UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

WORLD INVESTMENT REPORT

2007

Transnational Corporations, Extractive Industries and Development

UNITED NATIONS
New York and Geneva, 2007

NOTE

As the focal point in the United Nations system for investment and technology, and building on 30 years of experience in these areas, UNCTAD, through DITE, promotes understanding of key issues, particularly matters related to foreign direct investment and transfer of technology. DITE also assists developing countries in attracting and benefiting from FDI and in building their productive capacities and international competitiveness. The emphasis is on an integrated policy approach to investment, technological capacity building and enterprise development.

The terms country/economy as used in this Report also refer, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage of development reached by a particular country or area in the development process. The major country groupings used in this Report follow the classification of the United Nations Statistical Office. These are:

Developed countries: the countries members of the OECD (other than Mexico, the Republic of Korea and Turkey), plus the new European Union member countries which are not OECD members (Cyprus, Estonia, Latvia, Lithuania, Malta and Slovenia), plus Andorra, Israel, Liechtenstein, Monaco and San Marino.

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

Developing economies: in general all economies not specified above.

The reference to a company and its activities should not be construed as an endorsement by UNCTAD of the company or its activities.

The boundaries and names shown and designations used on the maps presented in this publication do not imply official endorsement or acceptance by the United Nations.

The following symbols have been used in the tables:

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

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

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

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

Use of a hyphen (-) between dates representing years, e.g., 1994-1995, signifies the full period involved, including the beginning and end years;

Reference to "dollars" ($) means United States dollars, unless otherwise indicated;

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

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

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

UNITED NATIONS PUBLICATION
Sales No. E.07.II.D.9
ISBN 978-92-1-112718-8

Printed in Switzerland

PREFACE

Foreign direct investment represents the largest share of external capital flows to developing countries. Just as transnational corporations can bring with them new technology, management know-how and improved market access, foreign direct investment can be a significant force for development. In 2006, developing countries attracted $380 billion in foreign direct investment — more than ever before. While two thirds of these flows went to rapidly growing markets in Asia, virtually all developing regions participated in the increase. Investments rose particularly fast in many countries that are richly endowed with natural resources.

As highlighted in this year's *World Investment Report*, recent years have seen a revival of foreign direct investment in extractive industries, reflecting higher commodity prices. This commodity boom, partly fuelled by rising Asian demand for various natural resources, should open a window of opportunity for mineral-rich countries to accelerate their development. This is especially important as we reach the midpoint in our efforts to reach the Millennium Development Goals.

The *World Investment Report 2007* focuses on the role of transnational corporations in extractive industries, and documents their presence in many of the world's poorest economies. Transnational corporations can bring in the finance and management skills these economies need to transform their resources into products that can be used locally or exported. The rise of new transnational corporations from the South, not least Asia, has given mineral-rich countries a wider spectrum of potential sources of investment.

But as we know, the extraction of natural resources involves considerable economic, environmental and social challenges. The objective is to ensure it is done in the most efficient and environmentally friendly manner possible, while at the same time contributing to poverty alleviation and accelerated development. For that, we need institutional and regulatory frameworks promoted by accountable Governments, as well as responsible investors. All relevant stakeholders need to join forces in a concerted effort. This year's *World Investment Report* offers useful insights to that end.

Ban Ki-moon
Secretary-General of the United Nations

New York, July 2007

ACKNOWLEDGEMENTS

The *World Investment Report 2007* (*WIR07*) was prepared by a team led by Anne Miroux, comprising Torbjörn Fredriksson, Masataka Fujita, Kálmán Kalotay, Devianee Keetharuth, Dong Jae Lee, Guoyong Liang, Padma Mallampally, Nicole Moussa, Abraham Negash, Hilary Nwokeabia, Jean François Outreville, Thomas Pollan and Astrit Sulstarova. Kumi Endo, Justin Fisher, Joachim Karl, Hafiz Mirza, Shin Ohinata, Olle Östensson, Joerg Weber and James Zhan also contributed to the Report.

Principal research assistance was provided by Mohamed Chiraz Baly, Bradley Boicourt, Jovan Licina, Lizanne Martinez and Tadelle Taye. Dana Al-Sheikh, Darya Gerasimenko, Niels Heystek and Saveis Joze Sadeghian assisted as interns at various stages. The production of the *WIR07* was carried out by Rosalina Goyena, Chantal Rakotondrainibe and Katia Vieu. *WIR07* was desktop published by Teresita Ventura. It was edited by Praveen Bhalla.

John H. Dunning was the senior economic adviser.

WIR07 benefited from inputs provided by participants in a Global Seminar in Geneva in May 2007, and three regional seminars on TNCs in extractive industries held in March and April 2007: one in Santiago, Chile (in cooperation with the Economic Commission for Latin America and the Caribbean), the second in Hanoi, Viet Nam (in cooperation with the ASEAN Secretariat), and the third in Randburg, South Africa (in cooperation with Mintek, South Africa's national mineral research organisation).

Inputs were also received from Bekele Amare, Glenn Banks, Damian Brett, Peter Buckley, Humberto Campodónico, Frederick Cawood, Ken Chew, Mélanie Clerc, Kim Eling, Hamed El-Kady, Florence Engel, Magnus Ericsson, Keith Jefferis, Thomas Jost, Paul Jourdan, Abba Kolo, Romy Kraemer, Josaphat Kweka, Bryan Land, Michael Likosky, Kari Liuhto, Shervin Majlessi, Yusuf Mansur, Jonas Moberg, Peter Muchlinski, Silane Mwenechanya, Yinka Omorogbe, Antonio M.A. Pedro, Nehru Pillay, Melissa Powell, Marian Radetzki, Huaichuan Rui, Jenny Rydeman, Pedro Sainz, Osvaldo Urzúa, Aimable Uwizeye-Mapendano, Peeter Vahtra, Eveline van Mil, Rob van Tulder, Peter Zashev and Zbignew Zimny.

Comments and suggestions were received during various stages of preparation from Murat Alici, Rory Allan, Luis Alvarez, Erman Aminullah, Isabelle Anelli, Toutam Antipas, Benjamin N.A. Aryee, Yoseph Asmelash, Neal Baartjes, Doug Bannerman, Diana Barrowclough, Klaus Brendow, Perla Buenrostro, Bonnie Campbell, Eduardo Chaparro, Charlie Charuvastr, Allen Clark, Jeremy Clegg, John Cole-Baker, Herman Cornielson, Graham A. Davis, Persa Economou, Rod Eggert, Erwiza Erman, Petrus Fusi, Stephen Gelb, Richard Goode, John Groom, Martin Hahn, Ben Hammouda Hakim, Fabrice Hatem, Andrew Hayman, Susan Hayter, Katsuyuki Higae, David Humphreys, Gábor Hunya, Grazia Ietto-Gillies, Rajeev Jain, Roberto Kozulj, Steve Lenahan, Deirdre Lewis, Michael Lim, Paul Mitchell, Rekha Misra, Jesús Mora Contreras, Juan Carlos Moreno-Brid, Michael Mortimore, Hudson Mthega, Sodhie Naicker, Boyko Nitzov, Gerald Pachoud, Pavida Pananond, Lorraine Ruffing, Zavareh Rustomjee, A. Edward Safarian, Fernando Sánchez Albavera, John E. Tilton, Peter Utting, Kee Hwee Wee, Susanna Wolf, Changqi Wu and Frida Youssef.

Numerous officials of central banks, statistical offices, investment promotion and other government agencies, and officials of international organizations and non-governmental organizations, as well as executives of a number of companies, also contributed to *WIR07*, especially through the provision of data and other information. The Report also benefited from collaboration with Erasmus University, Rotterdam on the collection of data on, and analysis of, the largest TNCs.

The financial support of the Governments of France, Norway, Poland, the Republic of Korea, Sweden and the United Kingdom is gratefully acknowledged.

TABLE OF CONTENTS

Page

PART TWO

TRANSNATIONAL CORPORATIONS, EXTRACTIVE INDUSTRIES AND DEVELOPMENT

Page

Boxes

Box figures

Box tables

Page

Figures

Page

Tables

Page

Annex A

Annex B

ABBREVIATIONS

AGOA	African Growth and Opportunity Act
ASEAN	Association of Southeast Asian Nations
bbd	billion barrels per day
BIT	bilateral investment treaty
CIS	Commonwealth of Independent States
DTT	double taxation treaty
DR-CAFTA	Dominican Republic-Central American Free Trade Agreement (with the United States)
ECA	United Nations Economic Commission for Africa
ECB	European Central Bank
ECLAC	United Nations Economic Commission for Latin America and the Caribbean
ECT	Energy Charter Treaty
EITI	Extractive Industries Transparency Initiative
EIU	Economist Intelligence Unit
FDI	foreign direct investment
FTA	free trade agreement
GCC	Gulf Cooperation Council
GDP	gross domestic product
GFCF	gross fixed capital formation
GSI	Geographical Spread Index
ICEM	International Federation of Chemical, Energy, Mine and General Workers' Unions
ICMM	International Council on Mining and Metals
ICSID	International Centre for Settlement of Investment Disputes
ICT	information and communication technology
IEA	International Energy Agency
II	Internationalization Index
IIA	international investment agreement
ILO	International Labour Organization
IMF	International Monetary Fund
IPA	investment promotion agency
IPO	initial public offering
IT	information technology
KPCS	Kimberley Process Certification Scheme
LDC	least developed country
LNG	liquefied natural gas
M&A	merger and acquisition
mbd	million barrels per day
MFA	Multi Fibre Arrangement
NAFTA	North American Free Trade Agreement
NGO	non-governmental organization
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PGM	platinum group metal
PSA	production-sharing agreement
R&D	research and development
SEE	South-East Europe
SME	small and medium-sized enterprise
SOE	State-owned enterprise
TNC	transnational corporation
TNI	Transnationality Index
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations (1974-1992)
UNDP	United Nations Development Programme
WAIPA	World Association of Investment Promotion Agencies
WTO	World Trade Organization

OVERVIEW

WIDESPREAD GROWTH IN FDI

Global FDI flows approach their 2000 peak level …

Global FDI inflows soared in 2006 to reach $1,306 billion – a growth of 38%. This marked the third consecutive year of growth, and approached the record level of $1,411 billion reached in 2000. It reflected strong economic performance in many parts of the world. Inflows increased in all three groups of economies: developed countries, developing countries and the transition economies of South-East Europe and the Commonwealth of Independent States (CIS).

The rise in global FDI flows was partly driven by increasing corporate profits worldwide and resulting higher stock prices that raised the value of cross-border mergers and acquisitions (M&As). M&As continued to account for a high share of FDI flows, but greenfield investment also increased, especially in developing and transition economies. As a result of higher corporate profits, reinvested earnings have become an important component of inward FDI: they accounted for an estimated 30% of total inflows worldwide in 2006 and for almost 50% in developing countries alone.

While FDI inflows in developed countries rose by 45% – well over the rate of the previous two years – to reach $857 billion, flows to developing countries and the transition economies attained their highest levels ever: $379 billion (a 21% increase over those in 2005) and $69 billion (a 68% increase) respectively. The United States regained its position as the leading host country, followed by the United Kingdom and France. The largest inflows among developing economies went to China, Hong Kong (China) and Singapore, and among the transition economies to the Russian Federation.

