiles and tourism), Nigeria (petroleum) and South Africa (various sectors, particularly banking and energy) will probably contribute to most of the increase. A large part of the outflows is expected to be intra-African. Judging by the data on cross-border M&As in the first half of 2006, the surge in M&A sales is likely to lead to a recovery of FDI from the region in 2006.

Figure II.6. South, East and South-East Asia, and Oceania: FDI inflows and their share in gross fixed capital formation, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

2. South, East and South-East Asia, and Oceania

FDI inflows to South, East and South-East Asia, and Oceania[21] reached a new high of $165 billion in 2005. As a growth pole in the world economy, the region is becoming increasingly attractive to market-seeking FDI. In particular, TNCs' investments in financial services and high-tech industries are growing rapidly. FDI outflows from the region as a whole declined to $68 billion in 2005, as outward investment from some Asian newly industrializing economies (NIEs) fell. However, outflows from China rose sharply, helping to reshape the pattern of outward FDI from the region.

a. Geographical trends

FDI inflows to South, East and South-East Asia, and Oceania maintained their upward trend in 2005, rising by about 19% (figure II.6), but their share of global inflows declined from 20% in 2004 to 18% in 2005. FDI outflows from the region dropped by 11%, to $68 billion, after tripling in 2004. China, Hong Kong (China) and Singapore retained their positions as the largest recipients of FDI in the region, while China emerged as a major outward investor (table II.5).

(i) Inward FDI: continues to soar

FDI increased in all subregions, though at different rates: South-East Asia witnessed a 45% increase in 2005, followed by South Asia (34%) and East Asia (12%). Inflows to Oceania declined from $705 million in 2004 to $397 million in 2005.[22]

(a) South, East and South-East Asia

Rapid economic growth in South, East and South-East Asia has contributed to the continued increase in FDI inflows.[23] The importance of the region in the world economy[24] and its high growth rate have made it more attractive to market-seeking FDI. The *2006 Global CEO Survey* (PricewaterhouseCoopers 2006) confirmed that reaching new customers is a more important motive than reducing costs for FDI in emerging markets in general, and in large Asian economies (such as China and India) in particular.

At the subregional level, the shift is slightly in favour of the south, with a sustained increase in flows to South and South-East Asia and slower growth in flows to East Asia. In 2005, East Asia, South-East Asia and South Asia accounted for 71%,

Table II.5. South, East and South-East Asia, and Oceania: country distribution of FDI flows, by range[a], 2005

Range	Inflows	Outflows
Over $50 billion	China	..
$10-49 billion	Hong Kong (China) and Singapore	Hong Kong (China) and China
$1.0-9.9 billion	Republic of Korea, India, Indonesia, Malaysia, Thailand, Pakistan, Viet Nam, Taiwan Province of China and Philippines	Taiwan Province of China, Singapore, Republic of Korea, Indonesia, Malaysia and India
$0.1-0.9 billion	Macao (China), Bangladesh, Cambodia, Myanmar, Brunei Darussalam, Sri Lanka, Mongolia, Marshall Islands, New Caledonia and Democratic People's Republic of Korea	Thailand and Philippines
Less than $0.1 billion	French Polynesia, Papua New Guinea, Lao People's Democratic Republic, Kiribati, Vanuatu, Maldives, Tuvalu, Nepal, Tonga, Palau, Timor-Leste, Nauru, Afghanistan, Bhutan, Tokelau, Solomon Islands, Samoa and Fiji	Pakistan, Sri Lanka, Fiji, Bangladesh, New Caledonia, Cambodia, Papua New Guinea, Vanuatu, Cook Islands, Maldives and Macao (China)

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Countries are listed according to the magnitude of FDI.

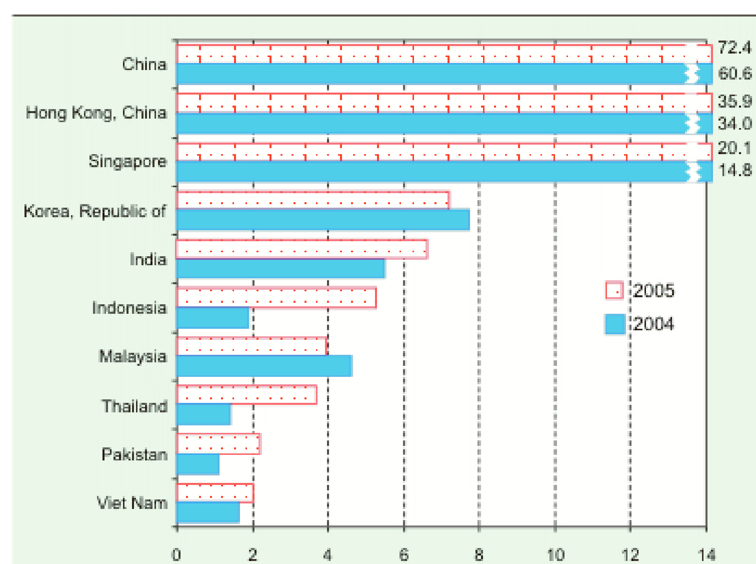
22% and 6% of the total FDI inflows to the region respectively.

East Asia[25] nevertheless remained the most important subregion for inward FDI, despite a slowdown in the growth of inflows in 2005. Major economies in this subregion showed divergent performance. FDI inflows into China and Hong Kong (China) continued to rise (figure II.7), while flows to the Republic of Korea and Taiwan Province of China declined. The increase recorded for China (of 13%,[26] to reach $72 billion) is partly related to changes in the methodology underlying Chinese FDI statistics – for the first time data on Chinese inward FDI include inflows to financial industries (box II.6). In 2005, non-financial FDI alone was $60 billion, and it registered a slight decline after five years of increase. FDI into financial services surged to $12 billion, driven by large-scale investments in China's largest State-owned banks. However, a significant share of China's inward FDI from Hong Kong (China) might be the result of round-tripping (box I.1). The drop in flows to the Republic of Korea (by 7% to $7.2 billion) after a doubling in 2004, and a similar decline in Taiwan Province of China (by 14%) are partly explained by a slowdown of economic growth in those two economies. In the Republic of Korea, policy changes related to FDI, in particular tightened tax rules (section c), are also a major reason for the decline, especially in M&As.

Most major economies in *South Asia*[27] experienced significant increases in FDI inflows: flows to Bangladesh, India, Pakistan and Sri Lanka rose by 50%, 21%, 95% and 17% respectively. Improved economic and policy conditions, especially in India, where the GDP growth rate exceeded 8% and the stock market grew by 36% in 2005, have led to growing investor confidence in the subregion. Increased FDI inflows were partly driven by large M&As, such as the acquisition of Gujarat Ambuja (India) by Holcim (Switzerland) for $607 million. Considering the high performance of the Indian economy since 2003 and the improving policy environment (section c), the growth of FDI does not yet reflect India's potential for attracting FDI.

Figure II.7. South, East and South-East Asia: top 10 recipients of FDI inflows, 2004-2005

(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

Box II.6. China's revised and new data on FDI

Before 2006, data on inward FDI released by the Ministry of Commerce (MOFCOM) and the State Administration of Foreign Exchange (SAFE) of China did not include FDI in financial services, as its total amounts were relatively small. But in 2006, they began to include these services, as inflows to them soared.

However, significant discrepancies exist between the data reported by these two agencies (box table II.6.1), due to methodological differences. The 2005 data reported by SAFE include intra-company loans in non-financial industries ($9.7 billion) and purchases of real estate by foreign institutions ($3.4 billion), while neither of these items is included in the MOFCOM data. In addition, MOFCOM reports FDI data on a gross basis (recording only credit transactions), while SAFE reports FDI data on a net (credit less debit) or balance-of-payments basis. Thus divestments, capital withdrawals and repayment of debt to parent firms are not included in the MOFCOM data.

While MOFCOM data deviate from the international standards based on the balance-of-payments concept, it is not clear to what extent SAFE data correctly reflect transactions in real estate.[a] The data used in this Report, as in previous *WIRs,* are based on MOFCOM data.

Box table II.6.1. Data on FDI inflows reported by MOFCOM and by SAFE, 1998-2005
(Billions of dollars)

FDI data	1998	1999	2000	2001	2002	2003	2004	2005
MOFCOM								
Gross data	45.5	40.3	40.7	46.9	52.7	53.5	60.6	72.4
Non-financial	45.5	40.3	40.7	46.9	52.7	53.5	60.6	60.3
Financial	-	-	-	-	-	-	-	12.1
SAFE								
Gross data	45.5	40.3	40.7	46.9	52.7	53.5	60.6	85.5
Non-financial [a]	45.5	40.3	40.7	46.9	52.7	53.5	60.6	73.4
Financial	-	-	-	-	-	-	-	12.1
Net data [b]	43.8	38.8	38.4	44.2	49.3	47.1	54.9	79.1
Non-financial [a]	43.8	38.8	38.4	44.2	49.3	47.1	54.9	..
Financial	-	-	-	-	-	-	-	..

Source: UNCTAD, based on data from MOFCOM and SAFE.
[a] Including real estate.
[b] On a balance-of-payments basis.

Source: UNCTAD, based on communications with MOFOCM and SAFE.
[a] Purchases of real estate by foreign individuals are not included in SAFE's FDI statistics.

FDI inflows to *South-East Asia*[28] continued to rise (to $37 billion) despite an economic slowdown in this subregion in 2005. The highest growth in FDI inflows in South, East and South-East Asia was recorded in a number of member States of the Association of Southeast Asian Nations (ASEAN), such as Cambodia, Thailand and Indonesia. FDI inflows into Thailand rose from $1.4 billion in 2004 to $3.7 billion in 2005, and those into Indonesia jumped by 177%, to $5.3 billion. Large cross-border M&As, such as the acquisition of Sampoerna (Indonesia) by Philip Morris (United States), accounted for the rise. The implementation of structural reforms in Indonesia during the past few years has strengthened its economic fundamentals,[29] and therefore helped enhance investor confidence.

Developing countries accounted for more than half of all FDI to South, East and South-East Asia, as they have done for most of the past 15 years (table II.6). Intraregional FDI constitutes the bulk of these flows. In 2005, 43% of cross-border M&As in South, East and South-East Asia were intraregional, up from 32% in 2004. Available data on the number of greenfield FDI projects also show that, while developed countries remained major sources of FDI in the subregion, accounting for more than four fifths of all recorded projects in 2004-2005, most other recorded projects were undertaken by companies from within the region.[30] In 2005, the United States was the major investor in terms of greenfield FDI projects (accounting for one third of them), followed by Japan, Germany, the United Kingdom and France, accounting for 14%, 8%, 6% and 4% of all projects respectively. Projects originating from the region were mostly undertaken by companies from Hong Kong (China), the Republic of Korea and Singapore, each contributing to 2-3% of all projects. A growing number of greenfield projects were also undertaken by companies based in West Asia.

The value of cross-border M&As almost doubled, to $45 billion in 2005. Rapid economic growth, low interest rates, rising stock markets and sufficient cash held by companies contributed to the increase. Hong Kong (China), China, Indonesia, the Republic of Korea, Singapore and India were the leading target economies in the region, accounting for the bulk of cross-border M&A sales in 2005 (annex table B.5). The growth in South-

Table II.6. Inward FDI of South, East and South-East Asia from major country groups, 1990-2004
(Per cent)

Type	Year	World	Regional share in inward FDI			
			Developed countries	Developing economies	South-East Europe and CIS	Unspecified
Flows	Average 1990-1994	100	37.4	56.9	0.1	5.6
	Average 1995-1999	100	42.0	50.2	-	7.8
	Average 2000-2004	100	33.5	62.3	-	4.2
	2002	100	37.8	58.5	-	3.7
	2003	100	38.8	52.2	-	9.0
	2004	100	34.6	56.7	-	8.7
Stock	1990	100	62.9	31.0	-	6.1
	1995	100	51.1	43.6	0.2	5.0
	2000	100	33.3	63.1	0.1	3.5
	2003	100	42.1	55.2	-	2.7
	2004	100	32.9	64.8	-	2.3

Source: UNCTAD, FDI/TNC database.
Notes: Only recipient countries for which data for the three main regions were available, were included. Therefore, the number of countries in the totals for South, East and South-East Asia may vary in each period or year, depending on the availability of data for each recipient country. For the countries with only approval data, the actual data included in the aggregates was estimated by applying the implementation ratio of realized FDI to approved FDI to the latter. The number of recipients and their share in total inward FDI to developed countries for each period/year were as follows: in 1990-1994, 17 countries were covered accounting for almost 100% of flows; in 1995-1999, 18 countries accounted for 86% of flows; in 2002, 20 accounted for almost 100% of flows; in 2003, 18 accounted for 99% of flows; in 2004, 17 accounted for 92% of flows; and in 2000-2004, 16 accounted for 92% of flows. Similary, in inward stock: in 1990, 15 countries accounted for 91% of stock; in 1995, 19 accounted for 99% of stock; in 2000, 15 accounted for 95% of stock; in 2003, 7 accounted for 61% of stock; and in 2004, 7 accounted for 48% of stock.

East Asia was particularly significant, with cross-border M&A sales in Indonesia and Singapore quadrupling. Cash-rich Asian investment companies, such as Temasek Holdings of Singapore (see box III.6), are among the major players in the region's M&A market. Reflecting a global trend (chapter I), private equity funds have also become a strong force in that market. Such funds, in particular those from the United States, engaged in a number of large deals in 2005 and early 2006 (table II.7)

(b) Oceania

FDI inflows into Oceania fell by 44% in 2005, to $397 million, although the value of cross-border M&As surged by 250%, to $184 million, driven mainly by increased sales in the mining industry.

Natural resource exploration is becoming increasingly attractive to foreign investors. In June 2005, for example, China Metallurgical Construction Group Corporation signed an agreement with the Government of Papua New Guinea to invest $650 million in the Ramu Nickel-Cobalt Project, a joint exploration project in which the Chinese side owns 85% of the equity. This investment is by far the largest FDI project in the subregion and China's largest overseas investment in metal mining.

(ii) Outward FDI: overall decline, but flows from China surge

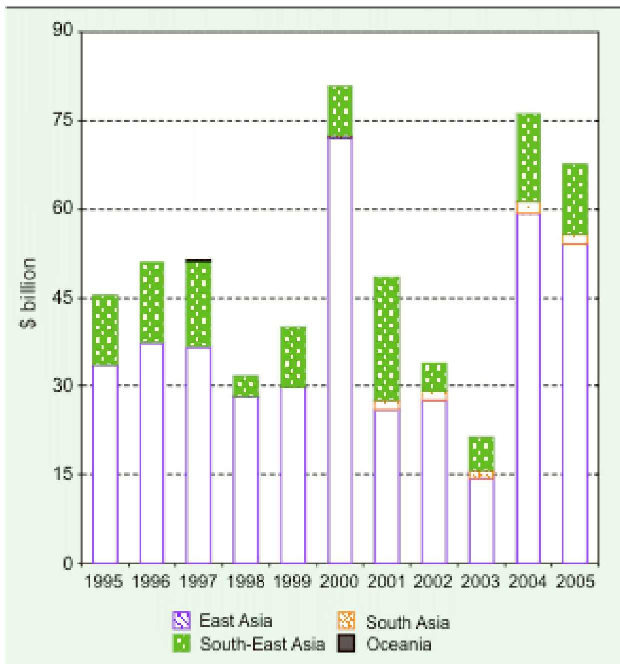
Following the dramatic increase registered in outflows from the region in 2004 – quadrupling to reach the second highest level ever – there was a decline of 11% in 2005 (figure II.8). Nevertheless, outflows remained relatively high ($68 billion) as a result of an 83% increase in the value of cross-border M&As.

Table II.7. Selected large M&A deals undertaken by United States private equity investors in South, East and South-East Asia, 2005-early 2006

Target company	Economy	Acquirer	Value of investment ($ million)
Goodbaby Group	China	Pacific Alliance	123
Harbin Pharmaceutical Group	China	Warburg Pincus [a]	282
Shriram Hldgs (Madras) Pvt Ltd	India	Newbridge Capital	100
Tanshin Financial Holding Co. Ltd	Taiwan Province of China	Newbridge Capital	800
Xugong Group [b]	China	Carlyle Group	375

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics) and data from various newspaper accounts.
[a] In cooperation with local partner CITIC Capital Markets.
[b] The deal was halted by the Chinese Government in 2006.

Figure II.8. South, East and South-East Asia, and Oceania, FDI outflows, by subregion, 1995-2005



Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

chemicals (India) acquiried Brunner Mond (United Kingdom) for $109 million.

Most of the leading investor countries in the region are also among the largest investors in the developing world (chapter III.A). Some recent developments deserve particular attention. For instance, the growth in outflows from Singapore is likely to resume, as Singaporean investment companies are actively investing in both developing countries – mainly those in South, East and South-East Asia – and developed countries.[32] China's FDI outflows surged in 2005, reaching $11 billion, driven mainly by some mega M&As in manufacturing[33] and natural resources (see next section). Given the strong performance of the Indian corporate sector, there is considerable potential for outward FDI from India.[34]

(a) South, East and South-East Asia

Asian NIEs, namely Hong Kong (China), China, Taiwan Province of China, Singapore and the Republic of Korea, in that order, remained the main sources of FDI from developing countries in general and developing Asia in particular,[31] despite a significant decline in their total outflows (figure II.9). Meanwhile, the rise in its foreign currency reserves accelerated the growth of outward FDI from China (box II.7), helping reshape the pattern of outward FDI from Asia.

M&As have become a major mode of entry into developed-country markets by TNCs from South, East and South-East Asia. In recent years, an increasing number of mega deals have been undertaken in the United States and Europe by Asian TNCs. In 2005, for example, a group of Hong Kong (China) investors acquired the Bank of America Center in San Francisco for $1 billion; BenQ (Taiwan Province of China) took over the mobile phone business of Siemens for $323 million; Tata

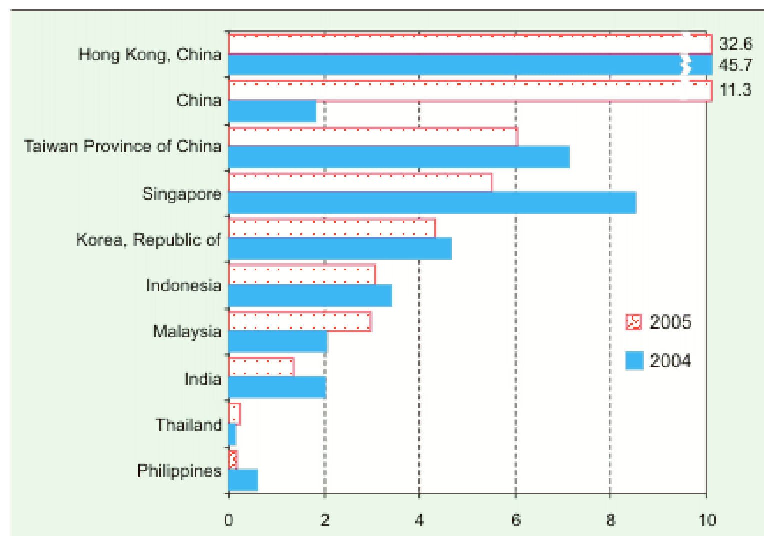
(b) Intraregional FDI

Intraregional FDI flows in South, East and South-East Asia have grown over the years. Today, it accounts for almost half of all FDI inflows to the region, and is particularly pronounced between and within East Asia and South-East Asia (figure II.10).

Intraregional FDI is particularly marked between East Asia and South-East Asia. Hong Kong (China), Singapore, Taiwan Province of China, the Republic of Korea, China and Malaysia, in that

Figure II.9. South, East and South-East Asia: top 10 sources of FDI outflows,[a] 2004-2005

(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Ranked on the basis of the magnitude of the 2005 FDI flows.

Box II.7. “China dollars” will stimulate more Chinese outward FDI

In 2005, China’s foreign currency reserves increased by $209 billion to reach $819 billion, equivalent to 37% of the country’s GDP. Having exceeded those of Japan, they have become the world’s largest in 2006. Despite efforts at currency diversification, a major share of these reserves is still in United States dollars. In view of the relatively low returns and high risks associated with these “China dollars”, the Chinese Government is considering alternative uses for them.[a] Suggestions include, for example, establishing an investment fund targeting high-quality assets both at home and abroad.

China’s foreign currency reserves have been accumulated mainly through its sustained surpluses, both in its current and capital accounts, since the mid-1990s.[b] Capital inflows, driven by the expectation of a renminbi appreciation, have also contributed to the soaring foreign currency reserves in recent years. With its total trade amounting to $1.4 trillion in 2005, China is now the third largest trading nation in the world after the United States and Germany. The country’s trade surplus more than tripled, to $102 billion in 2005, which is likely to increase pressure from its main trading partner to speed up appreciation of the renminbi.

In the 1980s, the rapid accumulation of foreign currency reserves in Japan led to a surge in Japanese outward FDI. A similar situation could arise in China in the coming years. Indeed, the pressure from the large and ever-increasing amounts of “China dollars” have made the promotion of outward FDI an imperative for the Chinese Government, leading it to adopt a “going global” strategy and take concrete measures to promote the internationalization of Chinese companies (box VI.4). Against this background, the strong growth in China’s overseas investment should continue in the coming years. China – ranked 17th in the world among outward investors in 2005 (annex table B.1) – is likely to become an even more important source of FDI in the near future.

Source: UNCTAD.

[a] In 2003, the Chinese Government had already drawn from the foreign currency reserves “strategically” by injecting $45 billion into the State-owned banking sector.

[b] China’s surpluses in both current and capital accounts have been related to the exchange rate of the renminbi, since a cheap renminbi stimulates exports. It also promotes inward FDI by making investments in China cheaper in foreign currency terms. Further appreciation of the renminbi could moderate the rapid accumulation of reserves by limiting the growth of both exports and FDI inflows and promoting outward FDI.

order, were leading investors in these two subregions. Most FDI from East Asia went to the relatively high-income South-East Asian countries. The largest FDI flows have been within East Asia and they had been rising until recently, largely dominated by China as a key destination. Intra-ASEAN investment accounted for 13% of cumulative FDI flows in this subregion between 1995 and 2004,[35] with Singapore as the leading investor. Within South Asia, intraregional FDI flows have been less significant compared with other subregions, and those between South-East Asia (as well as East Asia) and South Asia have not been as significant as those between East Asia and South-East Asia.

Petrodollars in West Asia have also led to more intraregional FDI in developing Asia as a whole, driven by the rapid rise of the Chinese and Indian economies and increasing opportunities in downstream industries. The interaction between West Asia and China in particular highlights a new development in intraregional investment in Asia: China is gaining access to upstream oil assets in West Asia, while West Asian countries are investing in downstream refinery projects in China (box II.12).[36] In January 2006, the Governments of China and Saudi Arabia signed an economic cooperation agreement focusing on oil and gas.

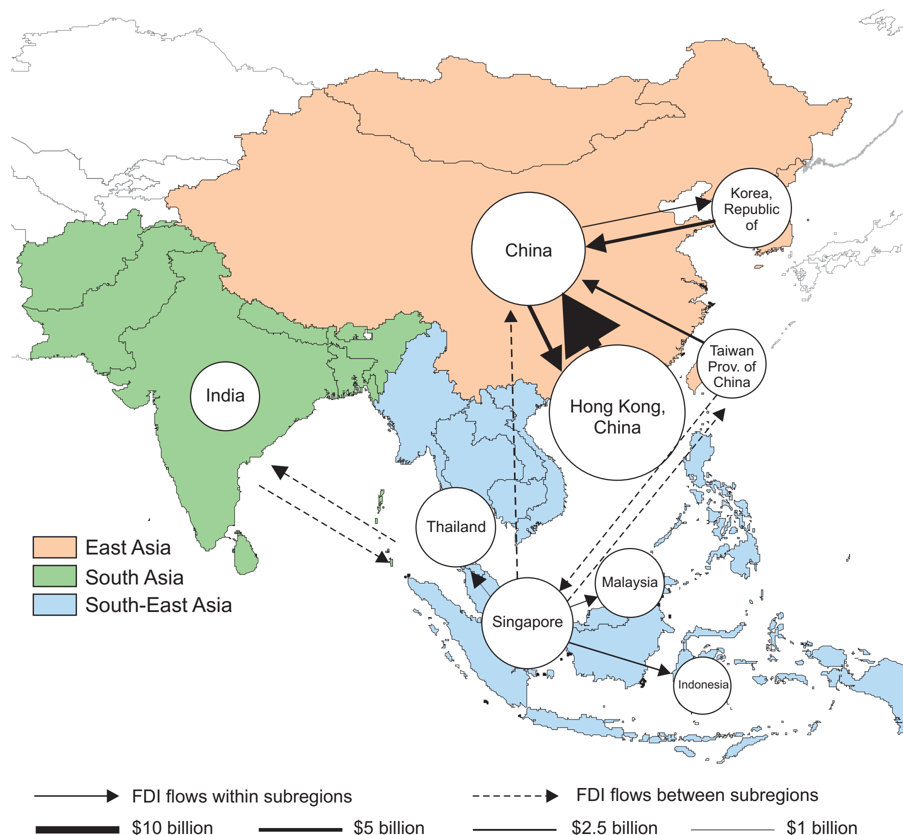
b. Sectoral trends

(i) Inward FDI: strong growth in services and high-tech industries

In 2005, all three economic sectors – primary, manufacturing and services – in South, East and South-East Asia, and Oceania received higher FDI flows. In particular, the primary sector is becoming more attractive to FDI. Manufacturing FDI continues to rise, driven by large greenfield investments, while inflows to the services sector, such as finance, telecommunications and real estate, are significant and increasing.

A number of countries in these subregions, apart from Oceania, are increasingly attracting high value-added and knowledge-intensive activities by

Figure II.10. Pattern of intraregional FDI flows in South, East and South-East Asia, 2002-2004 [a]



Source: UNCTAD.

[a] The width of arrows reflects the annual average of FDI flows during 2002-2004 (based on FDI inflow data from host economies). FDI flows below $400 million are not shown, except for those between India and South-East Asia. The size of circles reflects the inward FDI stock in 2004.

leading TNCs, including, for instance, Intel (United States). The trend of increased FDI in R&D in the region, noted in *WIR05*, is continuing (box II.8).