Developed-country TNCs remained the leading sources of FDI, accounting for 84% of global outflows. While there was a rebound of FDI from the United States, almost half of world outflows originated from European Union (EU) countries, notably France, Spain and the United Kingdom in that order. TNCs from developing and transition economies continued their international expansion in 2006, led by Hong Kong (China) in the former group of economies and the Russian Federation in the latter. Total FDI outflows from these groups of economies reached $193 billion, or 16% of world FDI outflows.

... driven by cross-border M&As with the increasing involvement of private equity funds …

Increased cross-border M&A activity supports the current rise in global FDI. Such transactions rose significantly in 2006, both in value (by 23%, to reach $880 billion) and in number (by 14% to 6,974), approaching the previous M&A peak in 2000. This growth was driven by higher stock market valuations, rising corporate profits and favourable financing conditions. In contrast with the M&A boom of the late 1990s, this time transactions have been predominantly financed by cash and debt, rather than through an exchange of shares. As many as 172 mega deals (i.e. deals worth over $1 billion) were recorded in 2006, accounting for about two thirds of the total value of cross-border M&As.

These transactions were widely spread across regions and sectors. In North America, due to several deals in the mining industry, cross-border M&As almost doubled. In Europe, the United Kingdom was the main target country, while Spanish companies were very active as acquirers. Cross-border acquisitions by Spanish companies (e.g. Teléfonica and Ferrovial) were valued at $78 billion, a record level for that country. Companies from developing and transition economies have also been increasingly engaged in such transactions, the largest in 2006 being the $17 billion acquisition of Inco (Canada) by CVRD of Brazil.

Another noticeable trend in global M&A activity has been the growing importance of private equity funds and other collective investment funds. In 2006, they were involved in cross-border M&As valued at $158 billion, an 18% increase over 2005. A growing appetite for higher yields and ample liquidity in world financial markets helped fuel these acquisitions. Private equity firms are increasingly acquiring large listed companies, in contrast to their former strategy of investing in high-yield, high-risk assets, and they are likely to continue to play a prominent role in M&A transactions. However, this scale of activity may not be sustainable due to a number of factors: competition is intensifying and the asset prices involved in recent acquisitions have increased substantially; there is also a possibility that the favourable fiscal treatment such firms enjoy in some countries may not last. Investments by private equity firms are often more akin to portfolio investment than to FDI, in that they tend to have relatively short time horizons. This has raised some concerns regarding the impact of such investments, in particular as regards the dismantling of the acquired companies and worker layoffs. As cross-border M&As by private equity firms are a relatively recent phenomenon, more research is needed to better understand their impact.

… and resulting in further growth of international production.

The production of goods and services by TNCs outside their home countries grew more rapidly in 2006 than in the previous year. The sales, value added and exports of some 78,000 TNCs and their 780,000 foreign affiliates are estimated to have increased by 18%, 16% and 12% respectively. They accounted for the equivalent of 10% of world GDP and one third of world exports. China continued to host the largest number of foreign affiliates in the world, while the growth rate of the number of TNCs from developing countries and transition economies over the past 15 years has exceeded that of TNCs from developed countries.

Employment in foreign affiliates of TNCs has increased nearly threefold since 1990, although at a slower pace than FDI stock. Foreign affiliates in China had the largest number of employees: 24 million as estimated by the country's Ministry of Commerce. Between 2001 and 2004, employment in foreign affiliates in the United States shrank to 5.1 million, representing a reduction of half a million. In comparison, reflecting the fact that United States firms are by far the largest direct investors abroad, their foreign affiliates created the largest number of jobs (9 million) among foreign-affiliates of all home countries**.** The employment impact of FDI in host economies varied by region, but for a given amount of inward FDI more jobs were created in developing and transition economies than in developed countries.

As in previous years, services accounted for the bulk of world inward FDI stock in 2005 – nearly two thirds – compared with 49% in 1990. Within services, the share of infrastructure-related industries rose in both absolute and relative terms. Manufacturing was the second largest sector, but its share declined from 41% in 1990 to 30% in 2005, while the share of the primary sector was less than 10% of world inward FDI stock. The share of extractive industries in total FDI increased somewhat between 2000 and 2005, having been on the decline since the Second World War. This rebound was fuelled by new investments in mineral exploration and extraction, as well as by a number of large cross-border M&As (see Part Two).

TNCs from emerging economies continue to expand overseas.

While the universe of TNCs is dominated by developed-country firms, the picture is changing. The number of firms from developing economies in the list of the world's 100 largest non-financial TNCs increased from five in 2004 to seven in 2005 (the most recent year for which data are available), in line with the rise of TNCs from the South. Rankings in the list of the world's top 100 TNCs have remained relatively stable, with General Electric, Vodafone and General Motors having the largest foreign assets. Although the foreign assets of the top 100 TNCs have remained virtually unchanged since 2004, their foreign sales and employment increased by about 10%.

Large TNCs from emerging economies are internationalizing particularly fast. In 2005, the foreign sales and foreign employment of the top 100 TNCs from developing economies increased by 48% and 73% respectively. However, these TNCs are still significantly less transnational in their reach than the world's top 100, with a presence in fewer countries abroad.

Asia dominates the list of the 100 largest developing-country TNCs, with 78 firms, followed by 11 each from Africa and Latin America. These TNCs operate in a broader range of industries than the largest TNCs from developed countries. As in previous years, the single most important industry in 2005 was electrical/electronic equipment, especially for a large number of companies from Asia.

The geographical pattern of FDI is changing, with greater South-South FDI flows.

The geographical pattern of FDI is showing signs of change, with new countries emerging as significant host and home economies. The rise of FDI from developing and transition economies and the growth of South-South FDI are important recent trends. Changes are taking place in the pattern of bilateral flows of FDI as well. In 2005, the largest bilateral outward FDI stock was that of the United Kingdom in the United States – at $282 billion; 20 years earlier, it was the reverse. Whereas bilateral links between selected economies, such as those between the United States on the one hand and Canada, the Netherlands and the United Kingdom on the other, dominated the global picture of bilateral FDI relationships in 1985, today, the situation is considerably more multifaceted, reflecting the involvement of many more countries in international production.

With strengthening relationships between countries within the same region, and the emergence of many developing countries as sizeable investor economies, geographical proximity is becoming increasingly important in bilateral FDI relations. For example, in the top 50 pairs of countries with the largest bilateral inward stock, 22 were from Europe in 2005, compared to 17 in 1995. FDI relationships between two economies can be further examined on the basis of the intensity of FDI, which compares the actual volume of bilateral FDI stocks with what would be "expected" on the basis of the share of each economy in global inward and outward FDI. Such a measure shows that the United States has a stronger-than-average FDI intensity with Canada, European countries with each other, and Japan with Asian countries. It also shows that South-South relationships have strengthened over the past decade, especially in the Asian region.

Most policy changes continue to favour FDI, though some restrictions have emerged in certain industries.

Governments continue to adopt measures to facilitate FDI. In 2006, 147 policy changes making host-country environments more favourable to FDI were observed. Most of them (74%) were introduced by developing countries. They included in particular measures aimed at lowering corporate income taxes (as in Egypt, Ghana and Singapore) and expanding promotional efforts (as in Brazil and India). Further liberalization of specific industries is under way in various countries, such as that relating to professional services (Italy), telecommunications (Botswana and Cape Verde), banking (the Lao People's Democratic Republic and Mali) and energy (Albania and Bulgaria).

In some industries, however, new restrictions on foreign ownership or measures to secure a greater government share in revenues were observed. Such steps were the most common in extractive industries and in industries deemed to be of "strategic" importance. For example, in Algeria, State-owned oil and gas enterprises must now hold a minimum of a 51% stake, and in Bolivia, by signing new contracts TNCs have returned ownership of petroleum reserves to the State oil company. In the Russian Federation, foreign investment is to be restricted in "strategic sectors" such as defence and extractive industries, with only minority stakes permitted in the latter. In Venezuela, nationalizations in the "strategic sectors" of energy and telecommunications are in progress.

The perception that these and other changes might trigger renewed protectionism has led to some concern. However, as in 2005, the trend appears to be confined to a relatively small number of countries, and to specific industries.

The number of international investment agreements (IIAs) has continued to grow, reaching a total of almost 5,500 at the end of 2006: 2,573 bilateral investment treaties, 2,651 double taxation treaties and 241 free trade agreements and economic cooperation arrangements containing investment provisions. The number of preferential trade agreements with investment provisions has almost doubled in the past five years. Developing countries are becoming increasingly important participants in international investment rule-making, partly reflecting growing South-South FDI.

FDI in Africa peaked, as its resources attracted increasing FDI.

At $36 billion in 2006, FDI inflows in Africa were twice their 2004 level. This was due to increased interest in natural resources, improved prospects for corporate profits and a more favourable business climate. The value of cross-border M&A sales reached a record $18 billion, half of which represented purchases by TNCs from developing Asia. Greenfield projects and investments in expansion also grew significantly. Despite this increase, Africa's share in global FDI fell to 2.7% in 2006, compared with 3.1% in 2005, much lower than that of other developing regions. FDI outflows from Africa also reached a record $8 billion in 2006, up from $2 billion in 2005.

FDI inflows rose in 33 African countries and in all subregions except for Southern Africa. The top 10 host African countries received about 90% of such flows. In eight of them, inflows exceeded $1 billion each. Large cross-border M&As as well as greenfield investments and expansion projects played an important role in the top host countries, particularly Egypt and Nigeria. In Egypt, the leading recipient in the region, inflows exceeded $10 billion, 80% of which were in expansion and greenfield projects in non-oil activities. South Africa witnessed a major decline in inflows due to the sale of a foreign equity stake in a domestic gold-mining company to a local firm, but it generated most of the outflows from Africa. The search for new natural-resource reserves led to increased FDI to African least developed countries (LDCs), amounting to $8 billion, following two consecutive years of decline. As a result, the LDCs accounted for 23% of the FDI inflows to the region – a significant rise over 2005. Of these LDCs, Burundi, Cape Verde, Djibouti, Ethiopia, Gambia, Guinea-Bissau, Madagascar, Somalia and Sudan saw the largest increases in FDI inflows mainly directed at new oil exploration and mining activities.

In 2006, many African countries adopted measures to attract FDI as well as to improve the impact of FDI on their development. Prospects for FDI inflows into Africa remain positive due to persistently high global commodity prices, though some moderation is expected in 2007.

Inflows to South, East and South-East Asia reached $200 billion, and outflows soared …

FDI inflows to South, East and South-East Asia maintained their upward trend in 2006, rising by about 19% to reach a new high of $200 billion. At the subregional level, South and South-East Asia saw a sustained increase in flows, while their growth in East Asia was slower. However, FDI in the latter subregion is shifting towards more knowledge-intensive and high value-added activities.

China and Hong Kong (China) retained their positions as the largest FDI recipients in the region, followed by Singapore and India. Inflows to China fell in 2006 for the first time in seven years. The modest decline (by 4% to $69 billion) was due mainly to reduced investments in financial services. Hong Kong (China) attracted $43 billion in FDI, Singapore $24 billion (a new high), and India $17 billion (an amount equivalent to the combined inflows to that country of the preceding three years).