FDI in the *primary sector* grew in 2005, partly driven by the increase in cross-border M&A sales in the agro-industry. However, cross-border M&A sales in mining, quarrying and petroleum declined (table II.8). In Indonesia, ExxonMobil Corp. and the Government reached agreement on Cepu, the largest oilfield in the country. This may lead to a large increase in FDI inflows into the Indonesian oil industry in the coming years.

FDI flows into the *manufacturing sector* have been rapidly rising, fuelled by large greenfield projects in industries such as automotives, electronics, steel and petrochemicals. Low-cost countries in South-East Asia are becoming attractive locations for the manufacturing activities of TNCs. For instance,

Box II.8. FDI in R&D continues to rise in developing Asia

In 2005, 315 new FDI projects in R&D were recorded in South, East and South-East Asia, four fifths of them located in China and India.[a] The number of foreign-invested R&D centres had risen to 750 in China by the end of 2005. In the automotive industry, for instance, Shanghai GM and Shanghai Volkswagen are expanding their existing R&D centres, and Nissan Motor, DaimlerChrysler, Honda Motor and Hyundai Motor, together with their respective local joint-venture partners, are establishing new R&D centres. After establishing the Toyota Technical Center Asia Pacific (Thailand) in May 2005 (*WIR05*, p. 145), Toyota Motor is also setting up an R&D centre in Tianjin, China.

Source: UNCTAD.

[a] Based on the Locomonitor database (www.locomonitor.com). This database includes new FDI projects and expansions of existing projects, both announced and realized.

Daewoo Bus Corporation (Republic of Korea) is investing in a production facility in Viet Nam, and Intel plans to build the country's first semiconductor assembly facility. Meanwhile, Intel is also expanding its assembly and test facility in Malaysia. In India, increased inflows are taking place in the steel and petrochemical industries in particular. Meanwhile, FDI in China's manufacturing sector has been shifting towards more advanced technologies. For example, foreign TNCs invested $1 billion in China's integrated circuit industry in 2005, and Airbus plans to build an A320 assembly line in China.[37] By contrast, investments by both foreign and domestic companies in some traditional industries are likely to be hindered by overcapacity.

The *services* sector in the region continues to receive increasing FDI flows: in 2005, these were driven by large deals in financial services, particularly in China, and in other services such as telecommunications. Foreign banks and financial institutions invested about $12 billion in China's banking industry in 2005, compared to $3 billion in 2004. According to the China Banking Regulatory Commission, 154 foreign banks had been allowed to do business in local currency in 25 Chinese cities by the end of 2005. In the past two years, foreign investors rapidly entered the market by acquiring stakes in Chinese banks, rather than establishing their own branches. Real estate continued to be a hot spot for FDI in the region (box II.9). The top three targets of cross-border M&As were finance, transport, storage and communications, and business services (largely real estate), accounting for 32%, 15% and 11%, respectively, of the total sales of all the deals in 2005 (table II.8).

The services sector remains the main target of cross-border M&As in developing Asia, but TNCs have been increasingly using M&As as a mode of entry or a means of increasing market shares in the manufacturing sector, particularly in consumer goods industries such as food, beverages and tobacco (table II.8).

(ii) Outward FDI: growing interest in natural resources

Outward FDI from South, East and South-East Asia still focuses on services, but a growing proportion of capital outflows from the region have been targeting manufacturing and natural resources.

Box II.9. Rising FDI in Asian real estate

The real estate market in Asia has attracted considerable FDI. Foreign investors enter this market through various channels, including establishing new real estate developers, acquiring local ones, investing via financial institutions and purchasing properties directly. The NIEs continue to be major destinations for FDI in this market, while the Chinese and Indian real estate markets are also becoming increasingly attractive.

According to MOFCOM, FDI into China's real estate industry, the second largest recipient of FDI inflows in recent years, was $5.4 billion in 2005. But as these data do not include non-resident purchases of properties, the real size of FDI in this sector is underestimated. Even if the SAFE's data on the purchase of real estate by foreign institutions ($3.4 billion) are taken into account, the actual amount of FDI in real estate in 2005 might be much higher than the combined figure ($8.8 billion).[a] According to an estimate by SAFE, foreign investment now accounts for 15% of China's real estate market.[b] Real estate investment has become one of the most important channels through which "hot money" flows into China, contributing to the overheating of the Chinese real estate market in recent years.

FDI in India's real estate industry was $120 million in 2005. Although real estate development has not formally opened up to FDI, the Securities and Exchange Board of India has allowed foreign funds to invest in the local real estate industry since April 2004. Over 30 foreign funds have applied to conduct business in real estate in India. For instance, Tishman Speyer (United States) has established a joint venture with ICICI Venture Funds Management (India) with plans to invest $600 million in the Indian real estate market.[c] Investment funds from West Asia have also entered this market, and firms from Singapore (such as GIC) recently announced plans for significant investments in the Indian real estate market.

Source: UNCTAD, based on various newspaper accounts.

[a] See footnote a in box II.6.

[b] Wang Hongru, "Foreign investment flushes in the Chinese real estate market, how to regulate", *China Economic Weekly*, 24 October 2005.

[c] Jim Pickard, "International transactions of real estate keep increasing", 13 February 2006, *FT Chinese*.

Table II.8. South, East and South-East Asia: distribution of cross-border M&A sales, by sector/industry, 2004, 2005
(Millions of dollars)

	Sales		Purchases	
Sector/industry	2004	2005	2004	2005
Total	24 193	45 132	19 319	35 349
Primary	421	469	819	4 312
Agriculture, hunting, forestry and fisheries	10	120	132	37
Mining, quarrying and petroleum	411	350	687	4 275
Manufacturing	7 386	13 300	4 769	14 805
Food, beverages and tobacco	1 575	6 256	373	7 040
Wood and wood products	320	997	162	30
Chemicals and chemical products	2 329	659	292	676
Electrical and electronic equipment	1 691	2 368	1 948	4 113
Motor vehicles and other transport equipment	516	1 047	223	596
Tertiary	16 385	31 363	13 730	16 222
Trade	421	1 863	157	652
Hotels and restaurants	62	1 845	541	244
Transport, storage and communications	840	6 604	491	1 172
Finance	10 911	14 529	7 315	10 803
Business services	2 820	4 804	834	2 441

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

In terms of cross-border M&A purchases, the shares of these two sectors rose significantly in 2005, while that of the tertiary sector declined, from 71% in 2004 to 46% in 2005, although the total value of purchases in this sector rose by 18%.

Both China and India have intensified their efforts to acquire oil assets. Following the failure of CNOOC (China) in its bid for Unocal in the United States, Chinese oil companies have been successful elsewhere: China National Petroleum Corp. (CNPC) won the bid for PetroKazakhstan, headquartered in Canada, in August 2005; CNPC and Sinopec jointly purchased EnCana's (Canada) oil assets in Ecuador in September 2005; CNOOC invested in the Akpo offshore oilfield, owned by South Atlantic Petroleum Ltd. (Nigeria), in January 2006. Chinese and Indian oil companies have also begun to cooperate in bidding for foreign oil assets.

Both China and India are also actively investing in mining. Companies from both countries participate in biddings for mining projects. In 2006, Chalco (China) won a bid for a project in Australia, and Minmetals (China) established a joint venture in cooperation with Codelco (Chile).

c. Policy developments

UNCTAD's survey of changes in national FDI policies suggests that countries in South, East and South-East Asia continue to open up their economies to inward FDI. Significant steps in this direction were taken in 2005, particularly in services. Several countries also streamlined administrative procedures and introduced new incentives to encourage more investment. A few measures also aimed at securing greater benefits from FDI, or addressing concerns over cross-border M&As. In terms of policies on outward FDI, some governments in the region continued to remove barriers or to strengthen support to the international expansion of domestic firms (chapter VI).

In 2005, several countries in the region took notable steps to further liberalize inward FDI in services. The Government of India, for instance, took the first step to open up its retail industry by allowing foreign single-brand retailers to enter the domestic market. It also began opening up industries such as radio broadcasting and construction to FDI, and raised the permitted level of foreign ownership in telecommunications. China lifted geographical restrictions on the operations of foreign banks and travel agencies, and allowed 100% foreign ownership of hotels as well as minority foreign ownership in television programming, distribution and movie production. Malaysia opened futures brokerage and venture capital firms to 100% foreign ownership. Some countries also liberalized FDI in the primary sector. For example, Timor-Leste issued a law permitting international energy companies to obtain licences for oil and gas exploration, both onshore and offshore.

Various other initiatives were taken to make it easier for foreign companies to invest in a country. Indonesia introduced a 15-year income tax break for foreign companies investing in special zones. The Republic of Korea shortened the approval period for FDI from 30 to 20 days and amended its Foreign Investment Promotion Act by introducing a new clause for transparency, fairness, and predictability in administrative examination. In Thailand, new incentives were introduced for FDI in pharmaceutical projects.

However, some new policy measures were adopted with a view to addressing growing concerns related to cross-border M&As. In the Republic of Korea, for instance, foreign M&As

have become a sensitive issue since foreign private equity funds began to cash in their holdings without paying taxes. In this context, the Government decided to adopt a special withholding tax procedure to combat schemes through which third-country residents establish shell companies in the countries of its tax treaty partners to claim undue treaty benefits.[38] Concerns related to foreign M&As are also being addressed in China, including, for instance, antitrust and national economic security investigations.

d. Prospects

As rapid economic growth in South, East and South-East Asia shows few signs of slowing down, a further expansion of FDI into the region is expected. A PricewaterhouseCoopers survey in 2006 suggests that two major Asian economies, China and India, are the two most attractive locations for FDI in emerging markets.[39] Rapid economic growth and expanding purchasing power in these and other economies in the region will continue to boost FDI inflows, and might also fuel a new round of outward FDI growth. With Government support strengthened and some mega M&A deals expected,[40] outward FDI from China in particular should continue to grow rapidly.

FDI may continue to rise in China's services sector, but, overall, is likely to stagnate in the manufacturing sector. Nevertheless, the quality of FDI in manufacturing is improving. Rising FDI in services and high-tech manufacturing, coupled with the economic impact of the 2008 Olympic Games in Beijing and the 2010 World Expo in Shanghai, might contribute to a new round of FDI growth in the country. However, rising labour costs, in particular in the coastal provinces, as well as policy changes related to foreign M&As and to FDI in real estate might have a negative impact on FDI growth.

FDI inflows to India have been gaining momentum in recent years, encouraged by sustained macroeconomic stability and a high GDP growth rate. A number of leading TNCs from the United States plan to expand their presence significantly in the country.[41] According to a recent survey (A.T. Kearney 2006), despite disadvantages and bottlenecks, such as poor infrastructure, the long-term prospects for the country in attracting FDI are promising.

FDI is also likely to continue its upward trend in South-East Asia, in particular in relatively low-cost countries. For instance, low labour costs and expanding markets in Viet Nam are attracting both market- and efficiency-seeking FDI. According to the JETRO survey of Japanese manufacturers operating in six ASEAN countries and India, most surveyed companies envisage growing demand in these markets and plan to expand business operations within the next two years.[42] A recent survey of Japanese manufacturers regarding their investment plans in the next three years shows that all but two (the United States and the Russian Federation) in the 10 most promising locations are in Asia (JBIC 2006).

A significant increase in FDI flows to Oceania is also expected, with the above-mentioned Ramu Nickel-Cobalt project being implemented in Papua New Guinea, and implementation of the China-Pacific Island Countries Economic Development & Cooperation Guiding Framework.[43]

Data on cross-border M&As support expectations for further increases in both inward and outward FDI: M&A sales and purchases in the first half of 2006 grew by 40% and 26%, respectively, over those in the same period in 2005.

3. West Asia

West Asia[44] saw historic growth in FDI flows in 2005: both inward ($34 billion) and outward ($16 billion). The growth rate of inflows was the highest in the developing world. Outflows from the region, particularly from the Gulf countries, more than doubled. Economic growth, high global oil demand, a favourable investment environment and economic diversification efforts were the main factors behind this growth. This rising trend in both inward and outward FDI flows is likely to continue in 2006, though there are some concerns about geopolitical uncertainty in some parts of the region.

a. Geographical trends

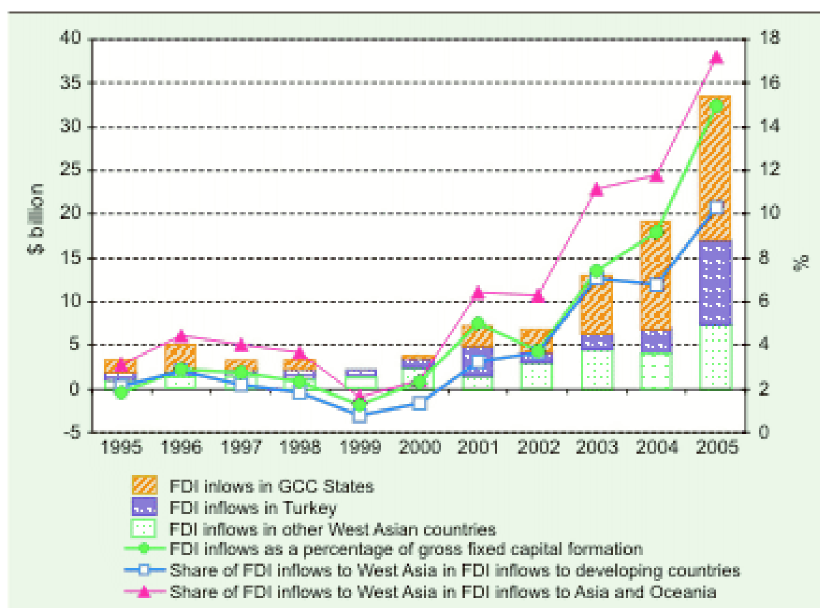
(i) Inward FDI: unprecedented rise

FDI flows into the 14 countries of West Asia rose by 85% in 2005, reaching a record $34 billion and resulting in the strongest FDI growth of all

the developing country subregions for the second consecutive year. Similarly, the share of West Asia's inward FDI in total inward FDI in Asia and Oceania was the highest since 1985: over 17%. Its share in all developing countries' inward FDI also increased, from 7% in 2004 to 10% in 2005. FDI as a percentage of gross fixed capital formation (15%) surpassed that of Asia and Oceania as well as of all developing countries for the first time in 2005 (figure II.11).

Several factors explain this high growth in 2005. First, the region experienced strong economic growth, spurred by production increase due to high commodity prices. During the period 2003-2005, the GDP growth rate averaged 7.4% in eight of the West Asian countries,[45] compared to 5% for the developing world. This raised the region's GDP per capita, which was already high.[46] Large-scale greenfield investments and cross-border M&A deals were attracted by the booming local economies and prospects for continuing high prices of oil and gas. FDI in downstream activities in the oil and gas industries has also been spurred by a rise in world demand for their products. Second, the business climate has also been favourable, as illustrated by the good performance of the Gulf Cooperation Council (GCC) members based on the World Bank's Doing Business indicators.[47] Third, liberalization efforts continued, with the privatization of services (telecommunications, water and energy supply, and banking) gathering momentum (box II.10). Finally, foreign affiliates in the region improved their performance, as illustrated by the profit-to-sales ratios of Japanese and United States affiliates.[48] This sent a promising signal to potential investors.

Figure II.11. West Asia: FDI inflows and their share in gross fixed capital formation, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

FDI inflows to West Asia in 2005 were spread unevenly among the region's economies, being concentrated in Saudi Arabia, Turkey and the United Arab Emirates. The Islamic Republic of Iran and Yemen failed to attract more inflows than in previous years, mainly due to increasing geopolitical uncertainty.

The United Arab Emirates was the largest recipient of FDI in West Asia, with a record high of $12 billion, mainly gone to the country's 15 free trade zones (figure II.12). Turkey followed, with a few mega deals that included the privatization of Türk Telekom (with $1.3 billion paid in 2005) and two deals in banking amounting to some $4 billion. Lebanon, for which FDI data on a balance-of-payments basis were reported for the first time this year, ranked fourth among 14 countries in the region.

Although developed countries continued to be the main sources of FDI, FDI from the developing world has also been rising. It is noteworthy that such FDI is increasingly intraregional, especially in services, and is concentrated in a few countries (box II.11).

Cross-border M&As in West Asia saw a historical increase from $0.6 billion in 2004 to $14 billion in 2005 (tables II.9 and II.10). As mentioned earlier, intraregional M&As, accounting for 65% of the total value and 30% in terms of numbers (box figure II.11.1), played an important role in this growth (box II.11). Large-scale acquisitions in services, mainly in telecommunications and banking, took place also in Turkey (for telecommunications, see also box II.10).

Box II.10. Recent privatizations involving FDI in West Asia

- *Bahrain*. In order to help diversify its economy, Bahrain has been implementing a privatization scheme through the Supreme Privatization Council created in 2001. For example, a privatization agreement for Hidd Power and Water was signed in 2006.[a] Privatizations of retail sales of petroleum products and postal services are also being considered (box table II.10.1).
- *Jordan*. The Government has been carrying out a number of privatizations, including through FDI, in line with the Privatization Programme launched in 1996 and Privatization Law No. (25) of 2000. The Programme focuses on transport, electricity, water and telecommunications. Out of six privatizations announced, two were completed in 2005-2006 (box table II.10.1).
- *Oman*. Full foreign ownership in privatization was allowed as of July 2004 by Royal Decree, which establishes a new privatization framework, targeting power, water and telecommunications. The seventh five-year development plan (2006-2010) envisages the gradual privatization of several State-owned enterprises and the launch of an investment fund using privatization proceeds to finance local infrastructure.
- *Turkey*. Privatization and the creation of an investor-friendly environment have been on Turkey's agenda since 1984. The new Mining Law of 2004 promotes privatization of the mining industry and welcomes FDI. A law adopted in 2004 lifted some of the foreign ownership restrictions in telecommunications. The largest share, reserved for the State, has been reduced, making foreign acquisitions easier. The Privatization Administration is currently planning to privatize several firms in insurance, hotels and ports.[b]
- *The United Arab Emirates*. In view of soaring demand for electric power, the Abu Dhabi Government has given particular attention to privatizing utilities, while Dubai is considering privatizing transport industries.

Box table II.10.1. Selected privatization projects involving foreign investors in West Asia, 2005-June 2006

Host country	Year of signature	Value ($ million)	Shares acquired (%)	Acquired company	Industry of acquired company	Immediate acquiring company	Ultimate acquiring company	Ultimate home country
Bahrain	2006	738	15	Hidd Power and Water	Water and energy	Investor group	Investor group	France/ Japan/ United Kingdom
Jordan	2005	55	80	Jordan Aircraft Maintenance Company (JorAMCo)	Aircraft engines and engine parts	ABRAAJ Capital Ltd	ABRAAJ Capital Ltd	United Arab Emirates
	2005[a]	..	80	Jordan Airmotive Limited Company (JALCO)	Aircraft engines and engine parts	..	..	..
	2005[a]	..	51	Central Electricity Generating Company (CEGCO)	Electricity	..	..	..
	2005-6[a]	..	41.5	Jordan Telecommunication Co. (JTEL)	Telecommunications services	..	..	..
	2005-6[a]	..	..	Jordan Post Company (JPC)	Mail services	..	..	..
	2006	112	37	Jordan Phosphate Mines Co. (JOPH)	Mining	Brunei Investment Agency	Brunei Investment Agency	Brunei Darussalam
Turkey	2005	6 550	55	Türk Telekom	Telecommunications services	Oger Telecoms Joint Venture Group	Saudi Oger Ltd	Saudi Arabia/Italy
United Arab Emirates	2005	1 700	40	Taweelah Bproject	Water and energy	Al Taweelah Asia Power	Marubeni/Powertek Berhad/BTU power company	Japan /Malasia/ United States
	2006	1 344	40	Union Water & Electricity Company (UWEC)	Water and energy	SembCorp Utilities	SembCorp Industries	Singapore

Source: UNCTAD, based on cross-border M&A database; information from national sources; companies' websites; and media accounts.

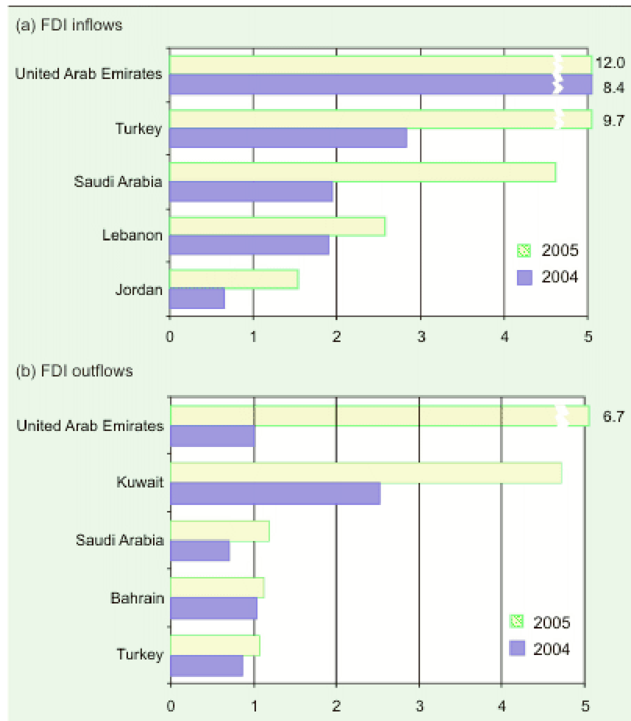
[a] Not completed.

Source: UNCTAD.

[a] This project, worth $738 million, has been given to a consortium comprising International Power of the United Kingdom (40% of the total value), Suez of France (30%) and Sumitomo Corporation of Japan (30%).

[b] Turkey, Privatization Administration, *Privatization 2006* (www.oib.gov.tr/yayinlar/publications.htm).

Figure II.12. West Asia: FDI flows, top five economies,[a] 2004-2005
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked on the basis of the magnitude of the 2005 FDI flows.

Box II.11. Intraregional FDI flows on the rise in West Asia

The real size of FDI flowing within West Asia is difficult to estimate due to the lack of statistics on bilateral FDI on a balance-of-payments basis. However, data on an approval basis reported by the Inter-Arab Investment Guarantee Corporation (IAIGC) on intra-Arab investments for 12 West Asian countries[a] suggest that intraregional flows have been soaring since 2001. There was a particularly sharp surge in 2005, partly due to increased flows from the Gulf countries profiting from high oil prices: such flows averaged $8 billion annually during the period 2001-2005, compared to $1 billion during the period 1997-2000. They were highly concentrated among the four top recipients: Lebanon, Saudi Arabia, the Syrian Arab Republic and the United Arab Emirates. These accounted for over 90% of the value of approved investments. Moreover, three oil-exporting countries, Kuwait, Saudi Arabia and the United Arab Emirates, were responsible for 88% of *outward* intraregional investment during this period. Data on cross-border M&As also show that intraregional deals have risen

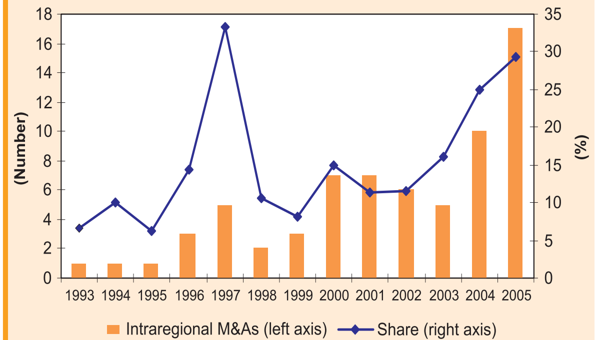
/…

Box II.11. Intraregional FDI flows on the rise in West Asia (concluded)

significantly since 2001(box figure II.11.1).

These trends reflect efforts undertaken by countries in the region, notably since 2000, to diversify their economies and improve the investment climate, liberalize the services sector and strengthen regional integration. For example, the Greater Arab Free Trade Agreement[b] provides for zero customs duties (see section on policy developments). The shared language, culture and religion of West Asia have also played a crucial role.

Box figure II.11.1. Number of intraregional cross-border M&As and their share in total cross-border M&As in West Asia, 1993-2005
(Number and per cent)



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

Source: UNCTAD and information provided by the IAIGC.

[a] There are 21 Arab member States eligible for the IAIGC, including the following 12 West Asian countries: Bahrain, Iraq, Jordan, Kuwait, Lebanon, Oman, Palestinian Territory, Qatar, Saudi Arabia, Syrian Arab Republic, United Arab Emirates and Yemen. The IAIGC employs the term "private and licensed inter-Arab investments", defined as "investment flows conducted by a private/mixed/joint Arab investors from one Arab country or more into another Arab country that depicts both private (including natural Arab persons, private Arab companies, mixed private-public companies, joint Arab companies, joint Arab-foreign companies, and joint Arab-foreign banks), and pure public or government investments, based on their nationality". This definition is different from the one used in the balance of payments, on the basis of which FDI statistics are normally compiled. The latter are used in this Report.

[b] The GAFTA members in West Asia are Bahrain, Iraq, Jordan, Kuwait, Lebanon, Oman, Palestinian Territory, Qatar, Saudi Arabia, the Syrian Arab Republic the United Arab Emirates and Yemen.

Table II.9. West Asia: distribution of cross-border M&As, by home/host region, 2004-2005
(Millions of dollars)

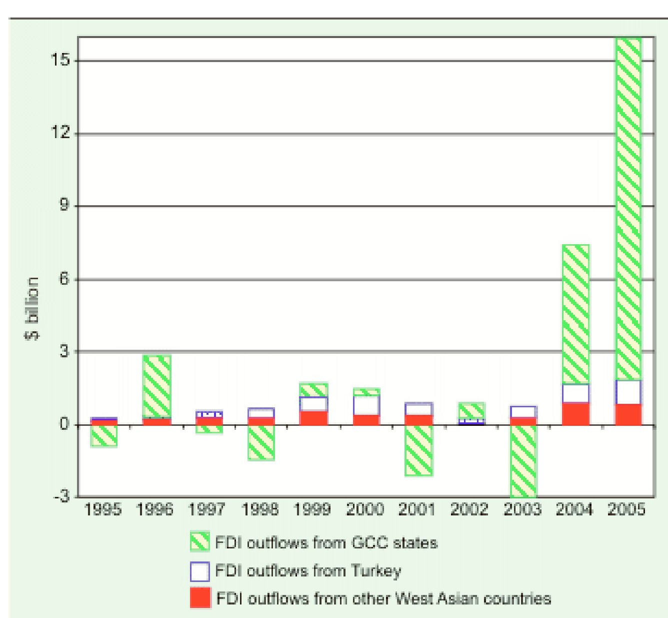
Home/host region	Sales 2004	Sales 2005	Purchases 2004	Purchases 2005
World	575	14 134	1 280	18 221
Developed countries	446	3 265	1 157	8 806
Developing economies	128	9 276	121	9 413
Africa	-	-	-	5
Latin America and the Caribbean	-	-	-	50
Asia and Oceania	128	9 276	121	9 358
Asia	128	9 276	121	9 358
West Asia	114	9 208	114	9 208
South, East and South-East Asia	14	68	7	150
South-East Europe and CIS	-	1 593	1	2

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

(ii) Outward FDI: petrodollars boost investment

Surging oil prices and increased foreign exchange reserves in many countries have made West Asia an important source of FDI outflows (figure II.13), notably by the State-owned investment firms of oil-exporting States such as Kuwait, Saudi Arabia and the United Arab Emirates (annex table A.II.1). In 2005, outward FDI flows from the region rose to $16 billion, compared to $7 billion in 2004. For the first time since 1990, outflows from the region surpassed those from ASEAN member States. In particular, outward cross-border M&As, mainly in services, increased twelvefold (tables II.9 and II.10). The oil-producing countries are increasingly investing abroad, notably in services and oil-related manufacturing. This phenomenon of "petrodollar recycling" is in sharp contrast to the one in the 1970s and 1980s, when portfolio investment dominated (box II.12).

Figure II.13. West Asia: FDI outflows, by subregion, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

Table II.10. West Asia: distribution of cross-border M&As, by sector, 2004-2005
(Millions of dollars)

Sector	Sales 2004	Sales 2005	Purchases 2004	Purchases 2005
Total	575	14 134	1 280	18 221
Primary	383	111	-	45
Manufacturing	146	55	922	19
Tertiary	46	13 968	357	18 157

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

Note: Sales and purchase data are compiled based on immediate target or acquirer country, rather than ultimate target or acquirer country. Thus, these data include equity acquisitions of firms' foreign affiliates in the countries where foreign equity ownership is not allowed. For example, primary sector sales in Kuwait include deals in the crude petroleum and natural gas industry (in which FDI is prohibited) undertaken by foreign affiliates operating in the country.

Private-equity and institutional investors from West Asian countries have invested in various areas, sometimes through large-scale investments (see chapter I). For example, Kingdom Holding – a Saudi State-owned company – which has been an active private-equity firm since the 1980s, targets not only blue-chip shares and luxury hotels in developed countries, but also emerging firms in developing countries, including in Africa. In Bahrain, Investcorp and Arcapita Bank use their private equity arms to purchase majority shares in companies in Europe and the United States. Recently, the Dubai Government (United Arab Emirates), through its private-equity firms, has made some significant cross-border equity acquisitions, including the purchase of Peninsular and Oriental Steam Navigation Company (P&O) of the United Kingdom through the State-run DP World (annex table A.II.1). This acquisition made DP World the world's third largest ports operator (chapters III and VI).

Box II.12. How are West Asian petrodollars recycled in FDI?

Spurred by soaring commodity prices over the past few years, oil-rich countries in West Asia have been increasingly spending their windfall profits not only in portfolio investments in developed countries but also in FDI worldwide.

In 2005, the six members of the Organization of the Petroleum Exporting Countries (OPEC) in the region[a] received the highest export revenues since 1998.[b] Available data on cross-border investment originating in these countries point to changing trends in petrodollar investment. Although the absolute amount of their outward FDI is still much smaller than their banking deposits and portfolio investments abroad,[c] the share of FDI in capital outflows has been growing since 1999, compared to that during previous oil price hikes in the 1970s and the 1980s (McGuire and Tarashev 2005).

For example, investments financed by petrodollars have flowed into the services sector all over the world – to other Asian and African economies (e.g. Egypt, India, Pakistan and Sudan) as well as developed countries. Kuwait, Saudi Arabia and Dubai (United Arab Emirates) are investing in telecommunications, hotels and real estate, both in the region and in developed countries (see also annex table A.II.1).

In addition, the "look-east" policy of Kuwait and Saudi Arabia, with a view to establishing stronger ties with the Asian giants in the energy industry, particularly oil, is bearing fruit. For example, Kuwait and the Guangdong Provincial Government in China are planning to build a refinery and petrochemicals complex for $5 billion. A new $3.6-billion refinery and petrochemicals plant was inaugurated in Fujian (China) by Saudi Aramco (with a 25% share) along with China's State-owned Sinopec (50%) and ExxonMobil (25%). Crude oil for the plant is to be supplied by Saudi Arabia, China's largest oil supplier. Saudi Arabia is also likely to be an equity partner for India's State-owned Oil and Natural Gas Corporation in a refinery project in the Indian State of Andhra Pradesh (see section 2 on South, East and South-East Asia).

Source: UNCTAD.

[a] Iraq, the Islamic Republic of Iran, Kuwait, Qatar, Saudi Arabia and the United Arab Emirates.

[b] *Source*: United States Department of Energy (www.eia.doe.gov/cabs/OPEC_Revenues/OPEC.html).

[c] For example, the Government of Kuwait transfers 10% of its oil revenue each year through the Kuwait Investment Authority (KIA) to KIA's affiliate in London (Kuwait Investment Office) that manages its funds as a global investor. *Source*: Kuwait Investment Authority (www.kia.gov.kw/KIA/KIO).

b. Sectoral trends: rising flows to energy-related industries

FDI data for the region by sector are scarce. However, available data suggest that West Asia's inward and outward FDI flows are highly concentrated in the services sector. FDI in manufacturing has also been taking place, for instance in textiles and ITC-related manufacturing (*WIR05*), as well as in areas related to oil and gas. In the case of inward FDI, the shift towards services is in response to increasing liberalization and promotion of FDI in this sector, whereas the rise of FDI in manufacturing is mainly in downstream activities (part of manufacturing) since FDI in upstream activities in the energy industries is not allowed in most West Asian countries. In response to increasing global demand, countries in the region are trying to attract FDI in downstream activities related to natural resources to increase production and improve productivity through advanced technologies. The following are the main characteristics of FDI in each sector:

- *Primary sector*. Data on the oil and gas industries are limited. However, as most West Asian countries do not allow FDI in exploration activities, FDI is likely to be very limited in the primary sector.[49] In Turkey, following the privatization of its mining industry (coal, chromite, copper, boron) in 2004 (box II.10), that industry received FDI inflows of $44 million in 2005.[50]
- FDI in the *manufacturing* sector has been soaring, notably in the energy-related industries, including oil refining and petrochemicals, bolstered by continuing high global demand. In Saudi Arabia, FDI inflows to these industries in 2005 amounted to $2.5 billion – almost four fifths of total FDI in manufacturing and more than five times higher than the level in 2004 ($425 million).[51] State-owned Qatar Petroleum has also been expanding its investment expenditures in joint projects in liquefied natural gas and petrochemicals with United States firms.[52]

- The *services* sector continued to attract the most foreign investment in West Asia in 2005, mainly through cross-border M&As (table II.10). Continued efforts of countries in the region to diversify their economies and promote FDI further through liberalization and deregulation of non-oil industries, together with booming real estate and financial markets, played a vital role in spurring inward FDI flows to these industries. The most targeted industries in the region are, among others, real estate, tourism, telecommunications and financial services, as well as transport and construction. FDI in real estate and tourism took place mainly at the intraregional level, partly because of some legal constraints on GCC (Gulf Cooperation Council) States with regard to receiving investments from foreign investors other than the GCC.

  In financial services, FDI was spurred by ongoing liberalization measures. For instance, the Qatar Financial Centre and the Dubai International Financial Exchange were both opened in 2005 and have already attracted some investments. Educational services and R&D have been an emerging area for FDI in some countries in the region.[53] In the telecommunications industry, both European and West Asian telecom operators actively invested in the region in 2005.[54] Kuwaiti Mobile Telecommunications Company, which purchased an 85% stake in Celtel International (Netherlands) in 2005 (with operations in 13 African countries), has been keen to expand its business abroad, particularly in the region (chapter III, and see also annex table A.II.1).

c. Policy developments

Most West Asian economies are progressively easing laws and regulations relating to FDI, in line with efforts to diversify away from oil. They are also strengthening FDI incentives. Liberalization of FDI applies particularly to non-energy sectors that have been experiencing an intraregional investment boom. Over 90% of policy measures introduced in West Asia at the national, regional and multilateral levels were favourable to foreign investors.[55]

In 2005, as part of a plan to attract more FDI in non-energy sectors, Qatar allowed a limited number of foreign investors to trade in the Doha Securities Market.[56] It also established the Qatar Financial Centre where full foreign ownership and repatriation of profits are allowed. Moreover, the Qatar Science and Technology Park – the first free investment zone – was also established to attract foreign investors in agriculture, technology, tourism and other non-energy activities. Meanwhile, the United Arab Emirates launched a national project in early 2005 to assist decision-makers to adopt policies promoting non-oil FDI, including in real estate and manufacturing activities. It includes the establishment of a comprehensive database on FDI in accordance with international standards, and it is hoped that the accurate and timely statistics provided will help in the development of sound policies (box II.13). The Emirates also opened the Dubai International Financial Exchange, which allows 100% foreign ownership. Turkey has also been enhancing its FDI incentives: examples include a new Law that allows additional low-income provinces to grant tax and insurance incentives and assist in the provision of energy and free land.[57] In addition, Turkey has been undertaking tax policy reforms to create a simpler and more stable tax regime that would be more consistent with international norms and would reduce the financial burden on foreign investors (Turkey, General Directorate of Foreign Investments (2006)).[58] The Kuwaiti Government is also planning to reduce corporate tax rates from 55% to 25% to attract FDI in non-oil industries.[59]

Governments in the region are undertaking trade liberalization policies at the national, regional and multilateral levels through the establishment of free trade areas and a series of trade agreements, as well as by closer integration into the global trading system. A number of free trade agreements (FTAs) at both bilateral and regional levels have been signed or are under negotiation. For instance, Turkey signed an FTA with Egypt in December 2005 as part of South-South integration in the Euro-Mediterranean Free Trade Area (see also Africa section).[60] Bahrain and Oman each signed an FTA with the United States in September 2005 and January 2006 respectively. The GCC has been seeking to expand the scope of agreements currently under negotiation to include services and investments with different partners. For example, while the EU-GCC free trade negotiation missed the 2005 year-end deadline, both these regional blocs remain keen to conclude an agreement in 2006. Negotiations between the GCC and India to finalize an agreement on a free trade area by 2007 are also in progress.[61] It will include agreements on investment and services to make it a comprehensive Indo-GCC economic cooperation agreement. On the other hand, FTA negotiations

Box II.13. Efforts in West Asia to strengthen national FDI databases in line with the ESCWA/UNCTAD joint project

With rapidly advancing economic diversification in the United Arab Emirates, supported by increasing FDI in the private sector, there is a growing need to better monitor the economy. The Government's awareness of the need to improve FDI data quality, coverage, periodicity, timelines and intrasectoral consistency at the Federal level resulted in a national project to establish a database on FDI, which coordinates efforts by the Federal Government and all seven Emirates authorities. In November 2005, a national working team was established by the United Arab Emirates Ministry of Economy and Planning with officials from key government departments and Emirates[a] to collect information on FDI, including its source, size and ultimate destination, and to design appropriate policies to attract more FDI.

That same year, national workshops were organized by UNCTAD, together with the Economic and Social Commission for Western Asia (ESCWA), in countries of the region, including the United Arab Emirates, Kuwait and Qatar. The workshops aimed at helping them to implement international methodological standards and set up data compilation and dissemination systems to produce internationally comparable statistics on FDI. They trained officials from the respective national statistical institutes in the implementation of effective survey systems to collect and disseminate data on FDI and the activities of TNCs. As a result of training workshops undertaken in the previous years, Bahrain, Oman and Saudi Arabia recently undertook surveys on FDI for the first time.

Source: UNCTAD and press release issued by the Ministry of Economy and Planning of the United Arab Emirates.

[a] That includes the Ministry of Economy and Planning, Chamber of Commerce (Abu Dhabi), Emirates Central Bank, Dubai West Asia Development and Investment Authority, Department of Commerce & Planning (Sharjah), Department of Commerce & Industry (Fujairah), Chamber of Commerce (Ajman), Department of Commerce (Um Al Quain), Department of Commerce (Ras Al Khayma), Ministry of Finance & Industry's Statistics Centre and Dubai Municipality.

between the GCC and Japan that were launched in May 2006 will cover only trade in goods and services.[62] At the regional level, the Greater Arab Free-Trade Agreement (GAFTA), which entered into force in 1998, eliminated all trade barriers among its members in January 2005. At the multilateral level, Saudi Arabia acceded to the WTO in November 2005, which has accelerated the country's integration into the global economy as well as its liberalization of inward FDI (box II.14).[63]

d. Prospects

The upward trend in inward FDI flows to West Asia is expected to continue in 2006, driven by high GDP growth (forecast at over 5%), ongoing economic reforms and high oil prices. Although recent surveys (e.g. by A. T. Kearney 2006 and JBIC 2006) do not suggest a rush of foreign investors to the region, their business sentiments are likely to remain stable. Meanwhile, the distribution of inflows in the region will remain uneven, mainly owing to heightened geopolitical uncertainty in some areas. Outward FDI is also expected to continue to rise mainly from oil-exporting countries benefiting from bullish oil prices.

Economies in the Gulf region and Turkey will continue to be key players in the inward FDI of West Asia. For instance, in *Saudi Arabia,* FDI in services that have been increasingly opening up (box II.14) should grow further, while the country's strong incentive to promote downstream industries will also play an important role in attracting increased FDI inflows.[64] In *Qatar*, along with FDI in the natural gas industry, the growing demand for transportation of liquefied natural gas will contribute to the rise of FDI inflows, in particular in activities such as shipping, dry-dock and repair yard construction. The Qatar Financial Centre is also expected to attract international financial service institutions and major TNCs. The *United Arab Emirates* will continue to attract FDI in various manufacturing and service activities, mainly to their free zones. Driven by the property laws enacted successively in Abu Dhabi and in Dubai, FDI in real estate is likely to remain prominent. With the eventual adoption of the planned federal Company Law to allow majority foreign ownership in non-free economic zones, the Emirates would continue to be the largest FDI recipient in the region. Lower corporate taxes and ongoing economic reforms may increase foreign investors' growing interest in *Turkey* – ranked 13th in the FDI Confidence Index (A. T. Kearney 2006)

Box II.14. Accession to the WTO and liberalization of FDI by Saudi Arabia

In negotiations to join the WTO, Saudi Arabia focused on the degree to which it would be willing to increase market access to foreign goods and services and the time frame for becoming fully compliant with WTO obligations. In the area of FDI, the list of sectors in which FDI is prohibited – defined under the new FDI Law adopted in 2000 – has been shortened progressively. Activities currently closed to FDI include three in manufacturing – oil exploration, drilling and production – and 15 in services.[a] The negative list will be further revised and shortened periodically.

Saudi Arabia's commitments on FDI in services include the following:

- *Insurance*. Foreign insurance companies are permitted to open and operate direct branches in Saudi Arabia. Commercial presence is also permitted for insurers that establish a locally incorporated cooperative insurance joint-stock company, in which foreign participation is limited to 60%. A three-year transition period is given to existing foreign insurance providers[b] to convert to either a Saudi cooperative insurance company or to a direct branch of a foreign insurance company.
- *Banking*. Banks are allowed a commercial presence in the form of a locally incorporated joint-stock company or as a branch of an international bank. Upon Saudi Arabia's accession to the WTO, the foreign equity cap for joint ventures in banking was increased to 60%. While financial services can be provided only by commercial banks, non-commercial-banking financial institutions are also allowed to provide asset management and advisory services.
- *Telecommunications*. Saudi Arabia will allow up to 70% foreign equity ownership of most of its committed sectors in telecommunications services [c] by the end of 2008, except for public fixed facilities-based voice telephone services, facsimile services, voice mail and some public mobile telephone services, where foreign equity will be kept at 60% by 2008. These telecommunications services are to be supplied by a company registered in Saudi Arabia.

Source: UNCTAD, based on Saudi Arabian General Investment Authority (SAGIA) (www.sagia.gov.sa), WTO (2005) and WTO, "WTO General Council successfully adopts Saudi Arabia's terms of Accession", Press/420, 11 November 2005, (www.wto.org/english/news_e/pres05_e/pr420_e.htm).

[a] These activities are listed in the negative list, available on SAGIA's website (www.sagia.gov.sa).
[b] They have been allowed to operate in the country through direct branches since April 2005.
[c] These commitments apply to both basic telecom services and value-added telecom services. Public telecom services will have to be provided by a joint stock company.

and 67th among 140 countries in the UNCTAD Inward Potential Index (annex table A.I.9). The country's financial and telecommunications industries will continue to attract large-scale FDI projects.[65] Data on cross-border M&As for the first half of 2006 showed a surge, reaching more than 65% of the total sales for 2005.

Outward FDI from West Asia is most likely to expand further, in particular in services, with petrodollars still one of the most important sources of finance. For instance, the Kuwait Investment Authority confirmed plans to buy a 10% stake (worth $2 billion) in the Industrial & Commercial Bank of China.[66] In recent months, Tecom of Dubai (United Arab Emirates) has purchased 35% of Tunisie Telecom, and Emirates Telecommunications Corporation (Etisalat) acquired a 26% stake in Pakistan's State-owned Pakistan Telecommunication Company Limited (PTCL). All in all, by June 2006 cross-border M&A purchases from West Asia had reached $17 billion, over three times their previous record level reached in 2005.

4. Latin America and the Caribbean

Latin America and the Caribbean experienced a slight increase in FDI inflows in 2005, following the rebound registered the previous year, as the result of strong economic growth and soaring commodity prices. Income on inward FDI increased significantly resulting in high reinvested earnings as a component of inward FDI. Higher growth and commodity prices contributed not only to higher inward FDI, but also to increased outward FDI, as improved earnings enabled Latin American and Caribbean firms to acquire foreign assets, mainly in telecommunications and heavy industries. A significant proportion of outward FDI from Latin

America and the Caribbean goes to other countries in the region, contributing thereby to the growth in their inward FDI. The share of the services sector in FDI inflows continued to decline, while that of the primary sector rose and that of manufacturing remained steady. On the other hand, soaring commodity prices allowed a noticeable improvement in the current-account balances of many countries, reducing policy constraints on governments. This affected the incentive regime set up to attract FDI into natural resources in the 1990s, when commodity prices were at a record low level. The regulatory environment for FDI in natural resources was tightened in many countries and, in some, there was a general policy shift away from the liberal reforms of the 1990s.

a. Geographical trends

(i) Inward FDI: strong increase to Andean countries

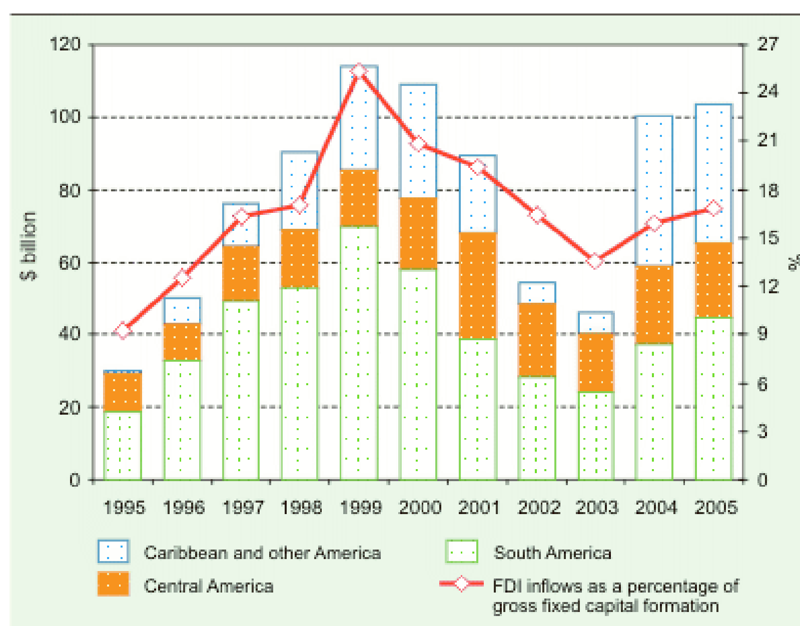
In 2005, FDI inflows to Latin America and the Caribbean reached $104 billion, 3% higher than the previous year. However, excluding the offshore financial centres, inflows increased by 12%, to $67 billion in 2005. While in 2004 the upturn in FDI inflows was widespread in the region, the increase in 2005 was unevenly distributed. Inflows to South America rose by 20%, to $45 billion, driven by strong increases in all but one Andean country, while those directed to the Central American and Caribbean countries, other than offshore financial centres, remained at the same level as in 2004 ($23 billion). Flows to the offshore financial centres decreased by 10%, to $36 billion, partly as a consequence of the Homeland Investment Act adopted in the United States (see box II.19). FDI inflows as a percentage of gross fixed capital formation increased slightly, from 16% in 2004 to 17% in 2005 (figure II.14).

In 2005, the increase in FDI inflows in the region, excluding offshore financial centres, consolidated the strong rebound of 2004 following four years of marked declines. Generally, the same factors as in 2004 were at play: sustained regional economic recovery, combined with the continued growth of the world economy, higher profits of TNCs' affiliates and considerably improved business prospects. Indeed, the region registered exceptional rates of GDP growth during the period 2004-2005, surpassing the average for the world economy for the first time in 25 years. Another characteristic of the current recovery is that for the second year in a row GDP growth was coupled with a surplus in the current account (ECLAC 2004a and 2005).[67] This is mainly the result of the strong demand for commodities, leading to a noticeable improvement in the region's trade balance.[68]

In this context, foreign companies' profits increased significantly: income on inward FDI in the top six FDI recipient countries – other than offshore financial centres – increased by 177% to $42 billion between 2002 and 2005 (see figure II.15). This increase was particularly marked in Brazil and Chile, where FDI income amounted to $11 billion each. Because of this, reinvested earnings have clearly gained in importance as a component of FDI inflows since 2003, particularly in South America where their share increased from 3% in 2000-2002 to 48% in 2003-2005.[69]

The trend in FDI inflows was different by country and by subregion. For example, they declined in Brazil (-17%), Chile (-7%) and

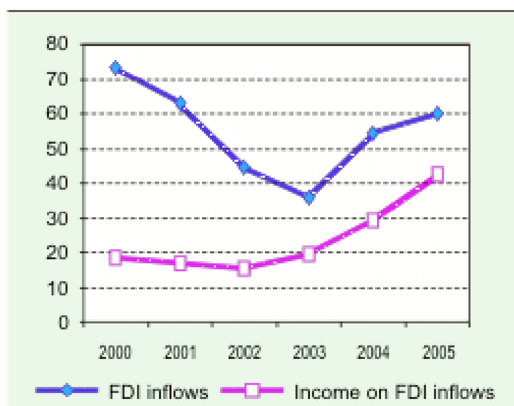
Figure II.14. Latin America and the Caribbean: FDI inflows and their share in gross fixed capital formation, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

Figure II.15. FDI inflows and income on FDI inflows in selected countries in Latin America and the Caribbean,[a] 2000-2005

(Billions of dollars)



Source: UNCTAD, based on balance of payments data from the central banks of the respective country.

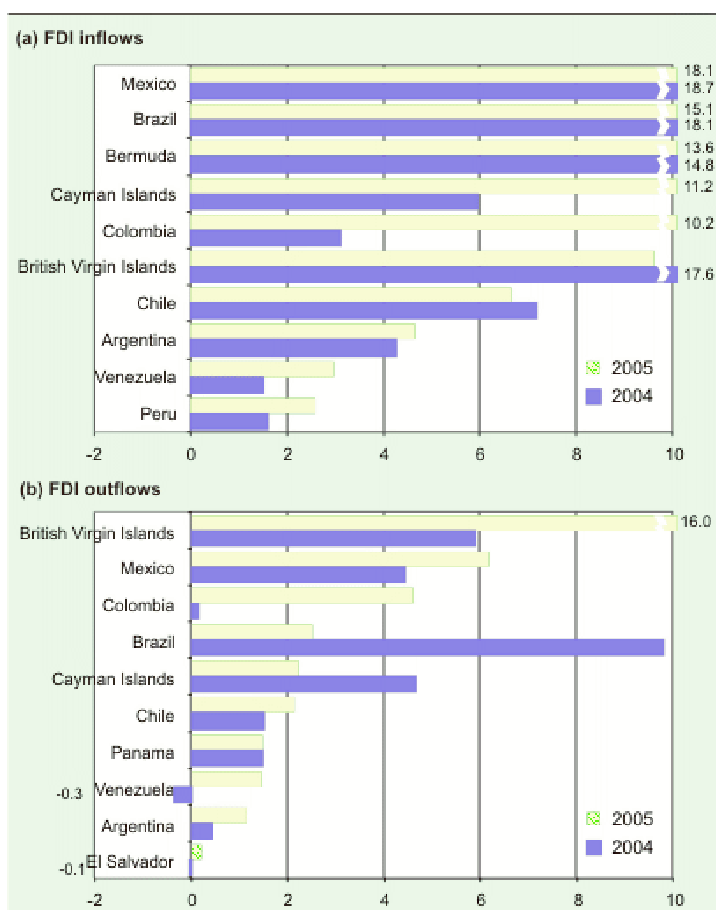
[a] The countries covered are those for which income on inward FDI data were available for 2005. These are: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela. Their share in total FDI inflows to Latin America and the Caribbean (excluding offshore financial centres) in 2005 was 89%.