FDI outflows from the region as a whole rose by 60% to $103 billion, with higher investments from all subregions and major economies. Outflows from Hong Kong (China), the largest source of FDI in the region, rose by 60% to $43 billion. China consolidated its position as a major investor, and India is rapidly catching up. Their emergence as important sources of FDI is challenging the dominance of the Asian newly industrializing economies (NIEs) in outward FDI from the region. Resource-seeking FDI from China and India continued to increase. In addition, the efforts of Chinese State-owned enterprises and of Indian privately owned conglomerates to acquire strategic assets abroad, as highlighted by the $11 billion acquisition by Tata Steel (India) of Corus Group (United Kingdom and the Netherlands), have led to greater FDI flows from these countries to developed economies.

Rapid economic growth in South, East and South-East Asia should continue to fuel growing market-seeking FDI to the region. The region will also become more attractive to efficiency-seeking FDI, as countries such as China, India, Indonesia and Viet Nam plan to significantly improve their infrastructure. During the first half of 2007, the value of cross-border M&A deals in the region increased by nearly 20% over the corresponding period of 2006. Increased FDI outflows from the region are also expected to continue.

…while FDI inflows into West Asia continued to climb to unprecedented heights.

In 2006, FDI inflows to the 14 economies of West Asia rose by 44%, to an unprecedented $60 billion. Privatization of various services progressed in 2006, and there was an improvement in the general business climate. The region's strong economic growth has encouraged investment, and high oil prices have been attracting increasing amounts of FDI in oil and gas and in related manufacturing industries.

A few mega cross-border M&As and the privatization of financial services made Turkey the largest recipient in West Asia, with inflows of $20 billion. Saudi Arabia was the second largest with $18 billion (an increase of 51% over its 2005 levels), followed by the United Arab Emirates, where the free zones attracted a significant share of its FDI inflows. Services remained the dominant sector for FDI in West Asia, a major proportion of which went to financial services as a result of privatization and liberalization policies of a number of countries in the region. There were also several major deals in the telecommunications industries in Jordan and Turkey. Efforts by the Gulf countries to diversify their production activities beyond oil-related activities succeeded in attracting greater FDI flows into the manufacturing sector. During the first half of 2007, the value of cross-border M&A sales increased by nearly 3% over the corresponding period of 2006.

FDI outflows from West Asia rose by 5% to reach a new high of $14 billion in 2006, as a result of the high oil prices and the current-account surpluses of the oil-producing countries. Kuwait accounted for the lion's share (89%) of the region's total outward FDI, mainly in the telecommunications industry.

The value of cross-border M&As by firms from the region totalled $32 billion, 67% of which involved firms from the United Arab Emirates, the second largest investor from West Asia.

In 2006, FDI inflows to Oceania amounted to $339 million, a decline of 11%, and they remained concentrated in the mining industry. Investments also went to onshore fish-processing activities in Papua New Guinea and the Marshall Islands, and to the tourism industry in some economies such as Fiji and Vanuatu.

Greenfield investments and reinvested earnings boosted FDI in Latin America and the Caribbean, and outflows hit new records.

FDI flows to Latin America and the Caribbean increased by 11%, to $84 billion. If the offshore financial centres are excluded, however, they reached $70 billion in 2006, which was the same level as in 2005. This is in sharp contrast to the soaring FDI outflows, which jumped by 125% to $43 billion (or $49 billion if offshore financial centres are included). Brazil and Mexico remained the leading recipients (with about $19 billion each), followed by Chile, the British Virgin Island and Colombia. The stagnation of FDI inflows in the region (excluding the offshore financial centres) hides disparities among different countries: in South America, most of the countries registered strongly positive growth in FDI flows, but this was offset by a significant decline in Colombia and Venezuela. Two features characterized the region's FDI inflows: greenfield investments became more important than cross-border M&As, and reinvested earnings became an increasingly important component (the largest component in South America alone).

Manufacturing again received the largest share of inflows, and the services sector's share increased slightly. In services, TNCs continued to withdraw from public utilities, mainly from the electricity industry. The primary sector remained attractive due to persistently high commodity prices.

FDI outflows were mainly targeted at extractive industries, followed by resource-based manufacturing and telecommunications. Brazil's outward FDI was the largest in the region, at $28 billion – its highest level ever – exceeding for the first time its inward FDI. This was mainly due to the above-mentioned purchase of Inco (Canadian nickel producers) by the mining company CVRD, the largest transaction ever by a developing-country company. Companies from other countries, especially those from Argentina, Chile, Mexico and Venezuela, are also increasingly seeking to internationalize through FDI.

The trend towards greater State intervention continued in 2006, but unlike the previous year when this occurred mainly in the extractive industries, it extended to other industries such as telecommunications and electricity, in particular in Bolivia and Venezuela. In Venezuela, a deal was negotiated with Verizon, AES and CMS (all United States firms) whereby the three firms agreed to divest their assets to the Government, while the Government of Bolivia is planning to take over Empresa Nacional de Telecomunicaciones (Entel), controlled by Telecom Italia. By contrast, the Government of Colombia is proceeding with a programme of FDI promotion and downsizing of the public sector, including in the extractive industries.

FDI inflows into Latin America and the Caribbean, excluding the offshore financial centres, are expected to rise moderately in 2007, increasingly driven by greenfield investments rather than by cross-border M&As.

FDI flows to South-East Europe and the Commonwealth of Independent States increased for the sixth consecutive year…

FDI inflows into South-East Europe and the CIS grew by 68%, to $69 billion – a significant leap from the inflows of the two previous years. The top five recipient countries (the Russian Federation, Romania, Kazakhstan, Ukraine and Bulgaria in that order) accounted for 82% of the total inflows. Those to the Russian Federation almost doubled to $28.7 billion, while those to Romania and Bulgaria grew significantly, in anticipation of their accession to the EU on 1 January 2007 and due to a series of privatization deals. FDI outflows from the region increased for the fifth consecutive year, to reach $18.7 billion. Virtually all of this outward FDI reflected the expansion abroad of Russian TNCs, especially some large resource-based firms seeking to become global players and some banks expanding into other CIS countries.

While the services sector was particularly buoyant because of increased cross-border M&As in the banking industry, the primary sector received higher inflows as a result of soaring demand for natural resources. In some natural-resource-based economies of the CIS, such as the Russian Federation, the State continued to increase its control in strategic industries. In countries of South-East Europe, FDI-related policies continue to be in line with their accession or aspirations to accede to the EU, and with their aim to step up the privatization of State-owned enterprises.

FDI inflows in the region are expected to be particularly buoyant in large economies such as the

Russian Federation and Ukraine, as well as in the two new EU members (Bulgaria and Romania).

… while the surge in FDI to developed countries was widespread.

FDI inflows to developed countries surged to $857 billion – 45% higher than in the previous year – reflecting another rise in cross-border M&As. In contrast to the upward trend of the previous FDI cycle at the end of the past decade, the current increase was widespread, across all the developed regions. FDI inflows to the United States rebounded strongly to $175 billion in 2006, with record flows in the chemical industry, while a wave of cross-border M&As in the mining sector caused Canadian inflows to double, to a record of $69 billion. Inward FDI in the 25 EU countries grew by 9%, to reach $531 billion. Declines in FDI flows to Ireland, Spain and the United Kingdom were more than compensated for by increases in Belgium, Italy and Luxembourg, while inflows in the 10 new EU members amounted to $39 billion – their highest level so far. Due to some large sell-offs of foreign affiliates to Japanese companies, FDI inflows to Japan turned negative for the first time since 1989 (-$6.5 billion). The share of foreign investment from developing countries in the total value of cross-border M&A sales was 9% in 2006 compared to 7% 2005, largely as a result of several mega deals.

FDI outflows from developed countries also grew by 45%, to $1 trillion. The United States and five EU countries ranked among the 10 largest outward investor economies in the world. France remained the second largest investor worldwide for the second year in a row ($115 billion), while Spanish companies continued their outward expansion at a rapid pace to reach $90 billion, the largest ever recorded for Spain. FDI outflows from the Netherlands amounted to $23 billion, mainly due to the acquisition of Arcelor (Luxembourg) by Mittal Steel (a company registered in the Netherlands) – the largest deal of the year.

While continuous financial deregulation was the main reason for the significant increase in cross-border M&As in financial services, high commodity prices and consolidation efforts spurred such deals in the mining industry. Many developed countries adopted policies that could, directly or indirectly, increase their attractiveness for FDI, although some protectionist sentiment remains or is again on the rise in certain developed countries.

The prospects for FDI in developed countries remain bright. Strong economic growth, albeit at a more moderate pace than in 2006, high corporate profits and the upward movement of equity prices are expected to further stimulate cross-border M&As; they had already increased by 66% during the first half of 2007 over the same period in 2006.

Overall, prospects for global FDI flows remain positive.

The upward trend in FDI is expected to continue in 2007 and beyond – albeit at a somewhat slower rate than in 2006. This would be in line with global economic growth, which should remain above its longer term trend, although it might slow down moderately. This forecast is confirmed by the rise in global cross-border M&As to $581 billion in the first half of 2007 – a 54% increase over the corresponding period of 2006 – and by the results of various surveys.

In UNCTAD's *World Investment Prospects Survey,* more than 63% of the responding TNCs expressed optimism that FDI flows would increase over the period 2007-2009. According to the survey, the most attractive FDI destination countries are China and India, while East, South and South-East Asia is considered the most attractive region. This is reinforced by several international organizations and research institutes, as well as by another survey conducted by UNCTAD/WAIPA, in which 76% of the responding CEOs of foreign affiliates expected to continue to increase investments in host economies over the next three years.

However, despite the generally positive prospects, several challenges and risks face the world economy, which may have implications for FDI flows in 2007 and 2008. These include global current-account imbalances causing exchange rate shifts, volatile oil prices, and a potential tightening of financial market conditions. Respondents in the UNCTAD survey also expressed some concerns regarding the possible rise of protectionism and of global threats such as terrorism and war. But they believed that the probability of these types of risks affecting the level of FDI in the short term was relatively low. Nevertheless, these considerations underline the need for caution in assessing future FDI prospects.

TRANSNATIONAL CORPORATIONS, EXTRACTIVE INDUSTRIES AND DEVELOPMENT

High prices of metals, oil and natural gas have led to increased activity of TNCs in extractive industries.

The involvement of TNCs in extractive industries has had a chequered history. In the early twentieth century, these industries accounted for the largest share of FDI, reflecting the international expansion of firms from the colonial powers. With a growing number of former colonies gaining independence after the Second World War, and the creation of the Organization of the Petroleum Exporting Countries (OPEC), the dominance of these TNCs declined, as did the share of extractive industries in global FDI. From the mid-1970s, in particular, the share of oil, gas and metal mining in world FDI fell steadily as other sectors grew much faster. However, as a result of rising mineral prices, the share of extractive industries in global FDI has recently increased, although it is still much lower than those of services and manufacturing. It is therefore an opportune time for the *WIR07* to revisit the role of TNCs in extractive industries and their impact on development.

Global mineral markets are characterized by an uneven geographical distribution of reserves, production and consumption. Some developing and transition economies are among the main producers and net exporters of various minerals, while developed countries and fast-growing emerging economies are the major consumers and importers. These imbalances sometimes create concerns among importing countries over the security of supply, and concerns among exporting countries over market access. The supply of minerals is essential for economic development: no modern economy can function without adequate, affordable and secure access to these raw materials. TNCs can be important for both host and home countries in this context. For countries that lack the necessary indigenous capabilities for transforming their natural resources into commercial goods, TNCs can bring the needed capital, knowledge and access to markets; for home countries, they can serve as vehicles for securing access to foreign supplies. Indeed, some of the world's largest TNCs are active in extractive industries, and a number of new ones have emerged in resource extraction in the past decade, not least from developing and transition economies. The overseas expansion of TNCs from the South is reflected in FDI data. Between 2000 and 2005, the aggregate share of developed countries in global FDI in extractive industries fell from 99% in 2000 to 95% in 2005.

Both government policies and TNCs' investment decisions are influenced by the volatility of mineral markets. The current price boom reflects in part a surge in demand for oil, gas and various metallic minerals, especially from some rapidly growing developing economies, notably China. Although by June 2007, prices of commodities such as aluminium, copper, gold and oil remained close to their highest levels in nominal terms, their future trends are difficult to forecast. However, experts agree that the costs of exploiting new mineral deposits are likely to rise, which might keep prices at relatively high levels in the coming years. The high prices have spurred an investment boom in mineral exploration and extraction. For example, global private investment in non-ferrous metal exploration rose from $2 billion in 2002 to an estimated $7 billion in 2006, and drilling for oil and gas doubled over the same period, pushing the rig utilization rate up to about 92%.

The relative importance of foreign affiliates in mineral production varies by economy and mineral…

Developed countries still attract the bulk of FDI in extractive industries, partly explained by significant cross-border M&A activity. However, their share in global inward FDI in these industries fell from about 90% in 1990 to 70% in 2005. The share of developing and transition economies as destinations for TNC investments in extractive industries has increased over the past two decades. Between 1990 and 2000, their estimated combined stock of inward FDI in those industries more than doubled, and between 2000 and 2005, it increased again by half. Following new mineral discoveries, a number of new FDI recipients have emerged, including LDCs such as Chad, Equatorial Guinea and Mali. During this period, the Russian Federation and other CIS members also became important destinations for FDI in extractive industries.

The importance of extractive industries in inward FDI varies by host economy. In all the major country groups, the extractive industries of some countries account for a significant share of the total inward FDI stock: for example, Australia, Canada and Norway among developed countries; Botswana, Nigeria and South Africa in Africa; Bolivia, Chile, Ecuador and Venezuela in Latin America and the Caribbean; and Kazakhstan in South-East Europe and the CIS. In a number of low-income, mineral-rich countries, extractive industries account for the bulk of inward FDI; many have few other industries that can attract significant FDI, due to their small domestic markets and weak production capabilities.

The relative importance of foreign companies in the production of metallic minerals and diamonds varies considerably by country. Foreign affiliates account for virtually all of the (non-artisanal) production in LDCs such as Guinea, Mali, the United Republic of Tanzania and Zambia, as well as in Argentina, Botswana, Gabon, Ghana, Mongolia, Namibia and Papua New Guinea. In these countries, TNCs generally operate through concessions granted in the form of exploration and mining licences. In another 10 major metal-producing countries, foreign affiliates account for an estimated 50% to 86% of production. By contrast, in the Islamic Republic of Iran, Poland and the Russian Federation their share is negligible.

In *oil and gas*, foreign affiliates generally account for a lower share of production than in metal mining. In 2005, they were responsible for an estimated 22% of global oil and gas production, with the average share being higher in developed countries (36%) than in developing countries (19%) and transition economies (11%). However, there was wide variation among developing countries. In West Asia, foreign affiliates' output amounted to an average of only 3% of production, whereas the corresponding share in sub-Saharan Africa was 57% on average. Foreign companies accounted for more than half of production in Angola, Argentina, Equatorial Guinea, Indonesia, Sudan and the United Kingdom. On the other hand, no production was attributed to foreign affiliates in, for instance, Kuwait, Mexico and Saudi Arabia.

… reflecting a diverse and changing universe of extractive-industry TNCs, with the dominance of privately owned firms in metal mining and of State-owned enterprises in oil and gas.

The relative importance of TNCs in the production of metallic minerals and of oil and gas varies considerably. In *metal* mining, 15 of the 25 leading companies in 2005, ranked by their share in the value of world production, were headquartered in developed countries. Eight others were from developing countries and the two remaining were from the Russian Federation. The top three were BHP Billiton (Australia), Rio Tinto (United Kingdom) and CVRD (Brazil). Three State-owned companies also featured on the list: Codelco (Chile), Alrosa (Russian Federation) and KGHM Polska Miedz (Poland). Following CVRD's acquisition of Inco (Canada), it was estimated to have become the largest metallic mineral producer in the world in 2006 – the first time that a Latin America-based company will have occupied that position. The level of internationalization of these leading companies varies greatly. In 2005, Rio Tinto had mining operations in the largest number (10) of host countries, followed by Anglo American, AngloGold Ashanti and Glencore International. In contrast, large producers like Codelco, CVRD and Debswana (Botswana) had no overseas mining production.

In *oil and gas*, private companies remain the largest corporations in terms of foreign assets. For example, 10 of them were included among the firms on UNCTAD's list of the world's top 100 TNCs (by foreign assets) in 2005. In terms of production, however, TNCs from developed countries no longer rank among the largest companies in the world. In 2005, the world's three largest oil and gas producers were all State-owned enterprises based in developing or transition economies: Saudi Aramco (Saudi Arabia), Gazprom (Russian Federation) and the National Iranian Oil Company. Saudi Aramco's annual production in 2005 was more than double that of the largest privately owned oil and gas producer, ExxonMobil (United States). More than half of the top 50 producers were majority State-owned, 23 had their headquarters in developing countries, 12 in South-East Europe and the CIS, and the remaining 15 in developed countries.

Although State-owned companies based in developing and transition economies control most of the global production of oil and gas, their degree of internationalization is still modest compared with that of the top privately owned oil TNCs. Indeed, none of the top three State-owned producers had significant foreign production in 2005, whereas foreign locations accounted for 70% of the production of the top three privately owned oil majors. However, some companies from developing and transition economies are expanding their overseas interests, and are fast becoming global players. The combined overseas production of CNOOC, CNPC, Sinopec (all China), Lukoil (Russian Federation), ONGC (India), Petrobras (Brazil) and Petronas (Malaysia) exceeded 528 million barrels of oil equivalent in 2005, up from only 22 million barrels 10 years earlier. China's CNPC, Sinopec and CNOOC, and India's Indian Oil Corporation and ONGC Videsh have invested large sums in oil and gas production deals around the world during the past two years. Both CNPC and Petronas are involved in oil and gas production in more than 10 foreign countries. A few State-owned oil TNCs from emerging economies have invested in host countries that developed-country TNCs are less likely to operate in, for a variety of reasons, including sanctions.

In metal mining, the top 10 companies account for a growing share of global production. Following a series of cross-border M&As, the 10 largest metal mining companies in 2006 controlled an estimated 33% of the total value of all non-energy minerals produced globally, compared with 26% in 1995. Concentration levels are even higher for individual metals. In the case of copper, for example, the top 10 companies accounted for 58% of world production in 2005. Conversely, in the oil and gas industry, the level of concentration has remained fairly stable over the past decade, with the top 10 producers accounting for about 41% of world production.

Varying motives drive the overseas expansion of different TNCs.

The drivers and determinants of investments by extractive-industry TNCs differ between activities, industries and companies. *Natural-resource-seeking* motives dominate FDI and other forms of TNC involvement in upstream (exploration and extraction) activities. A TNC might seek resources to meet its own needs for its downstream refining or manufacturing activities, to sell the minerals directly in host, home or international markets, or to secure the strategic requirements of its home country (as formulated by the country's government) for energy or other minerals. The latter has been a major driver of the recent overseas expansion of State-owned TNCs from Asia, for instance.

Market-seeking motives figure mainly among the drivers of overseas downstream activities. For example, Russian TNCs in extractive industries have invested abroad to enhance control over distribution channels linked to those activities, and Saudi and Kuwaiti State-owned oil companies have partnered with the Chinese firm Sinopec in two separate refining and petrochemical ventures in China. *Efficiency-seeking* motives apply mainly to investments in the processing or early metal manufacturing stage, where TNCs seek to exploit differences in costs of production between countries. *Strategic asset-seeking* motives can be linked especially to the rise of cross-border M&As in various extractive industries and activities: companies may invest to acquire strategic assets in the form of know-how and technology from other companies or from specialized technology providers, or to speed up their rise to global status by accessing the resources, capabilities and markets of the acquired firms.

Access to financial resources is an advantage over domestic firms in host countries, enjoyed by both traditional and new TNCs. International experience with extractive projects may increase the ability of TNCs to borrow or raise funds through stock markets. Financial strength can also be linked to home-country institutional arrangements. State-owned TNCs from some emerging economies benefit from financial backing by their governments, which may enable them to assume greater risks when investing abroad and to pay more for access to mineral resources.

With some important exceptions, proprietary technology is of relatively limited importance as an ownership-specific advantage for the internationalization of most extractive-industry firms. Technologies used in most metal mining operations and oil and gas extraction are well known today, and can be obtained in the open market. Important exceptions include technologically challenging projects, such as those related to deep offshore drilling, and production of liquefied natural gas and development of unconventional energy sources. However, expertise in managing long-term projects and the associated risks remains critical for successful overseas expansion. Access to markets and to transportation and distribution channels are other potentially important firm-specific advantages, at least in the case of oil and gas.

TNC participation in extractive industries can have significant impacts on host economies…

Mineral endowments provide opportunities for economic development and poverty alleviation in the countries where they are located. Indeed, some of today's developed countries as well as a number of developing countries have successfully leveraged their mineral resources for accelerating their development process. In other cases, however, the impact of extractive activities has been and remains disappointing.

For many mineral-exporting countries, the current commodity price boom has led to improved terms of trade. This applies in particular to many low-income countries, where revenues from mineral exploitation and exports represent a large share of their national income. But natural resource endowments do not translate automatically into development gains for a country, with or without TNC involvement in the extraction process. There are many underlying determinants of the performance of resource-rich countries that are related to the global forces of demand and supply and to policy failures rather than to TNC participation per se. Nevertheless, TNCs can influence the outcome.

They may complement domestic investment and boost production by contributing capital, technology and management skills. Such a package of assets is generally needed the most in low-income countries that lack domestic capabilities. On the other hand, reliance on TNCs may also raise concerns associated with unequal bargaining strengths, ownership and control over non-renewable resources, rent-sharing, transfer pricing practices and various environmental and social costs.

Thus TNC involvement in extractive industries may have both positive and negative economic, environmental, social and political impacts on a host country. Considerable efforts to address these issues are necessary for harnessing the earnings from extractive industries to boost development.

… including various economic impacts …

The economic challenge for a host country is threefold: how to add value through extractive activities, how to capture that value locally, and how to make the best use of the revenues generated.

In terms of adding value, the benefits of TNC involvement vary by country. Developing countries that possess sufficient financial resources, engineering expertise and technically competent State-owned oil companies have successfully developed their own capabilities to exploit their natural resources. West Asia is a typical example, where much of the oil and gas extraction is undertaken with known technology and little participation by foreign companies. In many other countries that lack the finance and ability to manage capital-intensive, high-risk and sometimes technologically challenging projects, TNC participation has helped boost their output and exports of minerals.