Mexico (-3%), while they strongly increased in Uruguay (81%). They also increased in most of the Andean countries: they more than trebled in Colombia, almost doubled in Venezuela, and increased by 65% and 61% in Ecuador and Peru respectively (figure II.16). These divergent performances suggest that, together with the common drivers referred to above, specific factors have been at play in each country:

- In Brazil and Mexico, the decline in inward FDI in 2005 is attributable to the lower value of cross-border M&As (table II.11).[70] Moreover, in the case of Brazil, the continued appreciation of its currency (the real) may also have negatively influenced the prospects for export-oriented activities.[71]
- The trebling of inflows to Colombia in 2005 was mainly the result of cross-border acquisitions of local companies,[72] although the dynamism of greenfield FDI in mining, oil and telecom activities also contributed to the upsurge.
- In Chile, the decline of FDI inflows in 2005 is due to equity inflows that halved as a consequence of the purchase of Telecom Italia's affiliate by the local group Almendral for $934 million. Reinvested earnings remained an important and increasing component of total FDI inflows: in 2005 they increased by 7%, to $6.3 billion, and their share in total FDI inflows increased from 83% in 2004 to 95% in 2005. The copper industry accounted for around half of total reinvested earnings.
- In Argentina, the 9% increase in FDI inflows came from high and sustained economic growth (8%-9% over the past three years) as well as a competitive exchange rate that favours export-oriented activities and lowers the cost of acquisitions and investments by foreign investors. TNCs from Latin America and the Caribbean are increasingly investing in Argentina.[73]

Figure II.16. Latin America and the Caribbean: FDI flows, top 10 economies,[a] 2004-2005

(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Ranked on the basis of the magnitude of the 2005 FDI flows.

Table II.11. Latin America and the Caribbean[a]: distribution of cross-border M&As, by sector/industry, 2004-2005
(Millions of dollars)

Sector/industry	Sales		Purchases	
	2004	2005	2004	2005
Total	21 840	22 532	11 977	10 179
Primary	1 333	814	8	881
Manufacturing	6 560	10 793	8 582	5 492
Food, beverages and tobacco	4 131	5 710	7 786	127
Metals and metal products	195	3 129	382	3 306
Stone, clay, glass and concrete products	634	1 025	-	1 672
Tertiary	13 947	10 926	3 322	3 806
Retail trade food stores	350	1 621	-	-
Telecommunications	6 811	3 502	1 553	2 532
Finance	4 770	1 077	1 725	1 107

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics).
[a] Excluding offshore financial centres such as Belize, Panama and the Caribbean countries other than Cuba, Dominican Republic, Haiti, Jamaica and Trinidad and Tobago.

- The strong increase in FDI flows to Venezuela and Ecuador was mainly the result of increased investment in oil and gas, while in Peru, in addition to the continued interest of foreign investors in mining, oil and gas activities, there was the $470 million sale of the local beer company UCP Backus y Johnston to SABMiller.
- In Central America and the Caribbean – excluding Mexico and the financial centres – inflows increased by 9%, to $4.5 billion, mainly in the services sector (ECLAC 2006a).
- In Uruguay, FDI inflows almost doubled, to an unprecedented $600 million, mainly due to the development of two large-scale pulp and paper projects (see section b below).

Many other countries remain small recipients, receiving less than $100 million in FDI inflows (table II.12).

(ii) Outward FDI: continued growth

FDI outflows from Latin America and the Caribbean increased in 2005 by 19%, to $33 billion (figure II.17). The offshore financial centres, where outflows rose by 24%, accounted for 43% ($14 billion) of this amount. The Central American and Caribbean countries (other than offshore financial centres), where Mexico is the main investor, registered the strongest growth (44%), with outflows amounting to $7 billion. Outflows from South American countries increased by 5% to reach $12 billion, with Colombia, Brazil, Chile, Venezuela and Argentina (in that order) as the main investors.

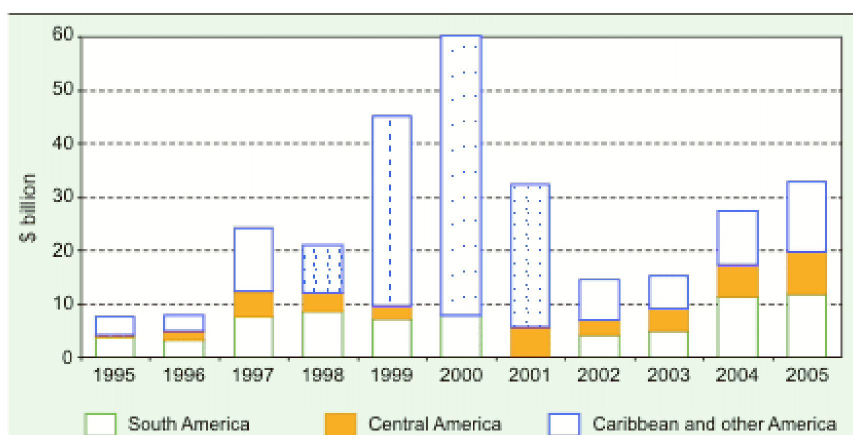
Excluding offshore financial centres, Mexico headed the region as the leading foreign direct investor with outflows of $6.2 billion in 2005 (figure II.16), mainly due to cross-border acquisitions by Cemex, Telmex and América Móvil.[74] Colombia ranked second after the acquisition of a 15.1% stake by the Santo Domingo Group in the brewer company SABMiller.[75] Brazil reverted to lower levels of outward FDI after the exceptional amounts reached in 2004 (*WIR05*). The most noticeable deal was Camargo Correa's purchase of the Argentinean cement company Loma Negra. Companies based in Chile, Venezuela and Argentina have also been

Table II.12. Latin America and the Caribbean: country distribution of FDI flows, by range,[a] 2005

Range	Inflows	Outflows
Over $10 billion	Mexico, Brazil, Bermuda, Cayman Islands and Colombia	British Virgin Islands
$5-9.9 billion	British Virgin Islands and Chile	Mexico
$1-4.9 billion	Argentina, Venezuela, Peru, Ecuador and Trinidad and Tobago	Colombia, Brazil, Cayman Islands, Chile, Panama, Venezuela and Argentina
$0.1-0.9 billion	Dominican Republic, Panama, Costa Rica, Jamaica, Uruguay, El Salvador, Bahamas, Honduras, Nicaragua, Paraguay, Guatemala, Barbados, Antigua and Barbuda, Aruba, Saint Lucia, Belize and Anguilla	El Salvador and Trinidad and Tobago
Less than $0.1 billion	Guyana, Saint Kitts and Nevis, Netherlands Antilles, Suriname, Saint Vincent and the Grenadines, Grenada, Dominica, Haiti, Montserrat, Cuba and Bolivia	Jamaica, Peru, Honduras, Aruba, Paraguay, Bolivia, Barbados, Netherlands Antilles, Belize, Uruguay, Costa Rica and Bermuda

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.2.
[a] Countries are listed according to the magnitude of FDI.

Figure II.17. Latin America and the Caribbean: FDI outflows, by subregion, 1995-2005



Source: UNCTAD (www.unctad.org/fdistatistics) and annex tables B.1and B.3.

active as outward investors. In Venezuela, PDVSA was particularly active in the petroleum industry, while in Argentina, Grupo Techint's purchase of the Mexican steel company Hylsamex was the largest outward FDI operation in 2005.

b. Sectoral trends: natural resources and manufacturing increasingly targeted

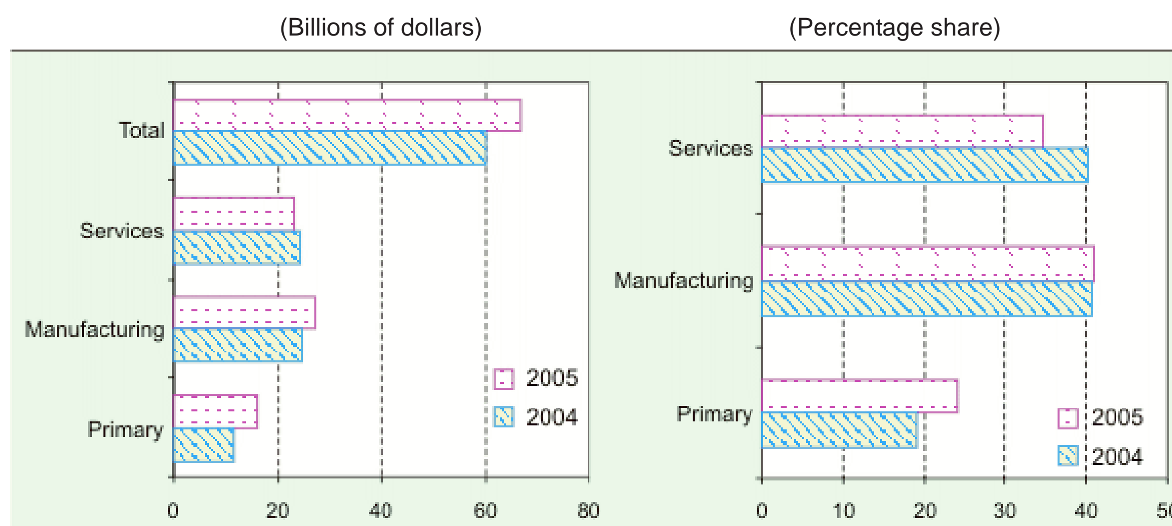
In 2005, the share of FDI directed to the services sector in Latin America and the Caribbean (excluding the offshore financial centres) continued to decline – a trend that had begun in 2001 (*WIR05*). Its estimated share in total FDI flows to the region fell from 40% to 35%, offset by gains in the primary sector whose share rose from 19% to 24%. FDI flows to the primary and manufacturing sectors increased by an estimated 40% and 11% respectively, and those to services decreased by 4% (figure II.18).

Primary sector

The growing attractiveness of the primary sector is due to soaring commodity prices, the stimulating impact of which, at least for the time being, outweighs the deterring effects of policy changes implemented in that sector by various governments since 2004 (*WIR05* and section c below).

Of the oil and gas producing countries, the only one where FDI to the primary sector seems to have declined – or even reached negative values – in 2005 was Bolivia, due to the delays and uncertainties surrounding implementation of its new law relating to oil an gas adopted in 2005 (*WIR05*). This was followed by a decree in May 2006 nationalizing the country's oil and gas resources that will further affect foreign oil companies operating in the country (see box II.16).

Figure II.18. Latin America and the Caribbean:[a] FDI inflows by sector, 2004-2005



Source: UNCTAD secretariat calculations, based on official data from Argentina (for 2004), Brazil, Costa Rica, Ecuador (for 2004 and the first half of 2005), Mexico and Venezuela (for the petroleum sector), and on estimates for the rest.

[a] Excluding offshore financial centres such as Belize, Panama and the Caribbean countries other than Cuba, the Dominican Republic, Haiti, Jamaica and Trinidad and Tobago.

Bolivia has relied heavily on foreign investment in upstream, midstream and downstream activities for the development of its natural gas since its privatization of the oil and gas industry in the early 1990s. About 25 international energy firms currently operate in that country.[76] Brazil's Petrobras and Span's Repsol YPF, whose strategies have relied heavily on Bolivian gas, are the most important among these. Negotiations on gas export prices and conditions are currently under way between the Government of Bolivia and the Governments of Argentina and Brazil, and foreign TNCs have taken no decision thus far regarding their operations in the country. On the other hand, the State-owned oil and gas companies of Bolivia and Venezuela (YPFB and PDVSA) are set to sign a joint venture to carry out gas projects in Bolivia.[77]

In the other Andean countries, FDI in oil and gas activities in 2005 registered strong increases. In Colombia, it rose by 134%, to $1.2 billion. In Venezuela, where foreign firms had to sign new joint-venture contracts (box II.16), FDI in oil and gas activities reached $1 billion, having registered a negative value in 2004.[78] Twenty-two private firms have signed new contracts, among them large foreign TNCs,[79] while Total (France) and Eni (Italy) were the only two that have not done so yet, and ExxonMobil and other smaller companies pulled out of the country.[80] In Ecuador, FDI in oil and gas activities increased by 72% in the first half of 2005.[81] A Chinese consortium entered the Ecuadorian oil industry by acquiring the oil and pipeline business of EnCana (Canada) at a time when policies relating to the oil and gas industry, which aimed at increasing taxes, were being discussed (box II.16).

In Argentina, declining oil and gas production and reserves in 2005, combined with increased domestic demand has put more pressure on firms to increase their investments, mainly in exploration.[82] Spain's Repsol-YPF – the country's main oil and gas producer – announced that it would invest $6.7 billion in Argentina in the period 2005 to 2009.[83] In Trinidad and Tobago, new capacities came on-stream in oil and gas activities, mainly as a result of activities by firms such as BHP Billiton and British Gas (EIU 2006c).

FDI in non-oil mining industries has also been buoyant in 2005. In Colombia, it grew by 59%, to $2 billion. The coal industry was particularly dynamic. Estimated investments in mining are $1.3 billion in Chile for 2005,[84] $1 billion in Peru, and $850 million in Argentina.[85] However, the marked growth in mining projects has increased hostility towards mining activities by local communities and environmentalists.[86]

Manufacturing sector

Several factors explain the rise of FDI in the manufacturing sector in 2005. The most important one is the increase in cross-border M&As, the growth of domestic and regional markets (as a result of strong economic growth), and the increase of manufacturing FDI to Mexico, mainly in response to dynamic demand from the United States.

Cross-border M&As in this sector increased by 65% in 2005 (table II.11). The most notable deals were SABMiller's acquisition of national brewers in Colombia and Peru, Grupo Techint's (Argentina) acquisition of the steel company, Hylsamex (Mexico), and Camargo Correa's (Brazil) acquisition of the Argentinean cement company, Loma Negra.

A significant part of FDI inflows in manufacturing in Latin America and the Caribbean (37%) is estimated to have gone to Mexico in 2005, where that sector accounted for more than half the flows (58%). Mexico's major attraction for direct investors still lies in its privileged access to the United States market. Although local operations face a growing threat from Asian producers, Mexico's geographic advantage remains strong, particularly in the automotive, heavy manufacturing and other industries in which low transport costs and just-in-time logistics are crucial to competitiveness. In 2005, *maquila* exports increased by 11%, to $97 billion.[87]

What is new in the *maquila* sector is the growing presence of companies that employ skilled workers to assemble complex products, such as medical supplies, aerospace and telecom components. There are also new Chinese investments in high-tech electronics.[88] In the more traditional *maquila* activities, carmakers, automotive parts manufacturers, and producers of household electronic appliances continue to invest in Mexico and are actually adding to their sophisticated, just-in-time production lines. Moreover, the FTA between Mexico and Japan that entered into force in May 2005 helped spark the interest of Japanese car makers in investing in Mexico. Labour-intensive and low-skilled activities, on the other hand, are becoming less important.[89] Overall, Mexico needs to increase the value-added and high-tech content of its exports

Box II.15. Latin American firms step into the breach

After the rush to acquire Latin American firms during the 1990s, several services TNCs from developed countries pulled out from the region. This opened space for domestic or regional competitors to expand their operations. The pull-out was mainly the result of the 1999-2003 economic crises and the surge of regulatory disputes in utilities in the early 2000s. This opened an opportunity for Latin American firms to exploit their competitive advantages such as knowledge of local conditions and the ability to cope with economic volatility.

Privatization and liberalization in the 1990s opened the region's markets in industries such as telecoms, power, water and sanitation, oil and gas, and steel. Among foreign investors, it has been the non-Latin American TNCs that seized this opportunity and established a presence in the region. At that time, only a few regional companies had the capacity to compete with TNCs for prime acquisitions, among them the Chilean electric companies Chilgener and Enersis, and the Argentinean oil companies YPF and Perez Companc. However, in the second half of the 1990s, three out of these four were subsequently acquired by foreign TNCs, while Perez Companc was acquired by Brazil's Petrobras.

Since the early 2000s, the trend has reversed, particularly in services:

Some Latin American firms, after consolidating their position in their home markets, adopted an aggressive strategy of expansion through acquisition when developed-country TNCs were withdrawing or downsizing their operations. This occurred mainly in telecoms and retailing: firms such as the Mexico's Telmex and América Móvil and the Chilean retailers Falabella and Farmacias Ahumadas, previously confined to their domestic markets, have now emerged as new regional TNCs (see chapter III).

Other Latin American firms have concentrated on acquisitions in the home market. This has been the case, for example, of the Brazilian banks Bradesco and Itaú, both of which have led the consolidation of the Brazilian banking system by actively purchasing assets put on sale by the State and by local and foreign companies. The most recent operation is the $2.2 billion acquisition by Banco Itaú, in June 2006, of Bank of America's BankBoston unit in Brazil.[a] Banco Itaú, which already has offices overseas, may initiate foreign expansion through acquisitions, as it has exclusive rights to buy BankBoston units in Chile and Uruguay as well. Other recent examples of the acquisition of foreign firms by local ones can be found in Argentina and Chile, where the Argentina's Dolphin acquired EDF's assets in the electricity distribution company Edenor in 2005, while Chile's Almendral took over Entel Chile owned by Telecom Italia.

The regional expansion of Latin American TNCs in the services sector demonstrates their ability to exploit the competitive advantages they have built or strengthened since the liberalization of the 1990s. However, it also entails the risk of being taken over by developed-country TNCs. Previous experiences have shown that the regional networks built up by Latin American TNCs have proved to be a "very valuable asset for TNCs wishing to achieve high market coverage in Latin America in a short time" (ECLAC 2006a, p.106). This was the case in the second half of the 1990s, as mentioned, and more recently in the case of the brewing companies of Brazil, Colombia and Peru.

Source: UNCTAD, based on ECLAC 2003, ECLAC 2004b, ECLAC 2006a, and *America Economia*, 19 May to 20 June 2006.

[a] Itaú will pay Bank of America with its preferred, non-voting shares, giving the United States bank 5.8% of its capital that should not, in principle, constitute FDI.

to face the challenge of Asian competition in the United States market. Among the factors hampering technology development are the weak interaction between *maquila* companies and educational centres, and the lack of venture capital for R&D.

Brazil accounted for an estimated 20% of total manufacturing FDI in Latin America and the Caribbean in 2005. However, FDI in this sector decreased substantially (-46%) from the exceptionally large amount registered in 2004[90] that included the $4 billion acquisition of Ambev by the Belgian company Interbrew (*WIR05*). In contrast, FDI in the Brazilian automobile industry continued to grow in 2005 (by 38% to $1.1 billion) because of a healthy growth in sales, while that in the plastics and rubber industry jumped form $100 million to $600 million because of the soaring global demand for large tyres, which led, for instance, Michelin (France) to undertake important investments in Brazil. However, the continued

appreciation of the local currency (the real) is affecting business prospects for companies that have invested in export capacity. The Brazilian Development Bank (BNDES), a pillar of Brazil's industrial policy, has announced new credit lines for automotive manufacturers, aimed at sustaining the current export drive, after the manufacturers began warning that their contracts were coming to an end and were not certain to be renewed (see section c below). In the metallurgy industry, a high-profile Chinese-Brazilian joint venture investment project to build a $2.4 billion steel plant (*WIR05*) is being postponed indefinitely, due to an excess of global capacity and an increase in Chinese domestic production.[91]

In Argentina, some foreign manufacturers, motivated by the competitive exchange rate, are expanding their production capacity to supply foreign markets. The automobile industry, for instance, has experienced a strong recovery, with its production tripling between 2002 and 2005 to 320,000 units. New projects were announced by some of the main assembly plants.[92]

Finally, two large-scale projects worth $1.1 billion and $728 million in pulp and paper have been launched in Uruguay, on the border with Argentina, by Botnia (Finland) and Ence (Spain). These projects, the largest ever by foreign TNCs, have provoked an unprecedented public outcry and raised bilateral tensions. Local residents and environmentalists in both countries fear that the projects may contaminate the Uruguay River and hurt tourism, one of the area's foremost economic activities. The Governments of Argentina and Uruguay have been unable to reach a bilateral solution and have resorted to international arbitration.[93]

Services sector

FDI flows in the services sector in Latin America and the Caribbean are estimated to have fallen by 4% in 2005 (figure II.18), due to a decline in cross- border M&As in this sector (table II.11). The tendency of TNCs to withdraw from services in 2004 (*WIR05*) continued unabated in 2005 and 2006 (*WIR05* and box II.15). However, while buyers (national, regional or extraregional) are being found quite easily in telecoms and retailing, motivated by strong economic growth in the region, in water and sanitation, private companies are more reluctant than before to invest in developing countries due to the growing number of regulatory disputes (section c below).

The retail industry in 2005 enjoyed a second year of strong growth in Latin America and the Caribbean, boosted by economic growth and newly available consumer credit. Rising sales are encouraging foreign retailers to expand through acquisitions or the launching of new stores. In 2005, the Brazilian and Central American retail markets were the scene of a series of consolidation moves driven by Wal-Mart (United States) and the French supermarkets chains, Casino Guichard Perrachon and Carrefour. In addition, Latin American retailers, such as Farmacias Ahumada (Chile), Falabella (Chile) and Elektra (Mexico) have also been expanding their outward operations within the region.[94]

In the telecommunication industry, there is an ongoing battle between the Mexican Grupo Carso's affiliates – Telmex and América Móvil – and Telefonica SA (Spain) to control the Latin American telecom market in both the fixed and mobile segments through the acquisition of assets divested by other TNCs (*WIR04* and *WIR05*).[95] The growing size and market position of the industry's two main competitors is putting pressure on Telecom Italia, the region's third largest operator. This company, which still has businesses in Brazil, Argentina, Cuba, Bolivia, and Paraguay could be the last major international telephone company to leave Latin America.[96]

Finally, in the electricity industry, Electricité de France (EDF) sold a controlling stake in its affiliate, Edenor, in Argentina to a local group, while in the water and sanitation sector, Aguas Argentinas (France) in Argentina and Uragua (Spain) in Uruguay have been de-privatized.[97] Others like RWE Thames Water (Germany) in Chile are looking for an acquirer (section c below).

c. Policy developments

The good economic performance of Latin America in recent years has not diminished social discontent due to persistent poverty and inequality. (ECLAC 2004b; Moreno-Brid and Paunovic 2006, Santiso 2006). Some countries have begun changing their economic policies, in varying degrees, towards a greater role for the State, partly with a view to reducing inequalities that they attribute to excessively market-friendly policies. This policy shift has been made easier by improved terms of trade and their positive impact on the current-account balance in many countries. This reduced governments' dependence on external finance and increased their policy space. For

instance, some countries have decided to undertake early repayments of their external debt to the International Monetary Fund (IMF), either totally (Argentina and Brazil) or partially (Uruguay). While most of the countries continue to be committed to liberalization and free-market policies and to following monetary and fiscal orthodoxy, some, like Argentina, have used other economic instruments to pull out of recession and secure a strong economic recovery.[98] Others, such as Bolivia and Venezuela, are introducing more radical changes. Bolivia nationalized all activities in oil and gas as a first step before extending the measure to all natural resources, while Venezuela created new State-owned companies in industries such as sugar processing, retailing and communications, and initiated measures to nationalize landholdings and other properties which are not being used productively.[99]

These policy changes are reshaping the map of regional agreements. Some countries have reconsidered their previous affiliations with regional blocs or their interest in new ones: for example in November 2005, Argentina, Brazil, Paraguay, Uruguay and Venezuela opposed the Free Trade Area of the Americas (FTAA) Agreement, which has been under negotiation since 1998; and Venezuela relinquished its membership of the Andean Nations Community (CAN) in April 2006. Others have joined existing blocs or signed new bilateral agreements or established alternative regional agreements: for example the Bolivarian Alternative for the Americas (ALBA) was created in December by Cuba and Venezuela and was joined by Bolivia in April 2006; bilateral cooperation agreements were signed by Venezuela with Argentina, Brazil and Uruguay; and Venezuela joined the MERCOSUR Council in July in July 2006. High oil prices have also affected regional integration schemes, leading simultaneously to diverging interests between exporters and importers (e.g. Bolivia-Brazil, Bolivia-Argentina, Argentina-Chile) and to cooperation initiatives between suppliers and consumers.

Along with these changes in orientation, there have been specific policy changes that directly affect foreign investors or the industries they dominate. Natural resources and public utilities attracted most of the FDI in Latin America and the Caribbean in the 1990s. In the 2000s, these areas saw a tightening of their regulatory environments (*WIR04* and *WIR05*), which expanded to more countries in 2005-2006. Although a restrictive environment has been most noticeable in natural-resource-related activities, it has also affected water and sanitation services. In other utilities, the trend has been towards the resolution of disputes. On the other hand, in Argentina and Brazil, new incentives were offered to FDI in the automotive industry. In all, while there were 21 regulatory changes reported in this region, according to UNCTAD, only a third were favourable to FDI.

The large windfalls recently generated in natural resources have led many countries to establish new rules that they believe are more appropriate to current price levels, as compared to prices prevailing in the 1990s (UNCTAD 2005a). Except for the royalty taxes on mining created in Chile and Peru in 2005 (*WIR05*), all the other changes apply to the oil and gas industry. Although all changes aim at increasing taxes in the natural resource area, their intensity differs from country to country, and some of them also aim at increasing State control over the enterprises through increased ownership (box II.16)

In utilities, disputes in 2005 were concentrated in water sanitation, where private companies are becoming increasingly reluctant to invest in developing countries. After an unfruitful search for private partners for a new concession following the cancellation of a contract with Aguas Argentinas (the affiliate of French Suez), the Government of Argentina announced the creation of a State-owned company, Aguas y Saneamiento Argentinos, to replace Suez that had been threatening to pull out for two years.[100] In Chile, the second largest operator of water utilities, Essbio – an affiliate of RWE Thames Water (Germany) – was fined by regulators for failing to honour its investment commitments. The company is seeking to sell its water assets not only in Chile but also in Australia, Canada, China, Egypt and India, to focus on the United States and European markets and develop its electricity businesses.[101] Moreover in Chile, a new water code, applied since January 2006, changes the previous regime that enabled a number of companies – particularly electricity-generating operations – to register in their names a vast amount of water rights that they could choose not to use. The company most affected will be the electricity generator Endesa (Spain), which uses only 13.3% of its water rights accumulated over the years.

In the case of other public services, such as electricity, gas distribution, telecommunications and transport, the economic recovery has attenuated

Box II.16. High oil prices have induced changes in oil and gas regulations

Soaring oil prices have increased the strategic importance of oil and gas resources and led many Latin American countries to renegotiate contracts signed with foreign oil companies in the 1990s, when prices were at a record low. The objective of these renegotiations is to increase the State's share in the oil and gas rent as well as its control over the industry.