While there are alternatives to TNCs for accessing funds, such sources may not be available to domestic enterprises in all countries. An advantage of involving TNCs in the financing of a mining project is that it does not generate foreign debt for host-country governments, and such financing comes with a bundle of other assets, such as technology and managerial expertise. For some extraction projects, access to technology and management know-how can indeed be a reason for countries to rely on TNCs. But TNC involvement comes at a price. TNCs may claim a significant share of the revenue generated and repatriate a certain proportion of their profits, thereby affecting the sharing of the value created.

TNC involvement also affects the second part of the economic challenge: capturing the value locally in the form of employment and wages, local procurement, and government revenue in the form of taxes, royalties or dividends. Large-scale mineral extraction generally offers limited employment opportunities, and hence has little impact on employment, at least at the macro level. This applies especially to projects involving TNCs, as these companies tend to use more capital-intensive technologies and processes than domestic enterprises. The scope for backward linkages is generally relatively small in extractive industries. In addition, foreign affiliates are more likely to use foreign suppliers of various inputs. In low-income countries, a lack of qualified suppliers and skills shortages can also reduce the scope for local sourcing as well as downstream processing. Thus the potentially most important direct contribution from mineral extraction is the rise in host-country income, much of which takes the form of government revenue.

The amount of net revenue and income generated for the host country from TNC operations in extractive industries depends both on the extent of the overall value created by their participation, and how that value is shared between the TNC on the one hand, and host-country factors of production and the government on the other. In general, the better the capabilities and competitive strengths of a country's domestic enterprises, the more choice that country has for project financing and implementation. In countries with limited domestic capabilities, relying on TNCs may well be the only viable option to transform dormant resources into commercial products.

The sharing of revenue from a project partly reflects the relative bargaining power of host governments vis-à-vis transnational firms, which influences the terms and conditions they can impose for the participation of the latter. The sharing of revenue is also influenced by TNC conduct, including their accounting practices, financial behaviour, the possible use of transfer pricing and the repatriation of a certain proportion of their profits. Various studies of fiscal regimes suggest that the government's take in revenues generated from oil and gas activities over the lifetime of a project vary between 25% and 90%, and in metal mining between 25% and 60%. However, empirical information on TNCs' tax payments on a country-specific basis is scarce, making enhanced transparency important.

There can also be various potential indirect economic impacts from TNC involvement. First, the entry of TNCs can constitute an important channel for knowledge and technology transfer to developing countries. However, the lack of educated and skilled human resources and of absorptive capacity in general can limit the positive effects on low-income countries of such knowledge transfers. Another potential indirect economic effect is linked to investments in infrastructure. TNC activities in extractive industries are often associated with the development of public utilities (such as electricity and water supplies) and with the building of the transportation infrastructure (roads, railways and ports) needed for extracting, transporting and exporting the minerals and fuels. If the new infrastructure is developed in populated areas, it is likely to provide greater benefits than if developed in more remote areas of a country.

The third part of the economic challenge is not directly linked to TNCs. Ultimately, the overall development impact of the revenue generated is determined by the way in which the revenues generated for the host country are managed, distributed and used by the government, and to what extent they support the development objectives and needs of both current and future generations. By enabling or boosting production, TNCs may influence the overall economic performance of a host country in terms of its macroeconomic stability, growth and income distribution. Whereas most of these impacts relate to extractive activities in general, the income generated through TNC involvement can help overcome initial hindrances to economic growth (such as low levels of savings and investment) and give it a big push. At the same time, a booming extractive industry, with or without TNC participation, can also have distorting effects, commonly referred to as the "Dutch disease", especially if windfall gains are not managed carefully and in accordance with long-term development strategies. Thus, even if TNC participation contributes to economic growth, for it to generate substantial development gains the benefits obtained need to be wisely used and equitably distributed.

… as well as considerable environmental, social and political impacts.

Extractive activities, regardless of who undertakes them, involve environmental costs. TNCs can play both a negative and a positive role in this context. On the one hand, they may add to environmental degradation in a host country simply by participating in resource extraction where there would otherwise be none. On the other hand, they may reduce adverse environmental consequences by using more advanced technologies in production, and by applying and diffusing higher standards of environmental management than domestic companies, where the latter – including artisanal and small-scale mining – exist. However, the net environmental impact of TNC activities is determined to a significant extent by a host-country's environmental regulations and its institutional capacity to implement them. In recent years, there has been growing environmental awareness among large, established TNCs in both metal mining and oil and gas extraction. While accidents and bad practices undoubtedly still occur, their environmental practices have generally improved over the past decade or so, although these vary by company. For example, TNCs originating from home countries where environmental legislation is at a nascent stage may be relatively less well equipped to manage the environmental consequences of their overseas projects than those from countries with more advanced environmental legislation and standards.

More than in other industries, investment in extractive activities can also have far-reaching social and political consequences; the outcome depends largely on the specific host-country situation. Negative social and political impacts have been observed mainly in mineral-rich poor countries with weak institutions. Problems are often associated with particular minerals, poor governance frameworks, and weak institutional capacities of host governments to formulate and implement laws and regulations.

Among various social concerns, health and safety in the extractive industries have consistently posed a challenge, particularly in artisanal mining in developing countries. However, problems also exist in some projects operated by major TNCs. Other concerns may arise from the relationship between TNCs and local communities, the influx of migrants to work in TNC-operated projects and related issues. Political problems may stem from disputes over the distribution of the resource revenues, corruption, and even armed conflict or war among different groups seeking to benefit from the revenues generated. TNC participation can introduce higher standards in dealing with various social issues, but it can also add to problems. By their mere presence, they may – directly, indirectly, or unwittingly – support or strengthen the existing order. When mineral deposits are known to exist in weakly governed or authoritarian States, companies need to consider carefully whether or not to operate in those locations.

Governance systems are important for maximizing development gains from resource extraction…

The quality of government policies and institutions is a determining factor for ensuring sustainable development gains from resource extraction, with or without TNC involvement. The management of a mineral-based economy is complex, and requires a well-developed governance system and well-considered national development objectives. In some mineral-rich developing countries, however, government policy-making may be aimed at short-term gains rather than long-term development objectives. Furthermore, the distribution and use of a host country's share of mineral revenues may be determined with little attention to development considerations. In some cases, easy access to revenues from mineral resources can make governments less accountable to their populations, and more inclined to preserve and extend the interests of a small governing elite.

These factors underline the importance of developing a legal system based on the rule of law, as well as an institutional environment in which companies have incentives to invest in productive activities. The quality of the physical infrastructure, education and health care also influences investment decisions. Moreover, proactive policies aimed at using government revenues from extractive industries to achieve development goals are essential for ensuring social cohesion; indeed, large increases in revenues can cause social disruptions and political instability if they are not channelled and managed carefully. Beyond the overall framework, appropriate sectoral institutions and policies are needed, including a legal and administrative framework for the exploration and exploitation of minerals, for health and safety, and for the protection of the environment and the rights of local communities.

In this policy-making process, all relevant stakeholders – governments, civil society, affected communities, indigenous peoples' organizations, labour unions, industry and international organizations – must be given a chance to participate in order to avoid inequitable outcomes. Allocating an acceptable share of the revenues to provincial and other lower levels of government can be a way to mitigate social conflicts in the local areas most directly affected by extractive activities. However, this also requires adequate governance systems and capabilities at the local-government level.

… as are the regulations and contractual forms relating to TNC entry and operations.

The way foreign involvement in extractive industries is governed has changed over time and still varies considerably by country. Approaches range from total prohibition of foreign investment in resource extraction (as in the case of oil in Mexico and Saudi Arabia) to almost complete reliance on TNCs (as in the case of metal mining in Ghana and Mali, or oil and gas extraction in Argentina and Peru). Various national laws, regulations and contracts govern TNC involvement. In addition, many countries have entered into international investment agreements (IIAs) of relevance to the operations and impacts of extractive-industry TNCs.

In the oil and gas industry, TNCs operate under contractual arrangements of various kinds, such as concessions, joint ventures, production-sharing agreements (PSAs) and service contracts. Overall, as of June 2007, PSAs were the most commonly used form, accounting for more than 50% of all contracts with foreign TNC participation in the main oil- and gas-producing developing economies. They were the main contractual form in countries such as China, Equatorial Guinea, Indonesia, Iraq, the Libyan Arab Jamahiriya, Qatar, Sudan and Viet Nam. Concessions and joint ventures are the next most commonly used contractual forms, and the dominant ones in Algeria, Angola, Brazil, Kazakhstan, the Russian Federation and Venezuela. Service contracts are less common but are important, for example, in the Islamic Republic of Iran and Kuwait.

The effect of a given contract depends on how its contents have been negotiated between the host State and the investor. Royalty and taxation rates are often contractually determined, as are issues related to local content, training, host-government control over key decisions and the extent of participation of a State-owned corporation, where applicable. More recently, contracts have also started to include provisions relating to human rights and environmental issues.

In metal mining, companies obtain concessions in the form of licences, which give them the right to explore for and produce minerals. The conditions for investment are typically set out in a mining code or a mining agreement. Such codes have evolved over time, reflecting changing market conditions and political priorities. Common features of current mining laws include increased security of tenure, open access to historical exploration reports, more streamlined and transparent exploration application procedures, geographically defined exploration areas, provision for dispute resolution and methods for resolving conflict over land use. A number of countries also stipulate conditions related to the employment of domestic and foreign employees in the metal mining industry.

In both the oil and gas and the metal mining industries, the evolving arrangements reflect an ongoing process through which governments seek to find an appropriate balance between the respective rights and obligations of States and firms. As government revenue is among the most important benefits from mineral extraction, it is not surprising that policymakers devote much attention to finding a mechanism that assures the government an appropriate share in the profits from mineral extraction. As the result of higher mineral prices in the past few years, a number of governments have taken steps to increase their share of the profits generated by amending their fiscal regimes or their contractual relations. Recent regulatory changes in developed, developing as well as transition economies suggest that many governments believed their previous regulations may have been overly generous vis-à-vis foreign investors.

Compared with earlier waves of government policy changes and nationalizations, an added dimension this time is the wider use of IIAs among countries. While such treaties subject these governmental actions to certain international law principles, they cannot ultimately prevent a State from putting an end to a contractual relationship under existing terms. However, IIAs may grant foreign investors the right to claim compensation through international arbitration in case of a dispute. Protection under IIAs therefore mainly becomes relevant in the context of an exit strategy of a foreign investor. The scope of protection granted by such an agreement depends on how the treaty is formulated and its interpretations by arbitration tribunals. Moreover, the outcome of the government policy changes depends partly on the bargaining power of the parties. For those host countries that posses proven and high-value mineral and petroleum deposits, unilateral actions may be a viable approach to capturing a larger share of the benefits from an extractive industry. However, other countries may be in a weaker position to take such actions.

Ensuring greater and more equitable development gains requires shared responsibility among stakeholders, including host and home governments….

In order to derive maximum economic gains from TNC involvement while keeping potential environmental and social costs to a minimum, concerted action by all relevant stakeholders is required, based on a consensus around coherent policies. A number of recommendations to host-country governments, home-country governments, the international community, civil society and TNCs emerge from the analysis in *WIR07*.