- In Bolivia, a decree for the nationalization of oil and gas resources was promulgated in May 2006. It gives the State control and management of the production, transport, refining, stocking, distribution, commercialization and industrialization of oil and gas in the country. It requires private companies to channel future sales of oil and gas through the State-owned energy company, Yacimientos Petrolíferos Fiscales Bolivianos (YPFB).[a] The State will also regain control of Bolivian oil and gas companies that were privatized in the 1990s through the repossession by YPFB of the shares of the Collective Capitalization Fund.[b] The decree obliges companies to comply immediately with the new dispositions and regularize their activities through new contracts authorized and approved by the legislative power within a period of 180 days, failing which they will no longer be allowed to continue operating in the country. Also, the decree fixes the share of private companies at 18% of the value of production,[c] compared to 50% accorded by the hydrocarbon Law approved in May 2005, and much lower than the 82% accorded at the time of privatization.
- In Venezuela, the 2001 Hydrocarbons Law rendered illegal the agreements that gave majority control to private local or foreign firms. But it was only in 2005 that the Government pushed for new contracts that gave control to the State-owned PDVSA, and took control of 32 extraction fields which were in the hands of private companies (accounting for approximately 17% of the country's daily extraction capacity).
- In Ecuador, the Congress approved in April 2006 a hydrocarbon reform bill that increases the State's share of private production to 50% from its current level, whenever international oil prices exceed those established in existing contracts. Moreover, the Government cancelled Occidental Petroleum Company's (United States) rights to an oilfield in the Amazon basin region and took control of its production infrastructure in May 2006.[d]
- In Trinidad and Tobago, the Government plans to reform the oil and natural gas tax regimes with a view to increasing its income from the firms involved.

Source: UNCTAD.

[a] The Government aims to assume responsibility for setting the price of its natural gas, previously set by the TNCs. Affiliates of the same TNCs controlled exports and imports: Pluspetrol's (Argentina) affiliate in Bolivia sold to Pluspetrol Argentina, Repsol Bolivia to Repsol Argentina, and Petrobras Bolivia to Petrobras Brazil.

[b] This fund was established during the privatization process: the Government sold 50% of the public enterprises' shares to capitalize the companies and retained the other half for the collective fund. The fund is managed by private pension funds.

[c] This rate is 50% for companies producing less than 100 million cubic feet of natural gas daily.

[d] Ecuador's decision followed a dispute over Occidental's 2004 sale of a 40% share in its Ecuador operations to EnCana (Canada) without first consulting the Ecuadorian authorities. Bilaterals.org, 19 May 2006 (www.bilaterals.org).

the intensity of conflicts. In Argentina, in particular, seven cases against Argentina for requiring companies to conform with the Government's conditions for negotiating new contracts have been suspended at the International Centre for Settlement of Investment Disputes (ICSID), and two have been discontinued after an agreement was reached,[102] while the negotiation process is still going on for many other cases.[103]

However, a few measures were adopted that did not specifically address foreign investors, but were favourable to industries where such investors play a significant role. This is the case of the automobile industry in Brazil and Argentina. In Brazil the BNDES adopted a financing programme in October 2005 for the production of automobiles for export, to compensate for the negative impact of the strong local currency (the real) on competitiveness and help boost overseas sales.[104] Similarly, in Argentina, the authorities are taking steps to assist the automobile industry that had been seriously affected by an overvalued national currency and economic recession between the second half of the 1990s and 2002.[105] They also obtained an agreement by Brazil to delay full

liberalization of bilateral trade in automobiles, previously scheduled for 1 January 2006, due to the persistence of important bilateral asymmetries.

At the interregional level, the trend towards increased liberalization and agreements to promote FDI is continuing in some countries. For example, Chile signed the following new agreements in 2005: an FTA with China, a Framework Agreement to Promote Economic Cooperation with India, and a Trans-Pacific Strategic Economic Partnership Agreement with Brunei Darussalam, New Zealand and Singapore. Colombia and Peru each signed an FTA with the United States in 2006. However, implementation of the Dominican Republic-Central America Free-Trade Agreement (DR-CAFTA), which was supposed to take effect on 1 January 2006, has been delayed. Costa Rica has yet to ratify the Agreement, and the respective legislatures in the other countries have failed to pass the necessary laws in time. El Salvador is the only country that has revised its domestic laws and regulations in line with the commitments made under the Agreement.[106] The numbers of BITs and DTTs concluded in 2005 were 13 and 9 respectively, for a total of 464 and 322 by countries in the region. About 83% of the BITs and 90% of the DTTs concluded are with countries outside the region.

d. Prospects

FDI inflows into Latin America and the Caribbean, excluding the offshore financial centres, are expected to slow down in 2006. They could even decline in some of the largest recipient countries, as suggested by preliminary FDI data for the first months of 2006.[107] Data on cross-border M&As in the region (excluding offshore financial centres) for the first six months of 2006 also show a 19% decline in the value of acquisitions of local assets by foreign TNCs compared to the same period in 2005.

Since the same factors behind the strong rebound in FDI in 2004 and its continued growth in 2005 (i.e. high commodity prices and strong economic growth, both at regional and global level) still exist, other factors would explain the likely decline in FDI inflows into the region. These include changes in policy stance resulting from higher prices and growing demand for commodities, and a reversal in the trend by foreign firms in the services sector to acquire local firms and assets.

High commodity prices have already had an effect on FDI in the natural resource industries by increasing the leverage of State-owned companies, reducing their dependence on capital from foreign firms, and prompting a tightening of FDI policy in that sector. Although for the time being the attraction of high commodity prices seems to be overriding the deterrent effects of policy changes (as discussed in the sectoral analysis section above), it is still premature to assess their real impact on FDI, especially in the oil and gas sector. The possibility of additional regulatory changes and of their extension to more countries is likely to increase uncertainty among investors.

On the other hand, high commodity prices have led to an appreciation of the value of local currency in many countries because of the improved current-account balance. This might affect business prospects for FDI in export-oriented manufacturing, though incentive measures such as those adopted by the Brazilian authorities may compensate for the negative impact of the currency appreciation. In the case of Mexico, FDI in the export-oriented *maquiladoras* is likely to grow as long as there is demand from the United States. Market-seeking FDI in the manufacturing sector is also likely to continue if the prospects for regional economic growth – estimated in 2006 at 4.3% (IMF 2006) – remain encouraging.

In the services sector, FDI could fall due to the significant decline in the number of domestic firms available for acquisition (after the boom of the 1990s) and to the solid growth of local firms. The decline of FDI in services activities would be indicative of a swing of the pendulum back towards the middle – that is, a more balanced distribution of the market between foreign and local firms.

With regard to FDI outflows from the region, Latin American and Caribbean firms are expected to continue to expand, principally to neighbouring countries and regionally, although global expansion is expected to gain momentum.

B. South-East Europe and the Commonwealth of Independent States

In 2005, FDI inflows into South-East Europe and the Commonwealth of Independent States (CIS) remained almost at the same level as in the previous year, at $40 billion. Inflows were uneven, with three countries, the Russian Federation, Ukraine

and Romania, in that order, alone accounting for close to three quarters of the regional total. Developed countries continued to account for the bulk of greenfield projects and cross-border M&As, in terms of numbers, EU members being particularly prominent in greenfield investments. FDI outflows from the region grew for a fourth consecutive year, reaching $15 billion. The Russian Federation alone accounted for 87% of such outflows, as oil prices and competition for resources prompted Russian TNCs to maintain a high level of investments abroad. Outward investment in greenfield projects targeted mainly other countries within the region, while the majority of cross-border M&A purchases took place in developed economies. Countries of the region have different policy priorities and are confronted with different issues related to inward and outward FDI, depending on their economic structure and institutional environment. In natural-resource-based economies, such as the Russian Federation, Azerbaijan and Kazakhstan, most of the policy issues relate to the management of the windfall earnings from high international commodity prices, and the definition, or redefinition, of the role of the State.

1. Geographical trends

a. *Inward FDI: fifth year of growth*

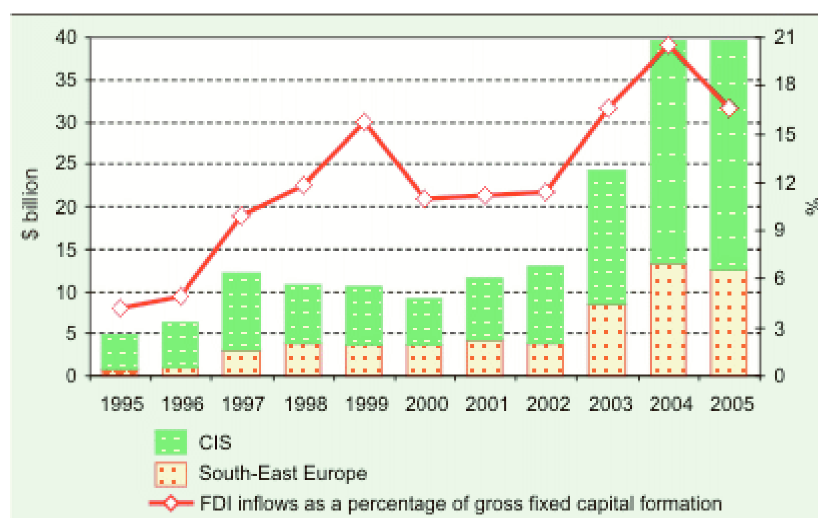
FDI inflows to the 19 countries of South-East Europe and the Commonwealth of Independent States (CIS) in 2005 remained at $40 billion (figure II.19). The share of inward FDI in gross fixed capital formation declined from 21% in 2004 to 17% in 2005, as domestic investment grew faster than FDI. In each of three main recipients – the Russian Federation, Ukraine and Romania – FDI inflows exceeded $5 billion (more than $10 billion in the Russian Federation alone) (figure II.20). At the other extreme, in 11 countries they remained below $1 billion (annex table B.1). Inflows rose in 8 countries (most notably in Ukraine) and fell in 11. After the peak of 2004, related to large oil and gas projects, inflows plummeted in Azerbaijan and Kazakhstan.

By subregion, the sharp increase in Ukraine accounted for much of the rise in inflows in the CIS, while declining inflows in Bulgaria drove inflows down in South-East Europe.

Developed countries continued to account for the largest number (more than four-fifths) of *greenfield inward FDI*[108] in South-East Europe and the CIS, in 2005. Members of the EU invested in three fifths of all new projects, while the share of the United States remained at over 10% and that of the Russian Federation at around 5%. In *cross-border M&A sales* in the region – mostly privatization deals in South-East Europe, and both privatizations and investment in private companies in the CIS – developed countries again dominated (table II.13). Between 2004 and 2005, their share in the value of transactions increased from about 80% to more than 90%. In 2004, Austria was the largest purchaser, while in 2005, reflecting a large acquisition in Ukraine (see below), the Netherlands became the largest cross-border M&A purchaser. The share of the Russian Federation as a source country in cross-border M&As remained at around 5%.

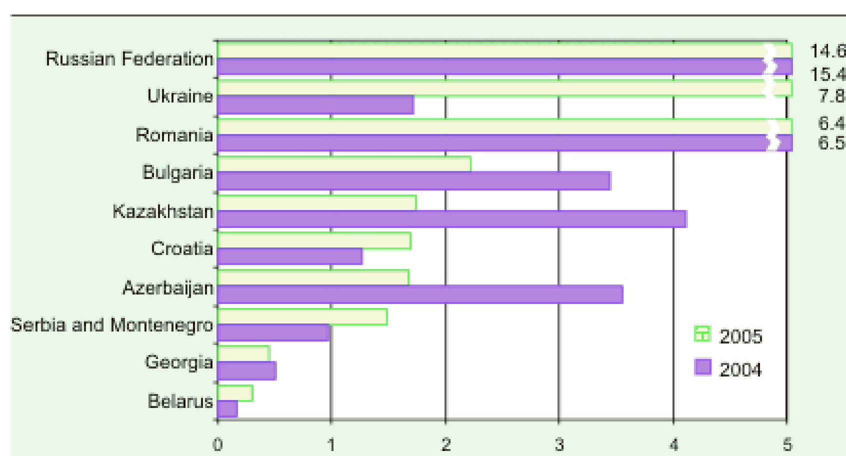
In the Russian Federation, inward FDI spanned a range of activities in all three sectors: from natural resources in the primary sector, through some manufacturing activities (such as Coca Cola's $501 million investment in food and beverages), to services (such as the $1.3-billion real estate and trading project in St. Petersburg by Baltic Pearl (China)). In Ukraine, the privatization

Figure II.19. South-East Europe and the CIS: FDI inflows and their share in gross fixed capital formation, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

Figure II.20. South-East Europe and the CIS: top 10 economies for FDI inflows,[a] 2004-2005
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Ranked on the basis of the magnitude of the 2005 FDI inflows.

of the Kryvorizhstal iron and steel factory led to its purchase by Mittal Steel (Netherlands/United Kingdom) valued at $4.8 billion – the largest deal in the country and in the CIS so far – and that of Aval Bank by Raiffeisen International (Austria) for $1 billion (re-sold to Hungary's OTP in 2006).

Table II.13. South-East Europe and the CIS: distribution of cross-border M&As, by home/host country, 2004-2005
(Millions of dollars)

	Sales		Purchases	
Home/host region (economy)	2004	2005	2004	2005
World	10 047	17 317	990	6 811
Developed countries	7 869	16 124	380	3 801
of which:				
EU-25	6 605	14 075	40	3 340
Austria	4 136	3 239	-	-
Czech Republic	344	635	4	284
France	-	505	-	-
Germany	188	570	-	15
Italy	103	730	-	652
Netherlands	-	6 189	-	-
United Kingdom	1 364	285	-	2 005
North America	1 176	1 999	339	-
United States	846	1 947	334	-
Developing economies	1 566	245	-	2 062
of which:				
British Virgin Islands	1 431	-	-	-
Turkey	-	-	-	1 593
South-East Europe and CIS	610	948	610	948
of which:				
Russian Federation	574	909	5	236
Ukraine	-	6	14	511

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

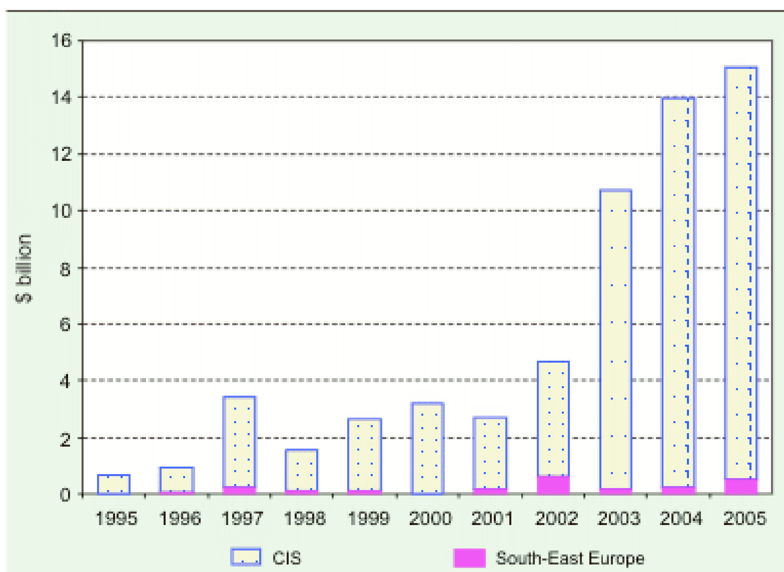
In South-East Europe, the strong performance of Romania and Serbia and Montenegro was explained in part by several privatization deals in banking (such as the acquisition of Banca Comerciala Romana by Erste Bank (Austria) in Romania, and of Kontinental Banka by Nova Ljubljanska Banka (Slovenia) in Serbia and Montenegro). In addition, in Romania, the privatization of natural gas providers and their purchase by Gaz de France and Ruhrgas (Germany) were responsible for a large proportion of the increase in FDI inflows.

b. Outward FDI: strong performance of Russian TNCs continues

In 2005, FDI outflows from the region grew for a fourth consecutive year, reaching $15 billion (figure II.21). Outward FDI was equivalent to about 7% of gross fixed capital formation, slightly down from the previous year. Russian TNCs continue to dominate the outward FDI of the region accounting for 87% of the total in 2005 (annex table B.1). Besides the Russian Federation, only outflows from Azerbaijan exceeded $1 billion in 2005. In *greenfield* outward FDI, more than half of the new projects originating from South-East Europe and the CIS targeted other countries within the region, followed distantly by the EU. In terms of value of *cross-border M&A purchases* by the region, more than half were in developed economies in 2005, especially the United Kingdom. Telecommunications-related investments in Turkey represented the second largest M&A purchases by South-East Europe and the CIS (table II.14).

Oil prices and competition for resources in 2005 prompted Russian TNCs to maintain high levels of investment abroad. In particular, the Russian TNC, Lukoil, reacted to the purchase of the Canadian-based independent oil company, Petrokazakhstan, by China's CNPC with the acquisition of another Canadian-based oil company, Nelson Resources. Both of the acquired companies have major exploration and extraction contracts in Kazakhstan. Russian firms were active in other natural resources such as aluminium: RusAl became a joint-venture refinery partner in Australia in 2005,

Figure II.21. South-East Europe and the CIS: FDI outflows, by subregion, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

while the electricity company, UES, won the privatization bid for power stations in Bulgaria. As for outward FDI from Azerbaijan, most of it has been related to the construction of the Baku-Tbilisi-Ceyhan pipeline, which crosses Georgia and Turkey, and in which the State Oil Company of Azerbaijan has a 25% share.

2. Sectoral trends: manufacturing dominates inflows, natural resources lead outflows

Inward FDI in some high value-added activities such as R&D reflects the relatively well-developed skills base of some of the countries of the region (*WIR05*). For example, in 2005, General Motors decided to locate one of its high-tech activities – the development of its new generation of electric vehicles – in a new research centre in Moscow, making it the firm's eighth global science laboratory. However, not all FDI projects in the region have a high-tech content. In some cases, low wages attract projects in low value-added activities such as assembly manufacturing. For example, between 1998 and 2004, low wages in Bulgaria attracted $226 million worth of FDI in "cut and make" textiles (in which customers provide all inputs except labour). However, with the end of MFA quotas and Bulgaria's potential EU accession in 2007, foreign investors in textiles, such as Miroglio (Italy) and Rollman (Germany), can no longer rely on wage competitiveness alone, and are upgrading their factories there from simple assembly to higher value-added activities (in which the manufacturer also buys and owns machinery).[109] In natural-resource-rich economies that are less likely to specialize in low-wage manufacturing, it is the concentration of FDI in natural resources and related activities that presents a challenge to policymakers as they seek to diversify by attracting FDI into higher value-added activities in a wider range of industries.

Data on the sectoral breakdown of FDI flows to the region are very limited. However, data on *cross-border M&A sales* (table II.14) show that the share of manufacturing was two fifths of that in 2005 (in value terms), although it rose in some industries such as metals and metal products. The share of services, although declining, is still close to one half of total cross-border sales and reflects the importance of transport, storage and communications, and finance. In some countries such as the Russian Federation, natural resources in M&A sales are also important, although the share of primary activities in the regional total remains relatively limited (just over one tenth).

As far as the sectoral distribution of outward FDI is concerned, data on *cross-border M&A purchases* show some interesting trends: the shares of petroleum extraction and of natural-resource-based manufacturing, such as metallurgy, were over one quarter each in 2005, making them the most prominent target industries, especially for Russian TNCs (table II.14). In 2004, telecommunications became the first non-resource-based Russian industry with significant investments abroad, although, reflecting the lumpiness of M&A deals, its share declined temporarily in 2005. However, as the three largest mobile telephone service providers of the CIS are firms from the Russian Federation (box II.17), the share of telecommunications in outward FDI is expected to rebound.

Table II.14. South-East Europe and the CIS: distribution of cross-border M&As, by sector/industry, 2004-2005
(Millions of dollars)

Sector/industry	Sales 2004	Sales 2005	Purchases 2004	Purchases 2005
Total	10 047	17 318	991	6 812
Primary	1 920	2 088	58	2 022
Mining, quarrying and petroleum	1 916	2 088	58	2 022
Manufacturing	589	6 747	286	2 553
of which:				
Food, beverages and tobacco	242	1 112	1	217
Textiles, clothing and leather	-	1	-	-
Wood and wood products	-	1	-	1
Chemicals and chemical products	23	232	-	484
Stone, clay, glass and concrete products	167	-	-	-
Metals and metal products	156	5 323	285	1 851
Machinery	-	12	-	-
Motor vehicles and other transport equipment	1.0	65	-	-
Services	7 538	8 483	647	2 237
of which:				
Electricity, gas & water distribution	851	1 488	-	52
Construction firms	-	-	-	-
Hotels and restaurants	-	129	-	-
Trade	9	108	4	-
Transport, storage and communications	4 919	3 155	591	327
Finance	347	2 677	52	1 858
Business activities	30	153	-	-
Community, social and personal service activities	31	760	-	-

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

3. Policy developments

In South-East Europe and the CIS, as in other regions of the world except Latin America and the Caribbean, most policy changes (32 of the 39) in 2005 affecting inward FDI remained more favourable to investors.

Countries of the region have different policy priorities depending on the specific issues they face and their economic structure and institutional environment. In natural-resource-based economies, such as the Russian Federation, Azerbaijan and Kazakhstan, most of the policy questions are related to management of the windfall earnings from high international oil prices, and to defining, or redefining, the role of the State in both inward and outward FDI. In the Russian Federation, the Government increased its share to a majority stake in one of the largest outward investing TNCs, Gazprom, a gas firm (*WIR05*, p. 78), and acquired a major outward investing oil firm (Sibneft). The acquisition of Gazprom shares was accompanied by the removal of the 20% cap on foreign ownership of the remaining shares and an easing of the rules on the trading of Gazprom shares. However, any transaction that could reduce the Government's ownership below 50% would be subject to clearance by the federal authorities. In an attempt to facilitate diversification away from natural resources, the Russian Federation adopted a Law on Special Economic Zones in 2005, which will allow the creation of special zones for up to 20 years. These will allow customs-free imports and certain tax benefits. In Kazakhstan, the Government has been exploring ways to increase its shareholding in Petrokazakhstan in the aftermath of its acquisition by CNPC (China). The country also adopted a new Production Sharing Agreements Law, reserving for State-owned KazMunaiGaz a 50% share in all offshore projects plus the right to determine (with the consent of the Ministry of Energy and Mineral Resources) the type of contract to be concluded.

In the rest of the region, policy priorities reflect, among others, the degree of association with the EU. Bulgaria and Romania are already in accession talks, and Croatia may follow soon. These accession talks can redefine the ways FDI-related policies are carried out. In 2005, as a prelude to EU accession (envisaged in 2007), Romania introduced a 16% flat tax on incomes and profits while eliminating most tax exemptions and tax allowances. At the same time, Bulgaria reduced its corporate tax from 19.5% to 15%. The two countries also announced legislation that will simplify the acquisition of real estate by EU residents after accession but keeps restrictions on agricultural and forest lands. Association and partnership agreements are also shaping FDI-related policies in various countries such as Albania, Bosnia and Herzegovina and Ukraine. Albania, like other countries, cut its tax rate in 2005, from 25% to 23%. Ukraine had already introduced a unified tax in 2004, with a starting rate of 13% but planned to rise to 15% in 2007. In Serbia and Montenegro, the corporate tax was reduced from 14% to 10% in 2005.

4. Prospects

South-East Europe and the CIS is expected to increasingly attract inward FDI in 2006 and beyond. Although data on cross-border M&As during the first half of 2006 show hardly any change compared with the first half of 2005, with an initial public offering of the oil company Rosneft

Box II.17. Russian mobile phone operators in the CIS

Telecommunications is the first non-resource-based Russian industry to have significant investments abroad, albeit mainly within the CIS. This is because the mobile telecommunications industry of the CIS is not yet saturated, and its duopolistic or oligopolisitic advantages promise high and sustained profits for operators, especially those that enter the markets early enough to reap the benefits of fast growth (Lisitsyn et al. 2005).

The three largest mobile service providers in the subregion in 2005 were the same firms that also dominated the Russian market (Mobile TeleSystems/MTS, VimpelCom and MegaFon). As of end 2005, MTS was present in various markets, while VimpelCom focused on Kazakhstan, Tajikistan and Ukraine, and MegaFon on Tajikistan. In addition, Alfa Group – the majority shareholder of VimpelCom and the joint venture partner of BP in the BP-TNK company – held shares in a Ukrainian and a Kyrgyz operator. With one exception, Russian mobile operators entered the local markets through acquisitions of local firms. The leading Russian mobile operators are an important source of finance, technology and managerial experience in the CIS host countries. Part of their expertise has been gained in the Russian Federation, and part from Western telecommunications companies that are minority shareholders in the Russian companies (the majority are owned by Russian financial capital). As Russian mobile telecommunications operators gain experience and strength, they are taking steps to move outside the CIS. In 2005, for instance, Alfa Group (the parent of VimpelCom) purchased a 13% minority share in Turkish Turkcell.

Source: UNCTAD, based on Lisitsyn *et al.* 2005.

(Russian Federation) in July 2006 in London for a value exceeding $10 billion, cross-border M&As received a major boost for the rest of the year.

Countries on the western side of the region have a more advantageous geographical location: close to the EU, which is one of the largest markets in the world. Thus the potential benefits for the "new neighbours" (following EU enlargement in 2004) can be enormous. In addition, some of the countries of the region possess significant natural resources, which are attracting large projects from major investors. Other countries offer relatively skilled labour at competitive wages. As for market-seeking investment, the main pull factor is a prospective increase in local purchasing power, which has been low so far. The region's largest economy, the Russian Federation (alone accounting for more than 60% of the region's GDP in 2004), offers a potential combination of natural resources, markets and cost efficiency. In a survey of Japanese manufacturing TNCs by JBIC (JBIC 2006), the Russian Federation was ranked 6th, making it the most promising host location for FDI projects in 2006-2008, behind four Asian economies and the United States. It was particularly attractive for FDI in general machinery (4th). Even in automobile production, in which global competition for new projects is particularly strong, it was ranked 7th. Finally, prospects for Russian TNCs' outward investments will largely depend on developments in international natural resource markets.