Host-country governments bear the main responsibility for ensuring that the exploitation of their extractive industries yields benefits that support development objectives. Each government should formulate a clear vision as to how the country's oil and mineral resources can contribute to sustainable development. In that respect, an overall development strategy, developed within a governance framework based on the rule of law, is essential for coherent policy formulation and implementation. It should consider all relevant stakeholders – both current and future generations. Governments also need to strengthen their ability and capacity to design and implement appropriate policies. Well-informed governments are in a better position not only to design an appropriate regulatory framework, but also to enter into negotiations with TNCs, where necessary. A clear strategy at both central and subnational levels of government indicating how to manage and use the revenue generated from mineral extraction is essential.

Policymakers need to consider from the outset how to derive long-term and sustainable development gains from the extractive activities of TNCs. It is crucial that the revenue generated from mineral extraction be invested in activities to enhance productive capacities, including human-resource and technology development, with a view to strengthening domestic private sector capabilities. They should also promote backward and forward linkages within the extractive industries and with related industries.

In designing and implementing policies, governments need to bear in mind the cost-benefit relationship, and the fact that mineral markets are volatile. If a country seeks TNC participation in its extractive industries, its business environment should be competitive to attract the desired investments and skills. To reduce the need for unilateral actions by governments, countries may need to develop frameworks that are robust over the different phases of the business cycle, for example by introducing progressive taxation systems for the fiscal treatment of revenues from extractive industries.

Host-country governments should also consider the environmental and social consequences of extraction activities. There have been some encouraging developments in this area in recent years. An increasing number of countries are introducing environmental legislation, often with specific regulations for extractive industries. However, many countries still need to develop the capabilities to implement and enforce their environmental laws. The protection of the interests and rights of the people that might be affected by resource extraction is first and foremost a government obligation. Nonetheless, it is important for the various relevant stakeholders in a host country to be given the opportunity to influence the decision-making process so as to ensure equitable outcomes. An important factor in this context is the need to enhance transparency. In several countries, information about revenue is still treated as confidential, and foreign investors may be required to sign confidentiality or non-disclosure agreements.

Home-country governments can influence the potential impact of their TNCs' investments on host countries. A number of developed and now also developing countries actively support their firms' overseas expansion, sometimes with a view to securing access to strategically important resources. They should promote responsible behaviour on the part of these TNCs. This is equally important if the home State is also the owner of the company.

More home countries can become involved in existing international initiatives related to the extractive industries, such as the Extractive Industry Transparency Initiative, the World Mines Ministers Forum and the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development. They may also provide the recipient economies with financial and technical assistance for effective policy formulation and for building efficient governance systems.

…the international community, civil society and the TNCs.

The *international community* can also help promote greater development gains from resource extraction. International organizations can facilitate learning opportunities from studying and comparing the positive and negative experiences of different mineral-rich countries. Initiatives at the regional level might be useful. For example, it is worth exploring the scope for regional geological surveys and for establishing regional mining schools in Africa. In addition, the international community can be instrumental in the development of standards and guidelines and in promoting the use and adoption of existing tools to help ensure a more development-friendly outcome of TNC activities in mineral-rich countries, notably in weakly governed or authoritarian States. In very serious instances, the international community may have to explore sanctions as a tool for protecting human rights.

Voluntary initiatives can also be a useful supplement in countries where appropriate legislation or its enforcement is absent. A number of multi-stakeholder initiatives have been established with the aim of reducing the risk of conflict-related resource extraction and setting standards for corporate behaviour in conflict situations. The most notable ones include the Extractive Industries Transparency Initiative, the Kimberley Process Certification Scheme, the Voluntary Principles on Security and Human Rights and the Global Reporting Initiative. Civil society has played an active role in promoting these initiatives. International as well as local NGOs can contribute expertise on economic and environmental as well as human rights issues; and they can play an important role in monitoring the actions both of governments and companies, drawing attention to any abuse or inappropriate actions. However, it is important for more countries and TNCs in extractive industries to become involved in these initiatives.

When engaging in resource extraction, the role of *TNCs* should be, first and foremost, to contribute to efficient production while, as a minimum, respecting the laws of the host country. When mineral deposits are located in weakly governed or authoritarian States, foreign companies need to consider the implications of investing there or not. While there are no easy choices in this respect, a number of new tools – such as those for compliance assessment developed by the Danish Institute for Human Rights and for risk and impact assessments and screening produced by International Alert – can provide guidance. However, even among the largest enterprises, the number of extractive TNCs that have signed up to relevant international initiatives is still small. A review of the top mining and oil and gas TNCs shows that very few of them are explicitly committed to these initiatives, particularly companies from developing and transition economies. Until more companies participate in them and abide by their commitments, their impact will be limited.

A concerted effort by all stakeholders is necessary to ensure that the vast mineral resources located in some of the world's poorest countries become a force for development. In low-income, mineral-rich countries, TNCs are likely to play an active role in the mineral extraction. The challenge is therefore to develop frameworks that create the proper incentives for local and foreign firms to produce efficiently while at the same time respecting environmental and social requirements that reflect the interests of local communities and society at large. A win-win situation can result if various minerals are produced efficiently and if host countries, with the support of various other stakeholders, can make the revenues generated work more effectively for sustainable development and poverty alleviation.

Supachai Panitchpakdi
Secretary-General of the UNCTAD

Geneva, August 2007

PART ONE

WIDESPREAD GROWTH IN FDI

CHAPTER I

GLOBAL TRENDS: SUSTAINED GROWTH IN FDI FLOWS

The upward trend in foreign direct investment (FDI) that began in 2004 accelerated further in 2006. FDI flows increased in all the major country groups – developed countries, developing countries and the transition economies of South-East Europe and the Commonwealth of Independent States (CIS) – but at varying rates. The sustained growth of FDI and related international production primarily reflect the strong economic performance and increasing profits of many countries in the world, further liberalization of their policies, and other specific factors such as currency movements, stock exchange and financial market developments and high commodity prices. Increases in cross-border mergers and acquisitions (M&As), fuelled substantially by private equity funds, also added to FDI growth.

This chapter first examines recent trends in global FDI flows, changes in international production, the comparative position of countries in terms of transnationalization and inward FDI performance and potential, and recent developments in FDI policies (section A). The changing geographic and industrial patterns of FDI are described in section B, while section C presents an analysis of the world's top transnational corporations (TNCs). Section D concludes with a review of future prospects for FDI, based on UNCTAD surveys of TNCs and their foreign affiliates.

A. FDI and international production

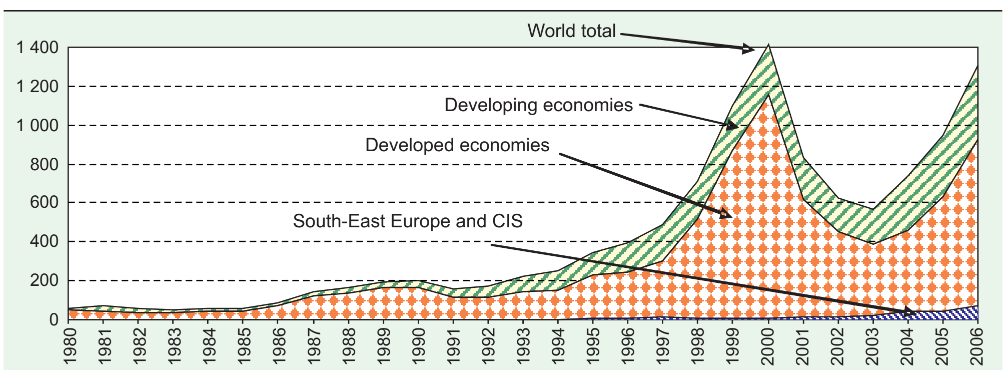
1. Trends in FDI

a. Overall trends

Global FDI inflows grew in 2006 for the third consecutive year to reach $1,306 billion, the second highest level ever recorded. All three major country groups – developed countries, developing countries and the transition economies of South-East Europe and the CIS – saw continued growth.

FDI inflows in 2006 were 38% higher than in 2005, approaching the peak of $1,411 billion reached in 2000 (figure I.1). Although FDI flows to all three major country groups rose, they varied greatly among regions and countries (chapter II).

Figure I.1. FDI inflows, global and by group of economies, 1980-2006
(Billions of dollars)



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

FDI flows to developed countries in 2006 rose by 45%, well over the growth rates of the previous two years, to reach $857 billion (figure I.1 and annex table B.1). The United States regained its position as the world's leading FDI recipient, overtaking the United Kingdom, which had led in 2005. The European Union (EU) remained the largest host region, with 41% of total FDI inflows. FDI inflows to developing countries and economies in transition rose by 21% and 68%, respectively, to new record levels for them (annex table B.1). Developing Asia retained its strong attraction for investors, accounting for more than two thirds of the total inflows to all developing countries in 2006.

- In *Africa*, FDI inflows exceeded their previous record set in 2005. High prices and buoyant global demand for commodities were again key factors. The oil industry attracted investment from TNCs based in both developed and developing countries (chapter IV). Cross-border M&As in the extractive industries rose fivefold to $4.8 billion. As in previous years, most of the inflows were concentrated in West, North and Central Africa. However, inflows remained small in low-income economies with few endowments of natural resources.
- Inflows to *Latin America and the Caribbean* increased on average by 11% in 2006. However, if the offshore financial centres are excluded, they remained almost unchanged over the previous year. Mexico was the largest recipient followed by Brazil. While inflows to Mexico were similar to 2005, those to Brazil rose by 25%. In the Andean group of countries, the commodity price boom induced a more restrictive regulatory environment governing TNC participation in the extractive industries (Part Two). The possibility of additional regulatory changes and of their spread to more countries may have raised uncertainty among investors in the primary sector, resulting in lower FDI flows to some countries in the region. In addition, high commodity prices and resulting improvements in current-account balances led to an appreciation of the currencies of some mineral-rich countries in the region, potentially harming the prospects for FDI in other export-oriented activities.
- FDI inflows to *South, East and South-East Asia, and Oceania* maintained their upward trend, reaching a new high in 2006 of $200 billion, an increase of 19% over the previous year. At the subregional level, the shift in favour of South and South-East Asia continued. China, Hong Kong (China) and Singapore retained their positions as the three largest recipients of FDI in the region. Outward FDI from the region surged, driven by the rapid rise in FDI from all the Asian subregions and major economies. FDI inflows to Oceania remained small, at less than $400 million.
- In *West Asia*, FDI flows – both inward and outward – maintained their upward trend in 2006. Turkey and the oil-rich Gulf States continued to attract the most FDI inflows, achieving record levels in 2006 in spite of geopolitical uncertainty in parts of the region. Energy-related manufacturing and services were the most targeted activities. Countries with large financial resources, led by Kuwait, accounted for most of the rise in outward FDI from the region. Cross-border M&As continued to be the main mode of outward FDI, particularly by State-owned enterprises. The region's closer ties with economies in other parts of Asia and Africa support its energy-related FDI.
- FDI inflows to the 19 countries of South-East Europe and the CIS expanded significantly in 2006, for the sixth consecutive year, and they more than doubled in the region's largest host country, the Russian Federation (annex table B.1).

The continued rise in FDI flows across regions largely reflects strong economic growth and performance in many parts of the world.[1] High corporate profits (and stock prices) boosted the value of cross-border M&As, which account for a large share of such flows. The number of greenfield and expansion investment projects increased by 13% to 11,800 projects, notably in developing countries (annex tables A.I.1) and in the services sector (annex table A.I.2). In 2006, FDI inflows accounted for half of all net capital flows to developing countries (World Bank, 2007a: 37).[2] Thus, as in more recent years, FDI flows continued to be the most important and stable source of external financing for developing countries (chapter II). Mobilizing international resources for development, including FDI, was set out as one of the objectives in the Monterrey Consensus.[3]

Global FDI flows also rose as a result of a weakening dollar in 2006. The United States attracted large inflows from both the euro area and Japan. Overall, however, the amounts in 2006 (as well as 2005) were not much higher than those of the 1990s. The sharp appreciation of the euro in recent years has not led to as strong an increase in FDI outflows from the euro area into the United States and Japan, possibly suggesting that TNCs from the countries in the euro area are reacting less to exchange rate changes than in the past. This is probably because they have already reached a relatively high degree of internationalization (section C), which makes their profits less vulnerable to exchange rate changes vis-à-vis particular host countries. Moreover, TNC strategies are now influenced by other secular developments. For example, the creation of the euro area has promoted greater regional integration and concentration of economic activity within the EU and led to increased intra-EU FDI flows to the common currency area as well as to the United Kingdom and the EU accession countries (chapter II, section C).

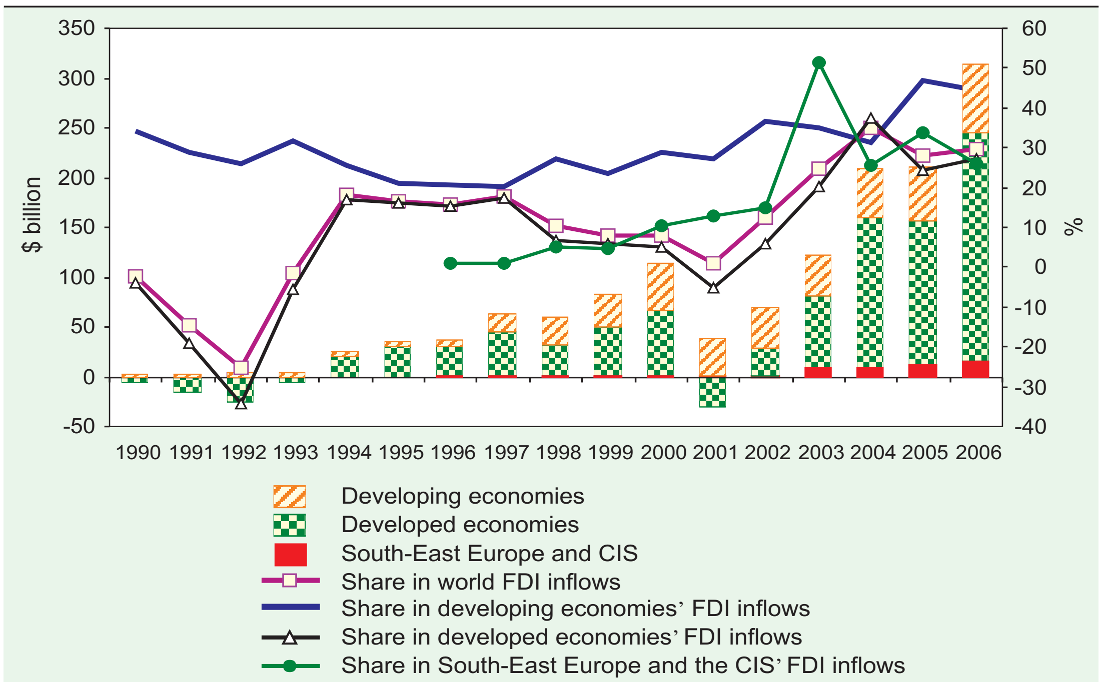
Increased corporate profits (and consequently higher stock values), also partly explain rising global FDI flows. They have boosted the value of cross-border M&As, which, as mentioned, account for a large share of FDI flows, and contributed to higher reinvested earnings. For example, the profits-to-sales ratio of the United States' top 500 firms in 2006[4] was the highest for the past two decades, and profits of Japanese firms have continued to rise, setting new records every year since 2003.[5] Similarly, profits of EU companies have surged: in the United Kingdom, for example, the net rate of return of private non-financial corporations in 2006 rose to an all-time high (United Kingdom, National Statistics Office, 2007). Profits earned abroad or by foreign affiliates were also high. Income on FDI (i.e. repatriated profits and reinvested earnings as recorded in host countries' balance of payments) rose another 29% in 2006, following a 16% rise in 2005.[6] In the 93 countries for which data on all three components of FDI – equity investments, reinvested earnings and other capital (essentially intra-company loans) – were available, reinvested earnings in 2006 reached a peak. They accounted for 30% of world FDI inflows and for almost half of total inflows to developing countries (figure I.2).

b. Continued rise in cross-border M&As

Cross-border M&As increased by 23% to $880 billion in 2006, and the number of transactions increased by 14% to 6,974 (figure I.3 and annex tables B.4-B.5), reflecting strong global M&A activity in general. Their value, however, still remained below the peak attained in 2000 (figure I.3). The rise in the value of cross-border M&As was largely fuelled by the growing strength of the stock markets,[7] and sustained increases in the asset values of enterprises.[8] In 2006, increases in stock values in emerging markets also played a role: for example, for the first time ever, the combined value of 13 stock markets in developing Asian economies exceeded that of the Tokyo Stock Exchange, now the second largest in the world.

The higher stock prices, increased purchasing power of investors, and the desire of firms to capture a growing market share in global competition led to a further increase in the number of mega deals (i.e. cross-border deals worth over $1 billion). In 2006, the number of such deals rose to 172, compared to 141 in 2005 and close to the record of 2000 (table I.1). They accounted for two thirds of the total value

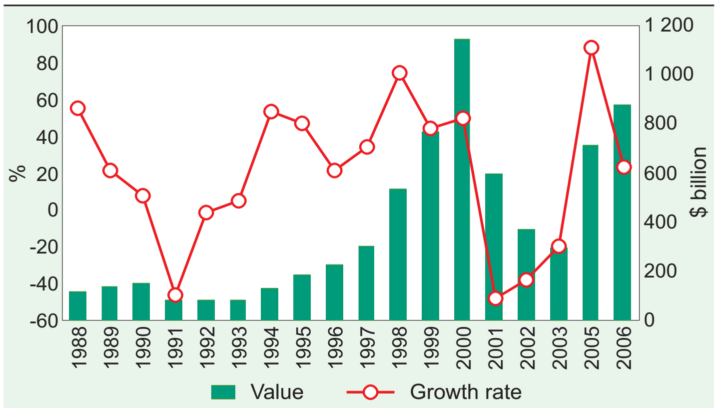
Figure I.2. Reinvested earnings: value and share in total FDI inflows, 1990-2006



Source: UNCTAD.

Note: Only 48-112 countries that reported all three components of FDI inflows already mentioned in the text are covered. They accounted for 74% of global FDI flows between 1990 and 2006.

Figure I.3. Global cross-border M&As, value and growth rate, 1988-2006



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

of global cross-border M&As – a higher share than in 2005, but still below that of 2000.[9]

Table I.1. Cross-border M&As valued at over $1 billion, 1987-2006

Year	Number of deals	Percentage of total	Value ($ billion)	Percentage of total
1987	14	1.6	30.0	40.3
1988	22	1.5	49.6	42.9
1989	26	1.2	59.5	42.4
1990	33	1.3	60.9	40.4
1991	7	0.2	20.4	25.2
1992	10	0.4	21.3	26.8
1993	14	0.5	23.5	28.3
1994	24	0.7	50.9	40.1
1995	36	0.8	80.4	43.1
1996	43	0.9	94.0	41.4
1997	64	1.3	129.2	42.4
1998	86	1.5	329.7	62.0
1999	114	1.6	522.0	68.1
2000	175	2.2	866.2	75.7
2001	113	1.9	378.1	63.7
2002	81	1.8	213.9	57.8
2003	56	1.2	141.1	47.5
2004	75	1.5	187.6	49.3
2005	141	2.3	454.2	63.4
2006	172	2.5	583.6	66.3

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

The current M&A boom is spread across regions and sectors. In North America, the value of cross-border M&A sales nearly doubled in 2006.[10] This is mainly because of a number of mega deals concluded in natural resources in Canada where cross-border M&A deals rose more than 2.5 times in value. Moreover, in 2006, the United States regained its position as the country with the largest cross-border M&A sales in the world. In Europe, M&A activity remained high in terms of both sales and purchases. The large number of M&A deals by European companies reflect the regained strength of European corporations after successful cost-cutting and restructuring efforts. The United Kingdom was the main target country for cross-border M&As by strategic investors from continental Europe. Three of the six largest cross-border M&As worldwide were acquisitions of United Kingdom companies by other EU investors (chapter II and annex table A.I.3).[11] These transactions partly reflect the United Kingdom's openness to cross-border M&As. Firms located in the new member States of the EU continued to remain important targets for cross-border M&As, but there were fewer mega deals, and the value of those deals fell considerably, from $19 billion in 2005 to $10 billion in 2006.

In 2006, developing countries and economies in transition (South-East Europe and CIS) further increased their role as buyers in the global M&A market. Investors from the fast growing emerging economies of Asia and from Eastern Europe – especially China, India and the Russian Federation – played a prominent role (box I.1). In the oil and gas industry, for example, two of the three largest companies worldwide (measured by market capitalization) – Gazprom (Russian Federation) and Petrochina (China) – have substantially increased their foreign investments through M&As. As several corporations located in the developing world have grown significantly in recent years (section C.2; *WIR06*: 32), they are expected to make larger acquisitions in the future. In some cases, their home-country governments also actively support their overseas expansion (*WIR06*, chapter IV).

Taking a look at cross-border M&A activity across industries, significant M&As were recorded in the consumer goods and service industries (including financial services) and in energy supply and basic materials. In contrast to the M&A boom of the late 1990s and early 2000s, which was largely driven by takeovers in the information and communications technology industries, there were fewer takeovers in telecommunications, media and technology services in 2006 (section B.2).