C. Developed countries

FDI inflows into developed countries[110] jumped by an estimated 37%, to $542 billion, in 2005. The rise in inflows was led by a sharp rise in investments in the United Kingdom – the highest ever recorded for a European country. With inflows 65% higher than those of the United States, the United Kingdom was the world leader for inward FDI for the first time since 1977. The significant increase in FDI flows to developed countries included a substantial increase in equity capital and a recovery in intra-company loans. The main driving forces behind the upswing in FDI flows to developed countries in 2005 were high corporate profitability – partly driven by successful cost-cutting efforts in the euro area – and a pick-up in cross-border M&A activity. In 2005, the volume of cross-border M&A transactions was the second largest ever recorded after 2000, partly reflecting higher share prices in many major financial markets. The number of large cross-border M&As also increased substantially.

Most major FDI recipients among developed countries (Canada, France, Germany, Netherlands, United Kingdom) recorded higher FDI inflows (as well as higher values of cross-border M&As). FDI inflows into the new EU member States also rose. In many of these countries, higher FDI inflows resulted from an increase in reinvested earnings,

but foreign acquisitions and greenfield investments also contributed to the increase, especially in the Czech Republic. FDI flows to Japan more than halved, returning to the lowest level since 1996, despite the Government's commitment to double the level of FDI stock within five years by 2006.

FDI outflows from developed countries grew in 2003 and 2004 after a two-year slump, but fell again in 2005 by 6%, to $646 billion. This is essentially due to a considerable decline in outflows of United States FDI in response to special tax incentives offered by that country's Government. In principle, outward FDI is on an upward trend, mainly driven by high profits, rising business expectations and the search for new strategic investments abroad. Prospects in 2006 for a further rise in FDI flows from developed countries, as a group, are favourable, as the fundamentals driving such flows appear positive.

1. Geographical trends

a. *Inward FDI: recovering from the downturn*

FDI inflows to developed countries increased by 37%, to reach $542 billion in 2005 (figure II.22). Inward investment was higher in 23 countries of the group, compared with 21 countries in 2004. FDI growth was thus fairly widespread.

FDI inflows into *North America* rose by 8% to $133 billion (figure II.22), with *Canada* accounting for most of this increase. After four consecutive years of decline, to $1.5 billion in 2004, inward FDI flows rebounded in 2005 to $34 billion. Strong economic growth and favourable domestic demand as well as a continued favourable investment climate attracted foreign investors with large investments.[111] Inward investments into the *United States*, still the world's largest host country for FDI, in terms of stock, fell by 19% to $99 billion in 2005, making that country the second-largest FDI recipient worldwide in 2005, after the United Kingdom (figure II.23).

Reduced equity capital inflows to the United States were more than offset by a substantial increase in intra-company debt inflows – a shift from the net outflows registered in the previous year – and an increase in reinvested earnings that allowed foreign affiliates to expand capacities in the United States. Reinvested earnings rose again, from $45 billion in 2004 to $49 billion in 2005, as the profitability and earnings of foreign affiliates in the United States improved.[112]

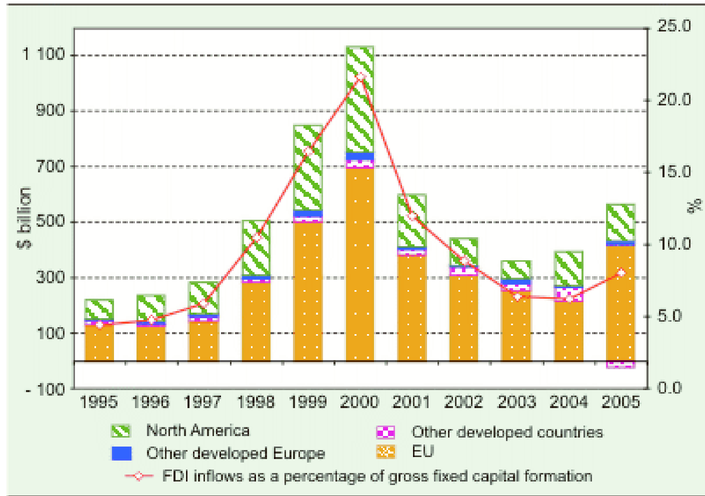
The strong growth in domestic demand in the United States attracted investors in trade, services, logistics and consumer goods industries. As in past years, the main investors in the United States in 2005 were United Kingdom firms (accounting for 29% of total FDI inflows in 2005): they were responsible for the lion's share of cross-border M&A purchases of United States firms, including large ones, such as the acquisition of Innovene, a chemical company, by INEOS Group (United Kingdom) for $9 billion (annex table A.I.7). After a long period of weak activity German companies also returned to the United States market as large investors; for example, Adidas-Salomon AG bought Reebok International Ltd. for $4.3 billion, Fresenius Medical Care AG spent $4.0 billion for Renal Care Group Inc. and Deutsche Bahn AG invested $1.1 billion for Box Global Inc.

In 2005, total FDI inflows into *EU* member countries increased substantially, nearly doubling, to $422 billion. Most of the increase was due to a rise in intra-EU FDI.[113] The picture varied considerably among the 25 EU members, depending on their level of development and their economic prospects. Some large-scale cross-border M&A deals also influenced the geographical distribution of FDI inflows to the EU.

FDI flows to the EU-15 amounted to an estimated $388 billion in 2005 – 109% higher than the previous year – helped by a surge in investments in the United Kingdom that was driven by M&As and by further market integration in the euro zone. FDI inflows to the 10 new EU members rose by 19%, to a record level of $34 billion, mainly due to high rates of reinvested earnings.

FDI inflows into the *United Kingdom* tripled, from $56 billion in 2004 to $165 billion in 2005. The increase was largely due to the merger of Shell Transport and Trading Company Plc and Royal Dutch Petroleum Company into Royal Dutch Shell, a Dutch company, for some $74 billion (a transaction reflected in the FDI outflow data of the Netherlands, as discussed below).[114] The increase also reflects several high-value cross-border acquisitions of United Kingdom firms: for example, Goal Acquisitions (France) bought Allied Domecq for $14.4 billion (annex table A.I.7). Financial services, telecommunications and transportation were the industries targeted the most by foreign investors. The United Kingdom's inward FDI stock at the end of 2005 amounted to $817

Figure II.22. Developed countries: FDI inflows and their share in gross fixed capital formation, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex tables B.1 and B.3.

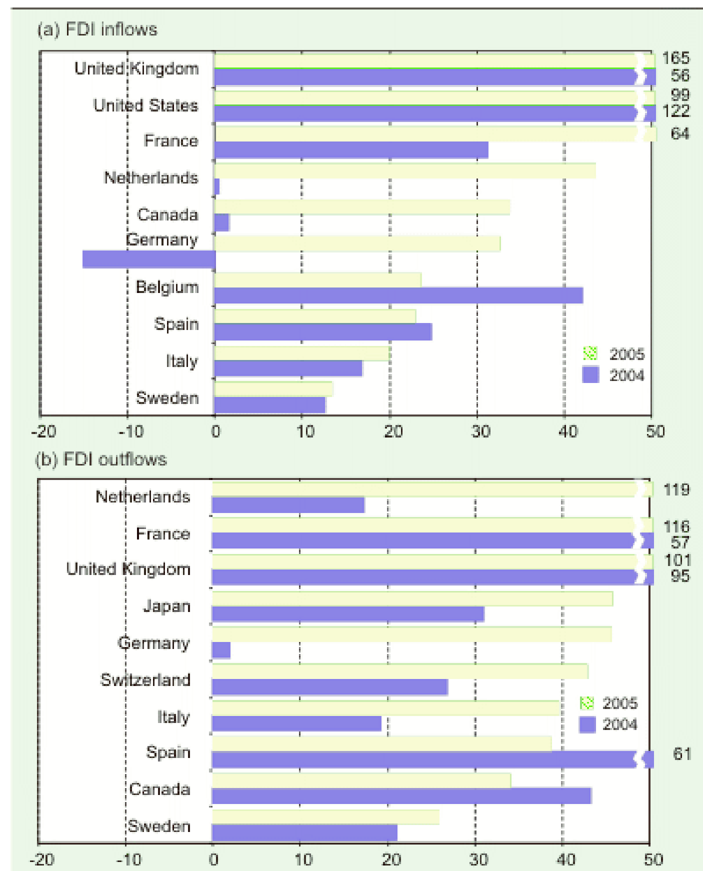
billion, the second-largest inward FDI stock worldwide after that of the United States.

In *Denmark* there was an upturn in FDI inflows to $5 billion in 2005, following disinvestments of FDI in 2004 of $11 billion. Larger inflows of equity capital, as well as a number of large deals accounted for most of the change.[115] In *Sweden* FDI inflows in 2005 amounted to $13 billion, slightly higher than the 2004 level. Larger intra-company loans and reinvested earnings contributed to this trend.

Inward FDI flows into the 12 countries forming the *European Monetary Union* (EMU-12) amounted to $205 billion in 2005, compared with $127 billion in 2004. Several of the countries received considerably larger FDI inflows than in 2004. FDI inflows into *France* more than doubled, from $31 billion to $64 billion, the highest level since 2001. Its economic growth – higher than its large neighbouring countries (Germany, Italy) – and an increasingly proactive policy to attract foreign investments may explain part of this increase (*WIR04*, p. 87). Inward FDI in *Austria* nearly tripled, to $9 billion in 2005, mainly due to an increase in inflows of equity capital ($6 billion). As in past years, German companies were the largest investors in Austria – accounting for 70% of FDI inflows – taking advantage of a favourable economic climate, wage levels lower than in other EMU countries and the country's geographical proximity to the new EU members. In Germany and the Netherlands, there was a rebound in FDI inflows. In *Germany* it amounted to $33 billion, compared to -$15 billion in 2004; the sharp turnaround was mainly caused by the halt to the large repatriations of intra-company loans that began in 2003 (-$17 billion) and peaked in 2004 (-$50 billion).[116] The *Netherlands* received $44 billion in FDI flows in 2005, compared to a low of $0.4 billion in 2004; as in the case of Germany, small inflows in 2004 were due to large repatriations of capital by foreign affiliates to parent companies (-$8 billion), whereas in 2005 loans to affiliates located in the Netherlands amounted to $34 billion. The examples of Germany and the Netherlands again show the high volatility of intra-company loans that depend on

Figure II.23. Developed countries: FDI flows, top 10 economies,[a] 2004-2005

(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Ranked on the basis of the magnitude of the 2005 FDI flows.

taxes, interest-rate differentials, exchange-rate changes and the profitability of TNCs and their foreign affiliates (*WIR05*, p. 11). FDI inflows to Italy rose to $20 billion as foreign investors undertook several acquisitions in the Italian financial sector, which, under pressure from the European Commission, is becoming more open to foreign investors. Thus, for example, the Dutch bank, ABN Amro, was able to purchase the Italian financial firm Antonveneta for $9 billion after a long and controversial dispute involving the Central Bank of Italy.

In contrast to these countries there were several EMU-12 countries with lower FDI inflows. FDI inflows to *Ireland* turned negative due to repayment of loans to parent firms. Flows to *Belgium* nearly halved. Inflows into *Spain* also declined. In *Luxembourg*, data on FDI flows, excluding trans-shipped FDI (mainly FDI in special purpose entities (SPEs)), that were made available for the first time to UNCTAD, show that FDI inflows have remained virtually static ($4 billion) since 2002.[117]

FDI inflows into the *10 new EU member countries* rose by 19% in 2005, from $28 billion in 2004 to $34 billion. The economic disparity between these countries and the earlier EU members (for example their GDP per capita is only half that of the earlier members) (*WIR 2005*, pp. 86-87), as well as among the 10 EU members, influences the amount and type of FDI that each of them receives. Most of the increase in inflows to the new EU member States went to the *Czech Republic,* its inward FDI rising by $5 billion to reach $11 billion. Its total inward FDI stock has now reached $59 billion, making it the third largest FDI recipient in Eastern Europe, just behind Poland ($93 billion) and Hungary ($61 billion). Foreign investors increased their FDI in transportation and communications services (that accounted for about half of FDI inflows in 2005), real estate and business activities (accounting for around one fifth) in the Czech Republic. *Hungary* registered record FDI inflows of $6.7 billion. In both Hungary and the Czech Republic, FDI is progressively shifting towards high-tech activities, including R&D, and other services (e.g. call centres). By contrast, FDI inflows into the other, larger new EU country, *Poland,* declined but remained at a relatively high level of $8 billion. The growth rate was the most marked in *Estonia*. The main mode of investment in most new EU countries was reinvested earnings of foreign affiliates: for example, in the Czech Republic, Estonia and Hungary together, 29% of FDI inflows in 2005 were reinvested earnings.

Among other non-EU countries in Europe Switzerland is noteworthy. FDI inflows in this country shot up from less than $1 billion to $6 billion because of capital repayments by finance and holding companies.

FDI inflows into *Japan* fell by 64% to $2.8 billion, the lowest in the past decade. This level, as well as its share in the country's gross fixed capital formation, is among the lowest for developed countries, and Japan's country ranking in the UNCTAD Performance Index was only 131 out of 141 (chapter I; annex table A.I.9). Recent moves may cast another shadow on further growth of FDI in Japan; these include the postponement, at least till 2007, of approval of cross-border M&As through the exchange of shares, and increased restrictions on the establishment of operations by large retailers, both domestic and foreign.[118] Since FDI in the country is increasingly likely to occur through cross-border M&As and to take place in the retail industry, this will certainly affect the level of FDI inflows and put into doubt the Government's commitment made in 2003 to double FDI stocks by 2006 (box II.18; and *WIR 2004*, pp. 82-83). The delay for the approval of cross-border M&As through share exchanges is due to concerns about hostile takeovers of the kind that recently involved corporate scandals and illegal activities. However, all these dubious deals have involved Japanese companies; according to Thomson Financial, no hostile takeovers by foreign investors have been reported in Japan.[119]

Australia experienced a dramatic decline in FDI inflows, from $42 billion in 2004 to -$35 billion. Similarly, a large decline was also recorded in FDI outflows, from $18 billion to -$41 billion. This is largely explained by a technical reason – the reincorporation in 2004 of News Corporation, one of the largest media companies in the world, in the United States whereby its primary listing was moved to the New York Stock Exchange. [120]

More than 90% of FDI inflows into developed countries originated in other developed countries (table II.15). But in terms of stock, investments from developing countries in developed countries have been on the rise over the past decade, and their share in 2004 surpassed the level reached in 1990. There were several mega deals by developing-country TNCs in 2005 such as the above-mentioned acquisition of Wind

Box II.18. Will Japanese FDI stock really be doubled by 2006?

The Government of Japan committed itself to doubling Japan's FDI stock from its 2001 level within five years (i.e. by the end of 2006) to 13.2 trillion yen ($119 billion) in 2006. The Japanese Prime Minister, in his General Policy Speech in January 2006, stated that Japan would achieve this goal and even set the goal of further doubling this level by 2011, to $26 trillion yen.[a]

Judging from recent trends in FDI inflows into Japan, however, it will be difficult to achieve the goal set for end 2006. By the end of 2001, Japan's inward FDI stock was 6.6 trillion yen ($60 billion). FDI inflows during the period 2002-2005 were 3.8 trillion yen. In order to reach a stock of 13.2 trillion yen, inflows of some 2.8 trillion yen ($25 billion) would be required in 2006. Japan has never received such a high level of inflows. Another and possibly fatal blow to attaining the target was GM's and Vodafone's selling off of their Japanese interests in 2006: GM reduced its share in Suzuki from 20% to 3% for 0.2 trillion yen ($2 billion) and Vodafone sold its affiliate Vodafone Japan to Softbank (Japan) for 1.7 to 2 trillion yen ($15 billion).

The only possibility of achieving the goal (at least technically) is if there are increases in non-transaction components of FDI stock, namely valuation changes due to changes in exchange rates[b] and prices,[c] and other adjustments.[d] Indeed, valuation changes accounted for 43% of changes in FDI stock in Japan between 2002 and 2005 (box table II.18.1). However, even if this component is taken into account, it will not yield more than 2 trillion yen per year, which is still below the 2.8 trillion yen required to meet the goal.

Box table II.18.1. Composition of inward FDI stock in Japan, 2001-2005

Year	FDI stock, flows and valuation	(Billions of yen)	(Billions of dollars)
2001	Stock	6 632	50.3
	Flows	759	6.2
	Changes and adjustments	1 978	16.3
2002	Stock	9 369	78.1
	Flows	1 159	9.2
	Changes and adjustments	- 918	-7.3
2003	Stock	9 610	89.7
	Flows	733	6.3
	Changes and adjustments	- 245	-2.1
2004	Stock	10 098	97.0
	Flows	846	7.8
	Changes and adjustments	959	-0.4
2005	Stock	11 903	100.9
	Flows	306	2.8
	Changes and adjustments	1 499	13.6

Source: UNCTAD, based on data from the Bank of Japan (www.boj.or.jp).

Source: UNCTAD.

[a] The Prime Minster, however, dropped this pledge later because of reported fears of hostile takeovers. "Koizumi drops FDI pledge on M&A fears", *Financial Times*, 2 February 2006.

[b] The depreciation or appreciation of the local currency vis-à-vis another country's currency (e.g. the United States dollar) affects the value of external assets and liabilities and the investment position of a country.

[c] Prices of securities can change in the stock market from the beginning of a period to the end of the period.

[d] Includes reclassifications (from foreign portfolio investment to FDI or vice versa), write-offs, expropriations, unilateral cancellation of debt and measurement errors.

Telecominicazioni of Italy ($12.8 billion) by Weather Investment of Egypt, an investment arm of Orascom, and that of the PC section of IBM by China's Lenovo through its Hong Kong affiliate for $1.8 billion. San Miguel (Philippines) also bought National Foods (Australia) for $1.5 billion (annex table A.I.7).

In 2005, cross-border M&A activity increased significantly and drove the rise in FDI flows to developed countries. The number and value of M&A deals reached was the highest after the record year 2000. Falling stock prices in the years following 2000 had led in many cases to massive financial losses to shareholders and a more sceptical view about the success of M&As. The strong resurgence of growth of M&As in 2005 was driven by favourable conditions in the world economy. Corporate profits in developed countries were historically high in 2005 (IMF 2005a, p. 6), giving a boost to investment generally and to FDI. Rising stock market prices worldwide reflected an upbeat business sentiment.[121] High liquid reserves and low costs of external financing in an environment of low real interest rates increased the chances of growing faster through M&As than through organic or internal firm growth. In 2005, private-equity funds and hedge funds became very active in cross-border acquisitions (chapter I). High yields on equity and low interest rates motivated

Table II.15. Inward FDI of developed countries from major country groups, 1990-2004
(Per cent)

			Regional share in inward FDI			
Type	Year	World	Developed countries	Developing economies	South-East Europe and CIS	Unspecified
Flows	Average 1990-1994	100	92.8	5.6	0.1	1.4
	Average 1995-1999	100	93.2	3.7	-	3.0
	Average 2000-2004	100	93.8	4.1	0.1	2.0
	2002	100	94.3	5.9	-	- 0.3
	2003	100	93.9	5.5	0.1	0.5
	2004	100	97.8	-2.9	0.3	4.9
Stock	1990	100	93.5	6.0	0.1	0.4
	1995	100	93.5	4.7	0.2	1.5
	2000	100	94.5	4.3	0.1	1.1
	2004	100	92.8	6.1	-	1.1

Source: UNCTAD, FDI/TNC database.
Notes: Only recipient countries for which data for the three main group were available, were included. Therefore, the number of countries comprising the totals for developed countries as a group may vary in each period or year, depending on the availability of data for each recipient developed country. Thus the number of recipients and their share in total inward FDI to developed countries for each period/year were as follows: in 1990-1994, 17 countries were covered accounting for 78% of flows; in 1995-1999, 22 countries accounted for 95% of flows; in 2002, 24 accounted for 93% of flows; in 2003, 24 accounted for 90% of flows; and in 2004 and in 2000-2004, 18 countries accounted for 61% and 71% of inward flows respectively. Similarly, in inward stock: in 1990, 11 countries accounted for 74% of stock; in 1995, 19 accounted for 82% of stock; in 2000, 27 accounted for 87% of stock; and in 2004, 11 accounted for 50% of stock.

such institutional investors that rely a great deal on financing by bank credits and individual funds to expand their investments through acquisitions.

More than 90% of cross-border M&As in developed countries were concluded by firms from other developed countries (table II.16). The share of developing countries in cross-border M&As in developed countries was 7%-8% in both 2004 and 2005 (compared to 4% in 2003), but developing Asian and African firms spent considerably more in 2005 than in 2004.

Unlike cross-border M&As, greenfield FDI in developed countries fell in 2005, judging from the number of cases recorded for that year: this number declined from 4,144 in 2004 to 3,981 in 2005 (annex table A.I.1). However, investments from South, East and South-East Asia rose by 9% to 268.[122] United Kingdom and United States investors also increased their greenfield investments in developed countries, though these increases were more than offset by decreases in FDI from other major sources (e.g. France, Germany, Italy).

b. Outward FDI: overall decline

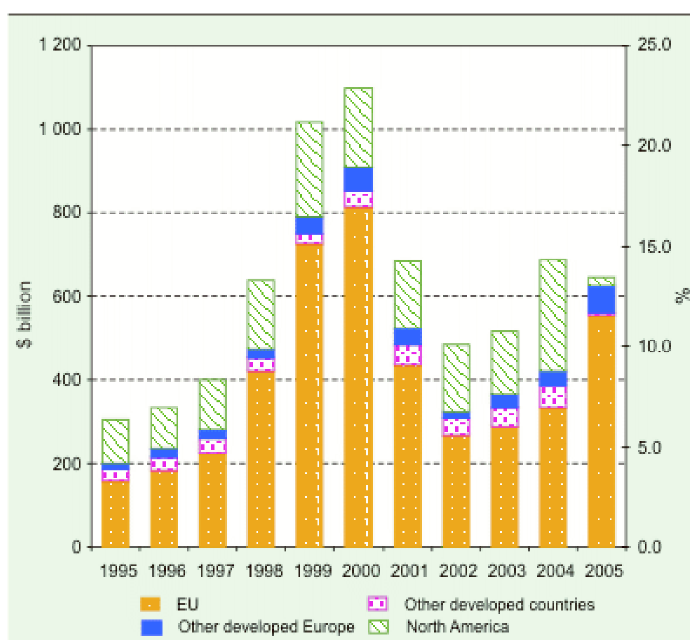
FDI outflows of developed countries in 2005 declined by 6% to $646 billion. The share of the EU in developed-country FDI outflows has been losing ground recently, while that of North America (Canada and the United States) has been gaining (figure II.24). But in 2005, the latter's share fell to only 3%. In 2005, with the exception of Canada, Japan, Norway and Switzerland, all developed countries with outflows of more than $10 billion were from the EU in 2005 (table II.17). Many developed countries tend to be both major sources and recipients of FDI and are ranked within the same range of outward FDI volume and inward FDI volume.[123] In the lowest range, there were many new EU countries. Overall, developed-country FDI outflows exceeded inflows, but the difference between the two flows narrowed by 64%, to $104 billion in 2005.

Table II.16. Developed countries: distribution of cross-border M&As, by home/host region, 2004-2005
(Millions of dollars)

	Sales		Purchases	
Home/host region	2004	2005	2004	2005
World	315 851	598 350	339 799	626 339
Developed countries	291 170	551 291	291 170	551 291
Developing economies	24 301	43 258	40 760	58 924
Africa	727	13 331	2 571	9 564
Latin America and the Caribbean	11 527	5 543	21 599	22 772
Asia and Oceania	12 047	24 385	16 590	26 588
Asia	12 044	24 382	16 539	26 434
West Asia	1 157	8 806	446	3 265
South, East and South-East Asia	10 886	15 576	16 092	23 169
South-East Europe and CIS	380	3 801	7 870	16 124

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

Figure II.24. Developed countries: FDI outflows, by subregion, 1995-2005



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

The regional distribution has not changed much over the past 15 years: the largest share of outflows from developed countries continues to be directed towards other developed countries (58% in 2004) (table II.18). There are some variations among countries: the importance of developing and transition economies as a destination (i.e. developing economies and South-East Europe and the CIS) fell for outward FDI from France and Germany (7-8% of total outward FDI stock), but rose for outward FDI from Austria, Canada, Denmark and Switzerland. For Japan and the United States, those economies' share as a destination has fluctuated over the years. Among major investors, Japanese firms directed their investment first to developing economies, particularly South, East and South-East Asia (23% of total FDI stock in 2005). Only two other countries, Switzerland and the United States, located more than one quarter of their FDI stock (27% each) in developing and transition economies.[124]

Despite a considerable decline in its outward FDI in 2005, which also means some loss of world pre-eminence in investment abroad, the United States remained the world's largest source of FDI in terms of stock. The decline in outward FDI flows of United States companies from a historical peak of $222 billion in 2004 to -$13 billion in 2005 was mainly due to an increase in distributed profits of foreign affiliates of United States-based companies; this of course led to a large decline in reinvested earnings of foreign affiliates, which has been the main mode of investment by United States firms abroad in previous years (see box II.19).

Other major sources of FDI from Europe were the Netherlands, France, the United Kingdom, Germany and Switzerland. FDI outflows from the *Netherlands* amounted to $119 billion. The large increase over outflows in 2005 resulted mainly from the previously mentioned merger of Royal Dutch Shell of the Netherlands and Shell Transport and Trading Company Plc of the United Kingdom. Because of this transaction, outflows from the Netherlands in 2005 reached a record level, making the country the largest investor in the world. Outward FDI from *France* doubled, to about $116 billion in 2005 – the highest level since the country's peak FDI outflows in 2000. This was due to abundant cash from strong corporate profits after three-year restructuring efforts to reduce costs.

Companies located in the *United Kingdom* invested $101 billion abroad, an increase of 7% over that in 2004, which made the country the third largest investor worldwide in 2005. At the end of 2005, the United Kingdom owned the second largest FDI stock abroad of approximately $1.2 trillion. A large increase in earnings of foreign

Table II.17. Developed countries: country distribution of FDI flows, by range,[a] 2005

Range	Inflows	Outflows
Over $50 billion	United Kingdom, United States and France	Netherlands, France, and United Kingdom
$10-49 billion	France, Netherlands, Canada, Germany, Belgium Spain, Italy, Sweden and Czech Republic	Japan, Germany, Italy, Spain, Canada, Sweden, Belgium, Norway and Ireland
$1-9 billion	Austria, Poland, Hungary, Israel, Denmark, Finland, Luxembourg, Norway, Portugal, Estonia, Japan, Iceland, Slovakia, New Zealand, Cyprus and Lithuania	Denmark, Austria, Iceland, Luxembourg, Finland, Israel, Poland, Greece, Hungary and Portugal
Less than $1 billion	Latvia, Greece, Malta, Slovenia, Gibraltar, Ireland and Australia	Czech Republic, Estonia, Slovenia, Cyprus, Lithuania, Slovakia, Latvia, Malta, New Zealand, United States and Australia

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Countries are listed according to the magnitude of FDI.

Box II.19. The effects of the Homeland Investment Act on United States outward FDI

The American Jobs Creation Act of 2004 signed into law on 22 October 2004, through its provision, the Homeland Investment Act, allows United States companies that repatriate earnings from their foreign subsidiaries for a period of one year (calendar year 2004 or calendar year 2005 at taxpayers' option) to be taxed at a reduced rate of 5.25%, instead of 35%, if certain conditions are met (Sauers and Pierce 2005; *WIR05*, pp. 89-90). At constant earnings of foreign affiliates, an increased distribution of earnings leads to an equal and offsetting decrease in reinvested earnings. A decline in reinvested earnings results in lower FDI outflows, as reinvested earnings are an important component of United States outward FDI.

Since many United States parent companies sought to take advantage of the incentive to repatriate foreign affiliates' earnings at reduced rates of taxation, the Homeland Investment Act led to a sizeable decline in reinvested earnings (box table II.19.1). FDI outflows in 2005 therefore shrank by $235 billion to -$13 billion.

Box table II.19.1. Earnings of foreign affiliates of United States TNCs, 2004/QI-2006/QI
(Millions of dollars)

	2004				2005				2006
Item	Q: I	Q: II	Q: III	Q: IV	Q: I	Q: II	Q: III	Q: IV	Q: I
Direct Investment income	53 551	57 209	56 121	59 343	58 427	61 906	63 889	67 148	69 459
Earnings	51 992	55 613	54 534	57 687	56 787	60 347	62 321	65 630	67 984
Distributed earnings	9 153	21 253	10 095	21 987	25 102	33 529	87 058	110 633	14 622
Reinvested earnings	42 839	34 359	44 439	35 700	31 684	26 818	-24 737	-45 003	53 362
FDI outflows	53 668	51 491	35 755	81 522	29 165	33 486	-29 738	-45 626	60 866

Source: UNCTAD, based on data from the United States Department of Commerce, Bureau of Economic Analysis, U.S. International Transactions Accounts Data, released on 14 March 2006 (www.bea.doc.gov).

Source: UNCTAD.

affiliates resulted in increasing reinvested earnings abroad.

In 2005, there was a turnaround in Germany's outward FDI from its low levels of 2003 and 2004 when German companies had cut their investments, both domestic and foreign, due to corporate restructuring. Thereafter, rising profits of large *German* companies led to an increase in German FDI abroad to $46 billion, with investing firms recently using more M&As, including hostile takeovers. Germany therefore regained its traditional role as a (net) foreign investor in 2005.

Switzerland also featured among the large investors in 2005. The surge of outflows from this country, from $27 billion to $43 billion, was due to increased investments by finance and holding companies as well as trading companies. Chemicals and food, typically for Swiss FDI, accounted for more than 90% of its outward FDI in manufacturing.

Although outflows from Spain declined significantly (by 36%), they still reached $39 billion, making the country one of the largest EU investors. Spanish firms are currently expanding their investments into Europe and the United States.[125] Their acquisitions are encouraged by a favourable tax regime: for example, goodwill acquired is tax-deductible. Moroever, with an expected slowdown of the economy, Spanish banks and construction companies are hedging their investments by moving abroad and diversifying businesses.[126] Generational change in the big family construction companies is another factor for increasing outward investments.[127]

With *Japan's* corporate debt reaching its lowest level since the bursting of the bubble economy, along with the highest profits (7.6% higher than in 2004 for all listed firms) as well as a recovery of stock exchange markets to their 2001 level, Japanese TNCs have been flush with financial resources for investment. Unsurprisingly, therefore, Japanese outflows rose to $46 billion in 2005. Automobile firms continued to be the main investors, producing more abroad than at home. An interesting feature in 2005 was the fact that major Japanese banks, which once topped the league table of the world's leading banks but then lost financial strength in the past decade, began resuming investment abroad. The most prominent

Table II.18. Outward FDI from developed countries to major country groups, 1990-2004
(Per cent)

Type	Year	World	Regional share in outward FDI			
			Developed countries	Developing economies	South-East Europe and CIS	Unspecified
Flows	Average1990-1994	100	79.1	19.0	0.5	1.4
	Average1995-1999	100	79.2	16.3	0.7	3.8
	Average 2000-2004	100	78.3	15.9	1.6	4.2
	2002	100	82.9	12.4	1.4	3.3
	2003	100	82.8	10.0	2.1	5.1
	2004	100	57.5	24.5	2.8	15.2
Stock	1990	100	82.2	16.6	0.1	1.1
	1995	100	79.6	17.8	0.2	2.4
	2000	100	81.4	16.7	0.5	1.4
	2003	100	81.6	16.3	0.6	1.5
	2004	100	75.4	20.5	0.6	3.5

Source: UNCTAD, FDI/TNC database.
Notes: Only source countries for which data for the three main group were available, were included. Therefore, the number of countries comprising the totals for developed countries as a group may vary in each period or year, depending on the availability of data for each source country. Thus the number of countries and their share in total outward FDI from developed countries for each period/year were as follows: in 1990-1994, 16 countries were covered accounting for 93% of flows; in 1995-1999, 20 accounted for 97% of flows; in 2002, 24 accounted for 94% of flows; in 2003, 23 accounted for 98% of flows; and in 2004 and in 2000-2004, 18 countries accounted for 72% and 73% of outward flows respectively). Similarly for outward stock: in 1990, 11 countries were covered accounted for 76% of stock; in 1995, 17 accounted for 84% of stock; in 2000, 26 accounted for 93% of stock; in 2003, 21 accounted for 91% of stock; and in 2004, 10 accounted for 53% of stock.

move was by the Bank of Tokyo Mitsubishi UFJ, the world's largest bank in terms of assets in 2006. Partly to follow their Japanese client base, Japanese FDI in banking has been spreading into new EU member States and the Russian Federation, as well as to traditional investment locations in Asia, the EU and the United States. Outstanding loans by these Japanese banking affiliates abroad, an indicator of Japanese FDI in the banking industry, tripled during 2004-2005 and rose by one third in 2005 alone, the highest growth rate since 1990. Finance and insurance accounted for one fifth of total Japanese FDI outflows in 2005.

2. Sectoral trends: inflows up in all sectors

Judging from data on the sectoral breakdown of cross-border M&As (table II.19), which reflect global trends towards more investment in the oil, mining and other natural-resource activities, the *primary sector* in particular gained in importance in sales (inward FDI) and purchases (outward FDI) of developed countries in 2005. FDI data also point in that direction, though the most recent data are available only up to 2004 (annex tables A.I.1-A.I.4).

Based on cross-border M&As in terms of both sales and purchases, FDI increased in developed countries' *manufacturing sector* in 2005 (table II.19). In particular, spectacular growth of FDI in metals and metal products reflected the high commodity prices: five times higher in cross-border sales and four times higher in purchases.[128] Motor vehicles and transport equipment also experienced high FDI growth, with a threefold increase in cross-border M&As. In recent years, the new member States of the *EU* have been attracting increasing FDI in the car manufacturing industry in Europe. Major TNCs such as Hyundai Motor (Republic of Korea), Hyundai-affiliated Kia Motors and Sanden (Japan) have announced greenfield investments worth $1.2 billion, $1.29 billion and $140 million, respectively, to open new production plants in the Czech Republic, Slovakia and Poland respectively (box II.20).

In general, there is increasing FDI activity in the *services sector* of developed countries, particularly in financial and real estate industries. In the telecommunications industry there were several large cross-border acquisitions that increased the value of FDI flows. In banking and insurance FDI inflows increased due to consolidation in the industry and to expansion, spurred by financial deregulation and globalization. Much of the increase was in the EU (box II.21).

3. Policy developments

In 2005, a number of developed countries adopted policies aimed at attracting FDI. These included further liberalization and privatization of State-owned enterprises in the manufacturing and services sectors, cutting corporate tax rates, and introducing tax exemptions and other incentives for foreign investors.

Many new EU member countries continued the process of privatization and liberalization. For example:

- In the Czech Republic, the Government sold its 51% stake in Cesky Telecom and a 99% stake in Vitkovice Steel to foreign investors.
- In Hungary, Latvia and Malta, formerly State-owned enterprises in such different industries as airport operations, State and municipal property, oil terminals and electricity were privatized and partially sold to foreign investors.
- In Poland, the Government sold State-owned firms in oil, gas and chemicals industries.

There were also some large-scale privatizations in other developed countries in 2005.

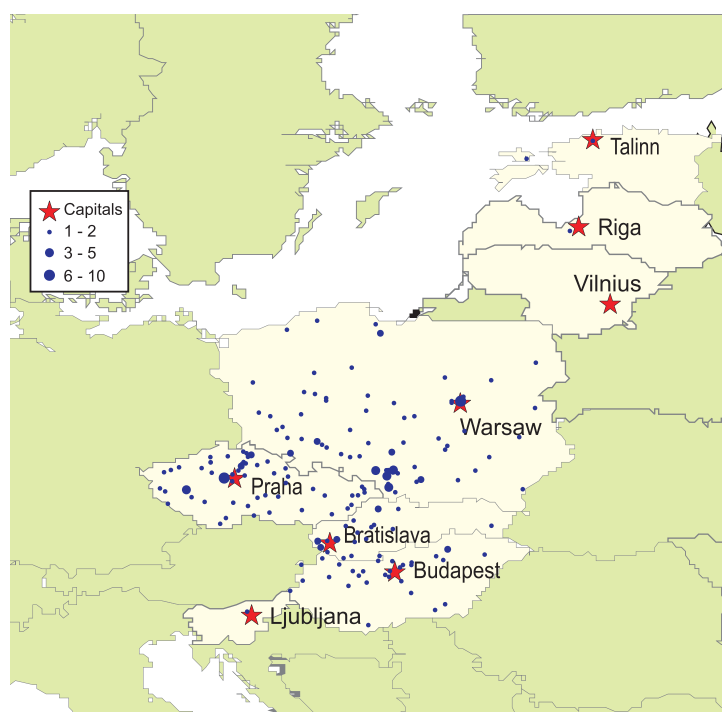
- In Austria, the Government sold its 15% stake in VA Tech, a metallurgy, power generation and infrastructure conglomerate, to Siemens (Germany).

Box II.20. New EU member States continue to attract international car manufacturers

The new EU member States have become new hubs of manufacturing for automobile production in Europe. In 2005, passenger car production in the new EU members exceeded 1.6 million cars, equivalent to 9.5% of the total production in the EU-25. Foreign affiliates in this industry are concentrated in four countries (box figure II.20.1). The Czech Republic and Poland are the largest producers, followed by Hungary and Slovakia. In the past 15 years, TNCs have invested heavily in the automobile industry in East European countries. About one tenth of inward FDI stocks in Hungary, Poland and the Czech Republic are in the automobile industry.

Foreign firms dominate the automobile industry in the new EU member States. They account for an estimated 70% of total employment in the industry. The bulk of inward FDI originates from European manufacturers. But since investing in these countries allows overseas investors to jump over EU tariff barriers, other investors (especially from Japan, the Republic of Korea and the United States) are becoming increasingly interested in the region (European Communities 2004, p. 188 ff). As large component suppliers have followed car producers, a dynamic manufacturing cluster with high output and export potential has developed.

Box figure II.20.1. Map of location of foreign affiliates in the new EU member States, 2005



Source: UNCTAD, based on Dun & Bradstreet, *Who Owns Whom Database*.

Note: Based on 275 majority-owned foreign affiliates, including those in the parts and supplies industry.

Further investments in the new EU member States are expected from large car-makers and component suppliers in the coming years because of several encouraging factors, including expected strong economic growth, low labour costs, a skilled workforce, a low tax environment, as well as several investment incentives. For example, in 2005, the average effective top statutory tax rate on corporate income in the Czech Republic, Hungary and Poland was 20.1%, compared to an average tax rate of 36.6% in France, Germany and Italy (box table II.20.1). Wages in the

/...

Box II.20. New EU member States continue to attract international car manufacturers (concluded)

new EU member States in 2005 are about 70% lower than those in the EU-15 countries[a] and they can be expected to remain at this level for quite a while (*WIR05*). Thus automobile production in the new EU member States is expected to double within the next five years, from 1.6 million to 3.2 million vehicles, increasing the share of the new EU-10 countries in total EU production to 16.5% (Csmauto 2005).

Box table II.20.1 Macroeconomic and other indicators for selected EU members

Country	Economic growth (average for 2006-2007) [a]	Tax rate on corporate income (2005 per cent) [b]
France	2.1	33.8
Germany	1.2	38.6
Italy	1.3	37.3
Czech Republic	5.0	26.0
Hungary	4.3	17.5
Poland	4.0	19.0

Source: UNCTAD, based on the following:
[a] IMF forecast (IMF 2006).
[b] Effective top statutory tax rate on corporate income (Eurostat 2005).

Source: UNCTAD.

[a] It should be noted that a simple comparison of wage costs expressed in one currency (e.g. the euro) is of limited value since productivity is not considered.

Box II.21. FDI in banking in the EU-15: trends, determinants and barriers to integration

There have been several large cross-border M&A deals in the European banking industry in recent years. Santander (Spain) acquired Abbey National (United Kingdom) for $15.8 billion in 2004, Unicredito (Italy) merged with the German Bayerische Hypo Bank for $18 billion in 2005 (annex table A.I.7), and the Netherlands' ABN Amro acquired Italian Antonveneta in 2006.

Despite growing activity, the degree of integration in banking in Europe lags behind expectations. In several European countries with a relatively large number of banks, the consolidation process in the banking sector has been relatively slow. The single market, the introduction of the euro and several deregulation measures, such as the Financial Services Action Plan, increased cross-border financial flows in the EU, but integration via cross-border expansion of banking institutions has advanced slowly (Berglöf, Fulghieri and Gual 2005). In Italy and Germany, for example, the market share of the top five banks is small (35% and 25% respectively) compared to 75% in France and 80% in the Netherlands (Berglöf, Fulghieri and Gual 2005). The market share of foreign-dominated institutions in many European countries is also small.

Part of the reason for this situation lies in the existence of institutional and regulatory barriers to foreign takeovers of resident banks in some countries. In Italy, an acquisition of more than 5% of shares in any Italian bank has to be approved by the Bank of Italy. The Bank of Italy can therefore resist any foreign acquisitions of Italian banks, as illustrated by the case of the Netherlands' ABN Amro's acquisition of Antonveneta. After the European commission initiated proceedings in early December 2005 against Italy for possible infringement of Single Market provisions on the free flow of capital, the Italian Government transferred part of the responsibility for dealing with anti-competitive behaviour – that was in the past often assumed by the Bank of Italy – to the anti-trust authority (IMF 2006). In Germany, State ownership of almost half of the banking system makes it very difficult for foreign investors to enter through M&As (Brunner, et al. 2004).

Source: UNCTAD.

Table II.19. Developed countries: distribution of cross-border M&As, by sector, 2004-2005
(Millions of dollars)

	Sales		Purchases	
Sector	2004	2005	2004	2005
Total	315 851	598 350	339 799	626 339
Primary	11 337	110 474	14 904	97 876
Manufacturing	105 202	171 020	91 269	125 604
Tertiary	199 312	316 856	233 624	402 823
Unknown[a]	-	-	2	36

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

[a] Including non-classified establishments.

- Part of the State-owned Danish postal service was privatized and sold to a foreign private equity fund.
- The Italian State-owned electricity company, ENEL, was partially privatized as well as Gaz de France.

Despite some progress in recent years, the EU continues to lag behind the United States in the opening up and deregulation of the services sector, which hinders further cross-border investments in this sector (ECB 2006b). The EU Commission's Proposal for a Directive on Services in the Internal Market could change this. According to some estimates, EU bilateral trade and investment in commercial services could eventually increase by up to a third once the Directive takes full effect (which could take until 2010) (ECB 2006b, p. 15 ff).[129] A further stimulus to intra-EU investments could be the accession to the EU of Bulgaria and Romania, which is currently scheduled for 2007.[130]

Partly with a view to enhancing their attractiveness, several countries completed or announced further cuts in corporate income tax and reforms of their tax regime. Estonia amended its corporate profit tax law to ease the setting up of holding companies in the country, and announced plans to reduce its flat income tax rate for companies and individuals from 24% in 2005 to 20% in 2009. Finland cut its corporate tax rate from 29% to 26%. Progressive corporate tax rate cuts were announced in Greece, Israel and the Netherlands.

In 2005, several developed countries also adopted incentives for FDI and measures aimed at facilitating the entry process for foreign investors. In Greece, for instance, a new law offers generous cash grants for investment. In Slovenia, a decree was passed to reduce entry costs for FDI that creates new jobs and contributes to the transfer of knowledge and technology.

In addition, countries continued to conclude BITs and DTTs – although at a reduced rate compared to previous years. In 2005, 45 BITs and 38 DTTs involved a developed country. This brought the total number of BITs and DTTs involving developed countries to 1,511 and 2,111, respectively, at the end of 2005.

There were also a number of protectionist moves in 2005 in the area of FDI. For example, the Spanish Government tried to prevent the takeover of the energy supplier Endesa by German E.ON. The French Government resisted the acquisition of Suez by the Italian firm ENEL by promoting the merger of Gaz de France and Suez and creating a "national champion". France, Germany, Italy and Japan have sought to tighten M&A regulations by allowing target companies to use "poison pills" (*WIR00*, p. 104). In the United States, for national security reasons, major cross-border M&As are reviewed by the Committee on Foreign Investment (CFIUS) (box VI.9). This led, for example, to the withdrawal of the bid by the Chinese oil firm, CNOOC, for the United States firm, Unocal, in 2005.

While Japan has introduced measures that may restrict M&A activities, it is trying to advance negotiations on FTAs and economic partnership agreements (EPAs), and aims at concluding an FTA with 15 countries or regions by 2010. However, according to a survey by the Japan Bank for International Cooperation (JBIC 2006),[131] Japanese manufacturing TNCs do not intend to make much use of what is offered by the agreements signed or under negotiation between Japan and ASEAN or Japan and six individual countries (Indonesia, Malaysia, the Philippines, the Republic of Korea and Thailand). The bilateral agreement they find the most useful is the one between Japan and Thailand, but even that is planned to be used by only 29% of Japanese TNCs, while in the case of the agreement between Japan and the Philippines only one eighth of Japanese TNCs responded that they found it useful. The FTA between Japan and Malaysia, scheduled to take effect in 2006, also evoked a lukewarm response.

4. Prospects

The prospects for a further increase in FDI flows to developed countries in 2006 are favourable, despite some downside risks. Economic growth in developed countries is expected to increase moderately, to 3% in 2006 (IMF 2006). Growth divergence among developed countries are expected to narrow. The United States economy will continue to be the main engine of growth, with an expected annual growth rate in 2006-2007 of 3.5%. The Japanese economy is expected to grow at 2.8%, and economic recovery in the euro area should be more sustained (+2%). Corporate profits of companies in developed countries reached historically high levels in 2005 (IMF 2006, chapter IV). Despite fears of protectionist measures, strong growth in world trade is expected (IMF 2006, OECD 2006): in 2006 and 2007 the volume of world trade in goods and services is expected to grow by 8.0 % and 7.5% respectively, which would be close to the 35-year trend line and much stronger than in 2005 (7.3%).

If business and consumer confidence grows further, it should result in additional investments by developed-country TNCs, which would further increase FDI inflows in developed countries. In addition, external financing conditions are still favourable. Short-term interest rates have continued to rise, but long-term interest rates are still considerably lower than long-term averages.

Surveys in several countries also point to continued robust FDI activity. The annual JBIC survey, for instance, suggests that 79% of surveyed companies plan to increase their FDI within the next three years (JBIC 2006).[132] A similar trend is confirmed by the Nikkei survey in October 2005, which revealed that 87% of Japanese manufacturing companies plan to expand foreign production over the next three years. The country that attracts them the most is China (85% of surveyed firms), followed by Thailand (23%), North America (19%) and Europe, including Central and Eastern Europe (5%).[133] According to an annual survey of German firms, FDI by the companies surveyed in the manufacturing sector in 2006 will continue to grow (DIHK 2006): 41% of the firms plan to invest abroad (slightly more than in 2005); 43% of them are planning to invest more and only 10% less than in the previous year. FDI outflows from the United States are also expected to increase considerably in 2006, as the massive reduction of reinvested earnings abroad – that led to low FDI outflows in 2005 – will most likely be reversed after the first quarter of 2006 (Bach 2006), due to time limitations in the American Jobs Creation Act (box II.19). The OECD's outlook for FDI flows in the coming years is positive, though it projects that both inward and outward FDI in 2006 in the OECD countries will remain unchanged or decline slightly (OECD 2006).

FDI by institutional investors is also expected to be strong in 2006. For example, in Japan FDI by private equity firms continues to be a significant determinant of the level of inflows. Permira (United Kingdom) alone plans to invest 100-150 billion yen ($0.9-1.4 billion) over the next three years, and Carlyle (United States) collected $2 billion in funds for investment in 2006. According to UNCTAD's estimates, private equity cross-border investments in the first half of 2006 show at least a similarly high level as in the corresponding period of 2005. Data on cross-border M&As in general indicate growing foreign investments – a nearly 40% increase over the same period of 2005.

Several risks for the world economy persist, with implications for FDI flows from developed countries. Most of them are not new. Global current-account imbalances have begun to widen dramatically, and the United States deficit increased to 6.5 % of GDP in 2005. This contrasts sharply with the current-account surpluses of China, Japan and other Asian countries, and of the oil-exporting countries, and could cause abrupt exchange-rate changes. High and volatile oil prices have caused inflationary pressures and a tightening of financial market conditions. High fiscal deficits in Europe in combination with rising interest rates could lead to tax and wage pressures. All these considerations underline the need for caution in assessing FDI prospects for developed countries.

Notes

1 *WIR05*, box I.2. These countries are also referred to as transition economies.

2 Based on OCO Consulting's Locomonitor database. See endnote 2 in chapter 1 for the nature of these data.

3 *Source*: "China makes more overseas investment in 2005, mainly in Asia", *People's Daily Online*, 10 February 2006 (www.english.people.com.cn/200602/10/eng20060210_241644.html).

4 Comprising: Algeria, Egypt, the Libyan Arab Jamahiriya, Morocco, Sudan and Tunisia.

5 For example, in 2005, Morocco privatized four sugar companies and two fixed-line telecommunications licences, while Tunisia sold Société Tunisio-Algerienne de Ciment Blanc to Prassa (Spain) and Banque du Sud to Banco Santander (Spain).

6 *Source*: "The domestic economy: Chinese and Indian firms eye new projects", Economist Intelligence Unit, 11 March 2005. (www.eiu.com/index.asp?layout=displayIssueArticle&article_id=1628141362&text=Sudapet%2C+Petronas).

7 Countries in the subregion are: Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, the Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone and Togo.

8 *Source*: "Israel Sierra-com to Invest US$3M in Sierra Leone Broadband and VOIP", *BalancingAct* (www.balancingact-africa.com/news/back/balancing-act_288.html).

9 Comprising: Angola, Cameroon, Central African Republic, Chad, Congo, the Democratic Republic of the Congo, Equatorial Guinea, Gabon and Sao Tome and Principe.

10 *Source*: "Phase two of Barclays deal to create African megabank", *BusinessDay*, 12 May 2005 (www.businessday.co.za).

11 Countries in the subregion are: Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Seychelles, Somalia, Uganda, the United Republic of Tanzania, Zambia and Zimbabwe.

12 The subregion comprises: Botswana, Lesotho, Namibia, South Africa and Swaziland.

13 For example, SABMiller's acquisitions of Bavaria Brewers (Colombia) for $4.7 billion (annex table A.I.7) and Shaw Wallace & Company (India), Topovar Brewery (Slovakia) and Funyan City Snowland Brewery (China) in 2005 were not recorded as outward investment from South Africa because the financing for these deals did not originate in South Africa.

14 A comprehensive analysis of FDI outflows from most African countries is constrained by the lack of adequate data, except for South Africa and a few other countries such as Nigeria, the Libyan Arab Jamahiriya and Côte d'Ivoire.

15 This transaction is apparently not reflected in the balance of payments of Egypt because payments were either not made in 2005 or made from countries other than Egypt.

16 Data from national sources.

17 *Source:* "Urgent need to broaden the base: Island takes a buffeting with lost income from its clothing and sugar industries", *Financial Times*, 14 March 2006.

18 *Source*: "Lesotho textile workers lose jobs", *BBCNews,* 12 January 2005 (www.news.bbc.co.uk/1/hi/business/4169587.stm).

19 See, for instance, ECA 2004.

20 *Source*: "Special report: spotlight on a continent that supplies two-thirds of the world's sparklers", *Financial Times Africa: Diamonds,* 28 June 2005.

21 South, East and South-East Asia, as well as West Asia and Oceania, were discussed under "Asia and Oceania" in previous *WIR*s. In this year's *Report*, West Asia is discussed in a separate section.

22 Marshall Islands accounted for 73% of FDI inflows to Oceania in 2004, but lower flows to the country in 2005 explain most of the decrease of FDI inflows to Oceania for that year.

23 For example, China has recorded 10% growth rates for three years in a row. The Government of China adjusted its GDP statistics, in particular in services, in December 2005, based on the results of a new economic census. For 2003, 2004 and 2005, growth rates are now estimated at 10%, 10.1% and 9.9% respectively.

24 In 2005, the region accounted for 12% of world GDP, but for 26% of the increase in world GDP.

25 Comprises China, Hong Kong (China), the Democratic People's Republic of Korea, the Republic of Korea, Macao (China), Mongolia and Taiwan Province of China.

26 The growth rate cannot be calculated directly, as the data for 2004 released by MOFCOM do not include FDI in financial industries (see box II.6). The adjusted figure (including FDI in financial industries) for 2004 is $63.8 billion (based on UNCTAD's communications with MOFCOM), which results in a growth rate of FDI inflows to China in 2005 of 13%.

27 Comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

28 Comprises Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.

29 Dan Kingsley, "Substance needed to woo investors", *The Jakarta Post*, 15 June 2006.

30 Based on the number of projects from the Locomonitor database (see endnote 2 in chapter I).

31 In 2005, they accounted for more than 41% of total FDI outflows from developing economies and about 72% of total outflows from South, East and South-East Asia, and Oceania.

32 In early 2006, Temasek (Singapore) purchased an 11.55% stake in Standard Chartered, the London-based bank that focuses on emerging markets, for £2.3 billion ($4.2 billion). Temasek also bought Shin Corp Plc (Thailand) valued at 73.3 billion baht ($1.9 billion).

33 For instance, Shanghai Automotive Industry Corporation Group acquired Ssangyong Motor (Republic of Korea) for $531 million, and Nanjing Automobile Group acquired MG Rover (United Kingdom) for $122 million.

34 The Government of India has not established a proactive policy for outward FDI as the Government of China has done (chapter VI), but leading Indian companies have already invested abroad intensively. Many of these companies are in software and IT-enabled services, in which Indian enterprises have already established strong competitiveness. Large deals undertaken by Indian companies in 2005 can also be found in chemicals and

pharmaceuticals. For example, Tata chemicals acquired Brunner Mond (United Kingdom) with an investment of $112 million; and Kemwell established operations in Uppsala (Sweden) after taking over a plant formerly run by Pfizer (United States).

35 Data from ASEAN Secretariat (2005a).

36 For example, Aramco (Saudi Arabia) is investing in Qingdao, Maoming, Quanzhou and Haikou in China, and Sinopec (China) is cooperating with Saudi and international companies in exploring oilfields in Saudi Arabia, as well as operating in a downstream project. Previously, Japan and the Republic of Korea were the partners in such joint projects, and now China and India have become increasingly attractive.

37 Currently, four Chinese cities are competing to become the third location for Airbus aircraft assembly, in addition to Toulouse and Hamburg.

38 From July 2006, foreign investors from the designated areas, such as offshore financial centres, deriving investment income (including interest, dividends, royalties or capital gains), in the Republic of Korea will be subject to a withholding tax at a regular rate, as stipulated in the domestic law. However, refund may subsequently be made if the investor concerned proves within three years that he or she is entitled to treaty benefits under the relevant double taxation convention. According to the Korean Ministry of Finance and Economy, the change is procedural in nature, rather than an attempt to apply the domestic tax laws without regard to existing bilateral tax treaties to which the country is party.

39 Of the CEOs surveyed 55% were willing to invest the most in China, followed by India (36%) and Brazil (33%).

40 The expected M&As include, for instance, the CITIC-Nations Energy (Canada) deal ($2.2 billion) and the Sinopec-Udmurtneft (Russian Federation) deal ($3 billion).

41 For instance, Boeing (United States) has agreed to invest $100 million in India, Ford is investing $75 million in the country, and IBM has announced that it would invest $6 billion in India in the next three years.

42 According to the monthly survey conducted by JETRO (www/jetro.go.jp).

43 The First Ministerial Meeting of the China-Pacific Island Countries Economic Development & Cooperation Forum was held in Nadi, Fiji on 5-6 April 2006. Ministers of Australia, China, the Cook Islands, Fiji, Micronesia, New Zealand, Niue, Papua New Guinea, Samoa, Tonga and Vanuatu attended.

44 Comprising Bahrain, the Islamic Republic of Iran, Iraq, Jordan, Kuwait, Lebanon, Oman, the Palestinian Territory, Qatar, Saudi Arabia, the Syrian Arab Republic, Turkey, the United Arab Emirates and Yemen.

45 They are the United Arab Emirates, Qatar, Kuwait, Bahrain, Turkey, Saudi Arabia, the Islamic Republic of Iran and Jordan, in that order.

46 In current prices, Qatar's GDP per capita, the highest in the Asia and Oceania region, exceeded that of the United States for the first time in 2005. Qatar was followed by the United Arab Emirates and Kuwait. *Source: IMF's World Economic Outlook Database* as of April 2006 (www.imf.org/external/pubs ft/weo/2006/01/data/index.htm).

47 The top three countries in the region ranked among 155 economies are Saudi Arabia (38th), Kuwait (47th) and Oman (51st), demonstrating relative strength in areas related to taxes, incentives and property registration. Bahrain and Qatar are not included in the ranking. For details, see: www.doingbusiness.org.

48 For example, the ratio of current profits to sales of affiliates of Japanese and United States TNCs operating in West Asia has been increasing since 2002. For Japanese affiliates, the ratio was nearly 10% in 2003 (5.4 percentage points higher than in 2001) compared with 5% in all developing countries and 2% in all developed countries. Similarly for United States affiliates, the ratio in West Asia was 16% in 2003 (9 percentage points higher than in 2001), compared with 14% in all developing regions and 9% in all developed regions (data from UNCTAD, FDI/TNC database (www.unctad.org/fdistatsitics)).

49 For instance, FDI inflows into Saudi Arabia's primary sector in 2005 were negligible (0.17% of total flows).

50 Based on data reported by the Central Bank of the Republic of Turkey.

51 According to the data reported by the Saudi Arabian General Investment Authority (SAGIA), March 2006. A single transaction of $2 billion by Sumitomo Corporation (Japan) to establish the $9.8-billion joint venture Rabigh Refining and Petrochemical Company with the State-run Saudi Aramco in this country was the main reason for this surge.

52 These projects include liquefied natural gas and petrochemical plants involving United States firms like ExxonMobil and Chevron Phillips Chemical.

53 For example, TNCs that invested in the Qatar Science and Technology Park (QSTP), established in 2005, include Royal Dutch/Shell Group (which is planning an expenditure of up to $100 million over a 10-year period) and Gartner Lee, a Canada-based environmental services firm (for the development and application of environmental and waste-management technologies) (see policy developments in section below). The QSTP is located in Doha's Education City, run on a non-profit basis by the Qatar Foundation. The Foundation was created in 1995 to enhance Qatar's educational, scientific and social infrastructure. *Source*: Qatar Science and Technology Park (www.qstp.org.qa).

54 For instance, some mega M&A deals have taken place in Turkey between Saudi Oger (Saudi Arabia) and Türk Telekom, while the Russian Alfa Group purchased Türkcell shares.

55 Based on UNCTAD's database on national laws and regulations.

56 Foreign ownership of a listed company is limited to 25% of issued share.

57 In addition to the 36 provinces with a per capita income of less than $1,500, 13 provinces were earmarked to benefit from the incentives scheme. *Source*: Turkey, the General Directorate of Foreign Investments (2006).

58 The minimum tax rate for firms with a minimum of 10% foreign participation has been lowered from 25% to 15%, effective from January 2006, while for Turkish firms, the corporate income tax has been lowered from 30% to 20% (Corporate Income Tax Law No. 5520).

59 Legislation is expected to be passed by mid-2007, enabling Project Kuwait, a $7 billion plan to encourage foreign investment and development of oilfields in northern Kuwait, to start in the first half of 2008 (EIU 2006b). There is no corporate tax for Kuwaiti nationals.

[60] In the Barcelona Declaration (1995), the Euro-Mediterranean Partners agreed to the establishment of a Euro-Mediterranean Free Trade Area by the target date of 2010. This is to be achieved by means of Euro-Mediterranean association agreements negotiated and concluded between the EU and the Mediterranean Partners, together with free trade agreements among the partners themselves. In 1995, Turkey signed an association agreement establishing the final phase of a customs union with the EU. *Source*: EU (europa.eu.int/comm/external_relations/euromed/free_trade_area.htm).

[61] The GCC, where four million Indian expatriate workers reside, is India's second largest trading partner. *Source* www.gulfnews.com/business/Trade/10028411.html.

[62] While Saudi Arabia, which is chairing the GCC, expressed its willingness as an individual State to revitalize discussions on how to further promote mutual investments, and indicated its readiness to resume negotiations on bilateral agreements for the protection and promotion of investment, investment issues at the GCC level were not covered in the joint statement in April 2006. *Source*: "Joint Statement - Towards the building of strategic and multi-layered partnership between Japan and the Kingdom of Saudi Arabia" (www.mofa.go.jp/region/middle_e/saudi/joint0604.html).

[63] Saudi Arabia began the progressive implementation of liberalization measures in the banking and insurance industries even before its accession to the WTO in 2005 (box II.14). It started in the late 1990s when the market was opened up to foreign banks only from the GCC, followed by the entry of non-GCC banks in 2003. The opening up of the insurance industry to foreign investors is more recent, in April 2005, in preparation for accession to the WTO. As of March 2006, 13 foreign insurance firms (e.g. from Bahrain, France, Germany, India, Japan, Jordan, Lebanon, the Netherlands, Switzerland, the United Kingdom and the United States) had been licensed to operate in the country. *Source*: WTO (www.wto.org/english/news_e/pres05_e/pr420_e.htm), Saudi Arabian Monetary Agency (SAMA, www.sama.gov.sa), Samba (2006) and SAGIA (www.sagia.gov.sa).

[64] Examples include Saudi Aramco, which, in 2006, signed deals with Total (France) and ConocoPhillips (United States) for two new refineries costing $6 billion.

[65] In 2006, Vodafone (United Kingdom) completed an acquisition of Turkey's second largest mobile operator, Telsim Mobil for $4.55 billion.

[66] *Source*: Ministry of Commerce (MOFCOM), China (ch2.mofcom.gov.cn/aarticle/chinanews/200603/20060301684361.html).

[67] According to ECLAC, "in the past, when GDP was growing at a good pace, the current account was deteriorating, and when the current account was improving based on positive trade balances, this was because imports were contracting owing to slack domestic demand." (ECLAC 2004a)

[68] The trade balance of Latin America and the Caribbean has shifted since 2002 from negative to positive and growing values amounting to $18 billion in 2004 (data from the UNCTAD secretariat on the base of *IMF Balance of Payment database*).

[69] Only those countries were covered for which data on reinvested earnings were available for 2005. In South America these countries are: Argentina, Bolivia, Chile, Colombia, Peru and Venezuela. They attracted 60% of total FDI inflows to South America in 2005. Brazil is not considered because its central bank does not report data on reinvested earnings. However, the strong increase in inward FDI in this country suggests that reinvested earnings might also have reached high levels.

[70] The decline in the value of cross-border M&As in Brazil and Mexico in 2005 is due to the exceptional amounts reached the previous year in both countries where two mega deals took place respectively: the Belgian beer company, Interbrew, paid $4 billion for the acquisition of Brazilan Ambev, and the Spanish Bank, BBVA, paid $3.9 billion to increase its ownership in its Mexican affiliate Grupo Financiero BBVA Bancomer from 59.4% to 99.7% (see *WIR05*).

[71] "The Real under fire", *Business Latin America*, 21 November 2005 (London: EIU), and *Business Latin America*, 30 January 2006 (London: EIU).

[72] The most important deal was the $4.7 billion purchase of the Bavarian beer company by SABMiller. Another significant deal was BBVA's (Spain) acquisition of a 98.78% stake in the country's top mortgage lender Granahorrar, via a privatization auction, for $424 million. Other deals included: the $292 million purchase of tobacco producer Coltabaco by Philip Morris International (United States); the $110 million purchase by Glencore (Switzerland) of La Jagua de Ibirico in the coal industry; the $69 million controlling stake purchased by Grupo Gerdau (Brazil) in the steel mills Diaco and Sidelpa; the purchase of the printing company Editora Cinco by Televisa (Mexico) for $40 million; and Copa Airlines' (Panama) acquisition for $30 million of a controlling interest in Aerorepública, Colombia's second-largest airline.

[73] Latin American countries have been increasingly investing in Argentina in recent years. In 2005, they were the source of 40% of the 23 cross-border M&A deals in that country, with the second highest deal completed by the Brazilian cement company Camargo Correa that purchased Loma Negra for $1 billion (UNCTAD cross-border M&A database). Moreover, the share of Latin American countries in inward FDI stock in Argentina increased from 14.3% in 2002, to 18.7% in 2004 (*Instituto Nacional de Estadísticas y Censos* (INDEC) (www.mecon.gov.ar/cuentas/internacionales).

[74] Grupo Carso acquired – through its affiliates Telmex and América Móvil – telecommunication assets in Brazil, Chile, Paraguay and Peru for more than $2.5 billion. Cemex took over RMC Group (Untied Kingdom) – one of Europe's largest cement producers and one of the world's largest ready-mixed concrete and aggregate suppliers – for $4.2 billion. This deal is excluded from table II.11 because RMC was acquired by Cemex's affiliate in the United Kingdom, and the table only takes into account the cross-border deals in which the immediate acquirer or the immediate target is in Latin America.

[75] Santo Domingo Group sold its affiliate Bavaria to SABMiller, which in turn gave a part of its share (15.1%) to Santo Domingo Group. In table II.11, only the acquisition of Bavaria by SABMiller is included.

[76] "Bolivian President seizes gas industry", *Washington Post*, 2 May 2006.

[77] "Bolivia turns to Venezuela for gas help", *Yahoo News,* 22 May 2006 (news.yahoo.com).

[78] Information from Central Bank of Venezuela (www.bcv.org.ve).

[79] Such as Chevron (United States), BP (United Kingdom), Royal/Dutch Shell (United Kingdom/Netherlands), Repsol YPF (Spain) and Petrobrás (Brazil).

[80] Exxon Mobil sold its stake in a Venezuelan field to its partner, Repsol YPF. See"New Year's seizures", *Business Latin America*, 16 January 2006 (London, EIU), and *BBC News*, 3 April 2006, news.bbc.co.uk, and ECLAC 2006a.

[81] *Central Bank of Ecuador* (www.bce.fin.ec).

[82] Since 1990, natural gas reserves have fallen from 30 years to 13.5 years of consumption, while crude oil reserves dwindled from 13 to 10.5 years. Private firms are reported to have exploited the reserves discovered by the previous state-owned firm with minimum spending on exploration ("En los últimos 10 años, salvo alguna honrosa excepción, no se han incorporado reservas por descubrimiento", *El Inversor Energético*, 2005, año 1, número cuatro, noviembre, and "The government is offering tax incentives to companies that commit to oil and natural-gas projects", *Business Latin America*, 30 May 2005 (London: EIU)).

[83] Repsol's *press release*, 12 January 2006 (www.repsolypf.com).

[84] This amount does not include investments in exploration and in routine maintenance (Chilean Copper Commission (Cochilco) (www.cochilco.cl).

[85] Ministries of Mining of Peru and Argentina, respectively.

[86] For instance, violent protests in Peru forced BHP Billiton Tintaya, the country's third-largest copper producer, to suspend operations for one month, and Newmont mining to suspend its gold exploration in Yanacanchilla. In Argentina, two provinces followed the example of the province of Chubut, where a law adopted in 2003 prohibited cyanide in open-pit mining (Torres 2005) and limited certain types of mining projects following public protests. ("Argentina's gold rush", *Business Latin America*, 13 March 2006 (London: EIU)).

[87] Instituto Nacional de Estadística, Geografía e Informática (INEGI) of Mexico (www.inegi.gob.mx).

[88] For example, six Chinese firms set up facilities in Tijuana during the second half of 2005 and many others have expressed their interest in establishing such facilities, with a view to targeting the United States and Latin American markets, as reported by the Consejo Nacional de la Industria Maquiladora de Exportación (Cnime). *La Nación*, 20 April 2006.

[89] See, for example, "Investors still bet on Mexico", *Business Latin America*, 5 September 2005 (London: EIU); "Maquiladoras get fitter", *Business Latin America*, 27 March 2006 (London: EIU); "Mexico-US railways: investors aboard", *Business Latin America*, 26 December 2005 (London: EIU); "Automotive - Mexico", *Business Latin America*, 6 February 2006 (London: EIU) and (ECLAC 2006a).

[90] Data from Central Bank of Brazil (www.bcb.gov.br).

[91] The joint venture was between the Chinese government-owned Baosteel and the Brazilian mining giant Companhia Vale de Rio Doce (CVRD), *Business Latin America*, 21 November 2005 (London: EIU).

[92] Peugeot Citroën will stop importing gear boxes from France and produce them in Córdoba, in partnership with Fiat (Italy), to fit various models of passenger cars and invest $125 million in manufacturing new export models; DaimlerChrysler will spend some $50 million on the production of a Mercedes Benz utility vehicle, to be sold exclusively in non-Latin American markets; and Renault will invest $30 million in 2006. (ECLAC 2006a, and Adefa (www.adefa.com.ar), and *Business Latin America*, 22 May 2006 (London: EIU).

[93] See ECLAC 2006a and "Uruguay: A sticky predicament", *Business Latin America*, 22 May 2006 (London: EIU).

[94] Farmacias Ahumada (Chile) acquired full ownership of Mexico's 30-unit Farmacias Fénix drugstore chain; Elektra (Mexico) is spending $400 million to open 60 stores in Mexico and Central America in 2005-2006; and Falabella (Chile) has opened a new store in Lima, Peru and is planning further expansions in that country as well as in Argentina, Colombia, Ecuador and Venezuela. (See ECLAC 2006a for more details on the regional expansion of Chilean retail businesses).

[95] After Telefónica Móviles acquisition in 2005 of the entire Latin American and Caribbean assets of Bellsouth (United States) *(WIR05)*, Telmex expanded significantly in Brazil, while América Móvil purchased mobile companies from foreign operators in Chile, Peru and Paraguay. Moreover, in early 2006, Telmex and América Móvil announced the acquisition of the US Verizon's assets in the Dominican Republic, Puerto Rico and Venezuela.

[96] The sale of Telecom Italia's Peruvian unit to América Móvil was its second divestiture in South America in 2005, after it sold control of its Chilean unit to a local company (Almendral SA). It also announced in May 2006 the sale of its Venezuelan mobile phone unit, to the Venezuelan start-up telecom group Telvenco SA. (*Computer Business review Online*, 16 August 2005 (www.cbronline.com) and marketwatch.com, 26 May 2006 (www.marketwatch.com)).

[97] See "Uruguay: Vázquez's investor nod", *Business Latin America*, 18 April 2005, (London:EIU); and "Kirshner le rescindió el contrato a Aguas Argentinas", *La Nación*, 22 March 2006, Buenos Iares; and *Business Latin America*, 25 July 2005, (London:EIU).

[98] These instruments include, among others, intervention in the foreign-exchange market to maintain national currency at a competitive level, export taxes to increase the State's revenues and to halt price rises on the domestic market, control of inflation through the freezing of public utility prices and negotiation of price agreements between the Government and leading producers and retailers.

[99] "Venezuela: Chavéz cashes in", *Business Latin America*, 8 August 2005, (London:EIU), and *Business Latin America*, 19 September 2005 (London:EIU).

[100] Although it is the fourth deprivatization by the Argentinean Government since the end of 2003, this move was not considered as representing an overall policy towards re-nationalization, but rather an attempt to regain control over deteriorating public services. (Inter Press Service News Agency, 10 May 2006 (www.ipsnews.net)). Previous moves towards the restoration of State control occurred in the postal services (operated by a national company) in 2003, the airwaves used by mobile phone operators and radio and TV stations (operated by the French Thales Spectrum) in 2004, and a passenger train line (run by the Argentine-

owned Taselli Group) in 2004.

101 *Business Latin America*, 7 February 2005 (London: EIU).

102 The companies that discontinued the claim are: Pioneer Natural Resources (United States) in hydrocarbon and electricity and France Telecom SA in telecommunications. The companies that suspended the claim are: 1)AES Corporation (United States) in electricity generation and distribution; 2) Camuzzi International (Italy) in electricity distribution and transport; 3) Gas Natural SDG (Spain) in gas supply and distribution; 4) Aguas Cordobesas (Spain), Suez (France), and Sociedad General de Aguas de Barcelona (Spain) (all together in the same case) in water services; 5) Enersis (Spain)in electricity distribution; 6) Electricidad Argentina (Argentina/France) and EDF International (France) (together in the same case) in electricity distribution; 7) SAUR International (France) in water and sewer services (www.worldbank.org/icsid).

103 *Clarín*, 16 February 2006 (Buenos Aires).

104 In October 2005, Volkswagen (Germany) received $300 million, Ford Motor (United States) $250 million, General Motors (United States) $200 million and Fiat (Italy) $100 million. An additional $250 million loan was accorded to Volkswagen in April 2006. (*BNDES* News, 31 October 2005 and 18 April 2006, www.bndes.gov.br.)

105 Accordingly, in July 2005 the Government announced a three-year plan to foster the integration of foreign automobile producers with the national auto parts industry. This consists of tax rebate for any automobile and truck terminals that buy parts that have 70% or more of national content in the production of motors, gears and axles as well as for the installation of new platforms. The rebate is 8% of the value of the parts purchased during the first year, 7% the second and 6% the third year (Decree 774/2005).

106 *Business Latin America*, 6 March 2006 (London: EIU), and *Business Latin America*, 13 March 2006 (London: EIU).

107 FDI inflows declined in the major host countries; for instance, they fell by 12% in Brazil during the first five months of 2006 compared to the same months of 2005. They dropped by 39% in Mexico and 37% in Argentina in the first quarter, while in Venezuela they registered a negative value. FDI to Colombia is also expected to drop from the exceptionally high level reached in 2005, as M&As by foreign investors are likely to decline. In contrast, FDI inflows into Chile increased by 150% during the first four months of 2006.

108 Data are from OCO Consulting's LOCOmonitor database (www.locomonitor.com). See note to annex table A.I.1 for its coverage.

109 See "Followers of fashion", *Business Europe*, 16-28 February 2005, p. 8.

110 The developed country category now includes, among others, eight countries formerly classified under the Central and Eastern European countries, and Cyprus, formerly classified as a developing country in West Asia, all of which became new EU member States on 1 May 2004. For a detailed explanation of recent changes in geographical groupings, see *WIR05*, box I.2, p. 6.

111 For example, the average value of cross-border M&As in Canada in 2005 was $94 million, compared with $68 million in 2004 (annex tables B.4 and B.6).

112 The rate of return on inward FDI in the United States (as measured by FDI income divided by the average of the beginning- and end-of-year of FDI stock) has been on the rise since 2001: 6% in 2004 (most recent year for which data are available), which was the highest ever since 1997 (data from the United States Department of Commerce, *Survey of Current Business*, various issues).

113 According to cross-border M&A data (FDI data for 2005 are not available), M&As from non-EU countries into the EU-25 doubled, to $142 billion in 2005, while those from EU countries nearly tripled, to $287 billion (data from UNCTAD cross-border M&A database).

114 This deal is a nominal financial rearrangement and has little economic significance.

115 These include, for instance, acquisition of Elsam by Vattenfall (Sweden) for $1.5 billion and Chr. Hansen-Food Ingredient by PAI Partners (France) for $1.4 billion (annex table A.I.7). A group of foreign private equity investors (Apax, Blackstone, KKR, Providence) also acquired the Danish telephone company TDC for a publicly reported value of $13 billion in 2005 (paid in 2006) – the largest cross-border takeover by private equity funds so far (table I.7).

116 In 2005, inflows of intra-company loans amounting to $12 billion were recorded for Germany, while FDI in the form of equity capital dropped by 50% to $13 billion. For an explanation of the negative FDI inflows to Germany in 2004, see *WIR05*, p. 85.

117 Data on trans-shipped FDI were made available for the first time to UNCTAD. They show that trans-shipped FDI (mostly FDI in SPEs) account for 95% of total FDI flows (box I.2). If FDI in SPEs were to be included, in 2002 Luxembourg was the world's largest recipient of FDI inflows (*WIR03*, p. 69). TNCs invest in such entities to take advantage of Luxembourg's favourable tax and financial environment, but they hardly spend there, unlike in other developed countries where FDI in SPEs is relatively large.

118 With only 4% of city planning zones being open to them, instead of 80% as was formerly proposed.

119 These are defined as cases in which the board officially rejected an offer, but the acquirer persisted in its takeover efforts, a definition used by Thomson Financial.

120 The reincorporation resulted in a debt entry in FDI outflows and caused both debit and credit entries in FDI inflows. Conceptually, there is no overall impact on the balance of FDI flow account. The FDI position (stock) was also treated in a similar manner.

121 The World Federation of Exchanges (2006, p. 73) recorded rising stock market prices in 51 of 56 major stock exchanges worldwide in 2005. In many countries stock prices jumped with higher, double-digit rates of increase.

122 Data on greenfield FDI are based on Loco Consulting's Locomonitor database (www.locomonitor.com).

123 This phenomenon has been observed since a long time. See Lipsey (2001).

124 Data from UNCTAD FDI/TNC database (www.unctad.org/fdistatistics).

125 Examples include acquisitions such as those of O_2 of the United Kingdom for $31 billion (concluded in 2006) and Cesky Telecom (Czech Republic) for $1.1 billion by Telefónica, that of Gecina (France) by Metrovacesa

for $6.9 billion, a 20% stake in Sovereign (United States) billion by Santander for $2.4, and the British Airport Authority by Grupo Ferrovial for $19 billion.

126 "Corporate conquistadors", *The Economist*, 18 February 2006, pp. 57-58.

127 "British economy grows used to encounters with the Spanish acquisition", *The Financial Times*, 14 February 2006.

128 Data from UNCTAD, cross-border M&A database.

129 After the Directive had been amended by the European Parliament, it was adopted by the EU Council at the end of May 2006 and sent back to the EU Parliament for a second reading. It is expected to be finally adopted under the Finish EU Presidency.

130 On 16 May 2006, the EU Commission decided not to postpone the admission of Bulgaria and Romania.

131 The survey, conducted in July-September 2005, covered 590 manufacturing TNCs.

132 However, this is 2 percentage points lower than in the 2004 survey.

133 The survey was conducted in September-October 2005 and covered 160 major manufacturing TNCs, 122 of which replied. *Nihon Keizai Shimbun*, 22 October 2005. Two thirds (64%) of those firms also plan to increase their domestic production.