In 2006, cross-border M&As were largely driven by favourable financing conditions worldwide, reflecting low debt-financing costs and an abundant supply of credit as a result of high corporate profits. Recent cross-border M&A transactions have been carried out primarily through cash and debt financing. In the previous M&A boom, transactions were to a large extent financed by the exchange of shares (table I.2). For example, in large deals, including many in the mining and oil industries, cash is now the standard payment method. Emerging economies awash with petrodollars (West Asia) and foreign exchange (e.g. China) have become very active in cash-based cross-border acquisitions. The increasing role of debt financing can partly be explained by the fact that the cost of equity capital remains significantly higher than the cost of debt financing. This reflects a corporate strategy of not holding excessive equity capital and instead using borrowings and internal funds in

Box I.1. Selected examples of major acquisitions by companies from developing countries and economies in transition

A few cross-border M&As by firms from developing and transition economies took place in the past two years, reflecting their increasing strength. The following are a few examples:

- In China, the largest and most active buyers are in the oil and gas industry. China National Petroleum Corporation acquired PetroKazakhstan for $4.1 billion in 2005, and Sinopec bought the Russian-United Kingdom joint venture Udmurtneft for $3.5 billion in 2006.[a]
- The main motives for Indian companies to undertake cross-border M&As are to gain access to new technologies and competencies, and to build stronger positions in global markets. The acquisition by Mittal Steel group (a company of Indian origin headquartered in the Netherlands) of the European steel company Arcelor for $32 billion, was the world's largest cross-border M&A transaction in 2006, and the largest deal ever made by a company with origins in a developing country (annex table A.I.3). In the same year, the Indian Tata Group acquired the Corus Group (United Kingdom/Netherlands) – also in the steel industry – for $9.5 billion (though the deal was not recorded in 2006, as the payment was not completed).
- The Russian oil and gas giants (Gazprom, Rosneft and Lukoil) have started to expand abroad. Gazprom has made several investments in Germany through M&As in the energy sector in order to reach directly the end-users of its natural resources.[b] Gazprom is also planning investments in the oil industry in Algeria, Bolivia and the Libyan Arab Jamahiriya. Some other large cross-border M&As by Russian companies included Russian Aluminium's acquisition of part of Glencore International (Switzerland) for $2.5 billion, and CTF Holdings' (Alfa Group) purchase of Turkcell Iletisim Hizmetleri, a telecommunications firm in Turkey for $1.6 billion[c] (neither of them was recorded in 2006).
- In the past, companies from West Asia, in particular from the Gulf region, were not very active in cross-border M&As; instead they preferred portfolio investments in foreign companies. But this has changed in recent years. For instance, Saudi Oger acquired Turk Telekom for $6.6 billion in 2005 and Ports Customs Free-Zone Thunder FZE United Arab Emirates bought Peninsular & Oriental Steam (United Kingdom) for $6.9 billion in 2006 (annex table A.I.3).

Source: UNCTAD.

[a] "Die Käufer des neuen Jahrtausends", *Frankfurter Allgemeine Zeitung*, 22 December 2006: 23.

[b] Gazprom holds stakes in Wingas (49.99%), VNG Verbundnetz (5.26%) and Winthershall Erdgas Handelshaus (50%).

[c] "Die Käufer des neuen Jahrtausends", *Frankfurter Allgemeine Zeitung*, 22 December 2006: 23.

investment to attain high managerial efficiency (measured, for example, by the return on equity).[12] In financing M&As, bank loans accounted for 36% of total finance during January-September 2006, compared to 29% in 2005.[13]

The continuing strong M&A activity can also be partly explained by the fact that the current M&A boom has produced more corporate value for the acquiring companies than the previous one; the value of the companies created by M&As in the previous boom shrunk continuously as these activities progressed (McKinsey, 2007a).

Table I.2. Cross-border M&As through exchange of shares, 1987-2006

Year	Number of deals	Percentage of total	Value ($ billion)	Percentage of total
1987	6	0.7	1.5	2.0
1988	14	0.9	1.6	1.4
1989	51	2.3	11.2	8.0
1990	45	1.8	12.6	8.4
1991	22	0.8	2.3	2.9
1992	48	1.8	3.0	3.8
1993	75	2.6	14.3	17.3
1994	71	2.0	5.3	4.2
1995	96	2.3	13.8	7.4
1996	113	2.5	29.8	13.1
1997	112	2.2	32.4	10.6
1998	134	2.4	140.9	26.5
1999	176	2.5	277.7	36.3
2000	271	3.4	507.8	44.4
2001	206	3.4	140.9	23.7
2002	142	3.2	39.9	10.8
2003	123	2.7	32.7	11.0
2004	161	3.1	62.2	16.3
2005	149	2.4	123.7	17.3
2006	171	2.5	96.0	10.9

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

Note: Covers only deals the transaction value of which is known.

c. FDI by private equity funds

Private equity funds[14] and other collective investment funds continued to engage in cross-border M&As in 2006. These, along with mutual and hedge funds, have become increasingly important participants in such transactions (*WIR06*:16-21). In 2006, collective investment funds were involved in 18% of all cross-border M&As, registering a record value of $158 billion, a value significantly higher than in previous years though slightly lower in terms of their share in the total value of all M&As (table I.3).[15] They accounted for 18% of worldwide M&As (domestic and cross-border) in 2006, compared to 12% in 2005 and 4% in 2000.[16] In 2006, private equity funds raised a record amount of $432 billion, compared to $315 billion in 2005 (Private Equity Intelligence, 2007).[17]

The funds benefit from the ample liquidity in the global financial markets. In addition, private equity firms have successfully devised alternative ways of fundraising. Unlike previous practices, these firms, such as Apollo Management (United States), RHJ International (part of Ripplewoods) (United States) and KKR (United States), listed their firms in stock markets in Europe in 2004, 2005 and 2006 respectively, and Blackstone (United States) in the United States in 2007, and collected funds from the general public.[18] Funds of funds (mutual funds that invest in other mutual funds) have become the single most important source of financing investment by private equity funds. It has been estimated that in 2006, $500 billion or 38% of total private equity assets globally were managed by funds of funds (Private Equity Intelligence, 2007). North America and the United Kingdom are still the most important regions for fundraising and investments by private equity firms but continental Europe and Asia (particularly West Asia) are gaining ground.

Table I.3. Cross-border M&As by private equity funds and other funds, 1987-2006
(Number of deals and value)

Year	Number of deals		Value	
	Number	Share in total (%)	$ billion	Share in total (%)
1987	43	5.0	4.6	6.1
1988	59	4.0	5.2	4.5
1989	105	4.8	8.2	5.9
1990	149	6.0	22.1	14.7
1991	225	7.9	10.7	13.2
1992	240	8.8	16.8	21.3
1993	253	8.9	11.7	14.1
1994	330	9.4	12.2	9.6
1995	362	8.5	13.9	7.5
1996	390	8.5	32.4	14.3
1997	415	8.3	37.0	12.1
1998	393	7.0	46.9	8.8
1999	567	8.1	52.7	6.9
2000	636	8.1	58.1	5.1
2001	545	9.0	71.4	12.0
2002	478	10.6	43.8	11.8
2003	649	14.2	52.5	17.7
2004	773	15.1	83.7	22.0
2005	889	14.5	134.6	18.8
2006	889	12.4	158.1	18.0

Source: UNCTAD cross-border M&As database.
Note: Private equity funds as well as other funds such as hedge funds are included. They are defined here to include funds managed by firms in the following industries: investment advice, investment offices not elsewhere classified, management investment offices and investors not elsewhere classified.

In 2006, of the 889 cross-border M&As undertaken by collective investment funds, the largest two – the acquisitions of Philips Semiconductor (Netherlands)[19] for $9.5 billion and of Altana Pharma (Germany)[20] for $5.8 billion – were done by club deals involving more than two private equity funds (annex tables A.I.3 and A.I.4).[21] However, the share of single funds in cross-border M&As increased substantially in 2006. Because of the growing size of the funds, private equity investors are now trying to buy larger and also publicly listed companies, such as the two firms mentioned above.[22]

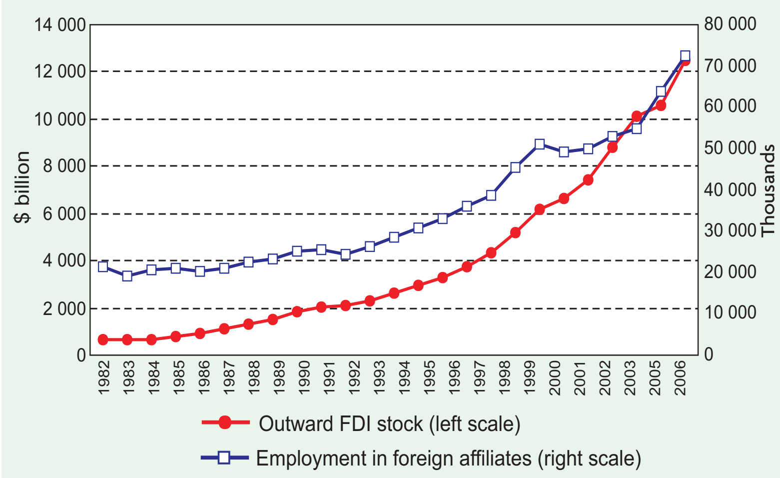
A number of factors raise doubts as to the sustainability of this high level of FDI activity by private equity and other collective investment funds.[23] First, the prices that private equity funds pay for their investments (mainly buyouts or acquisitions of firms) have increased substantially in recent years (Standard and Poor's, 2006). This is partly because competition is becoming stronger and partly because they are targeting larger firms. A second, related factor is that private equity funds are increasingly acquiring listed companies, in contrast to their former strategy of investing in high-yield and high-risk assets. Third, the abundance of funds available for private equity markets is resulting in greater competition between buyers, which makes it increasingly difficult to find profitable target firms for investment. Other factors include rising interest rates, the fact that the favourable tax rates offered to private equity firms are being examined by authorities in some countries,[24] and risks associated with the financial behaviour of private equity firms.[25]

Nevertheless, these firms will continue to play a role in M&As, including cross-border ones. Over time, in general, acquired firms improve performance (Kaplan and Schoar, 2005). This is the case for buyouts, whether by public companies or private equity firms, and the available evidence does not suggest any additional efficacy of the buyouts by the latter. Nevertheless, while private equity firms may not improve the efficiency of buyouts any more than public companies, it is argued that they help raise the overall efficiency of economies by expanding the sheer scale of domestic and cross-border M&A activity.[26] Against this are attendant concerns. Private equity firms have typically shorter time horizons than public companies engaged in buyouts, as they are inclined to look for options that offer quick returns, more akin to those of portfolio investors. This has raised concerns regarding the dismantling of the acquired companies and layoffs of their workers.[27] There are also worries about less transparency,[28] especially when public companies are taken into private ownership. These concerns notwithstanding, cross-border M&As by private equity firms are still a relatively recent phenomenon that needs further investigation, especially given their rising involvement in developing countries.

2. International production

International production, as measured by indicators of the value adding activities of TNCs outside their home countries, is continuing to grow. In keeping with the large increase in FDI flows worldwide, several indicators rose more rapidly in 2006 than in the previous year (table I.4). The estimated foreign capital stock of TNCs (i.e. the total assets of foreign affiliates) rose by 20% in 2006, while the estimated sales, value added (gross

Figure I.4. Outward FDI stock and employment in foreign affiliates, 1982-2006



Source: UNCTAD, FDI/TNC database.

Note: For the employment estimation method, see footnote g in table I.4.

product) and exports of foreign affiliates increased by 18%, 16% and 12% respectively (table I.4). These affiliates also accounted for an estimated 10% of world GDP, compared to 9% in 2005.[29] The expansion of the foreign assets and operations of TNCs, however, is largely due to acquisitions rather than to organic growth. To the extent that additions to FDI take place through M&As rather than greenfield investments, they involve a shift in production control and management from domestic to foreign firms, rather than additions to global production capacity (*WIR06*: 10-13). Such a shift may, nevertheless, lead to sequential FDI through greenfield projects that

Table I.4. Selected indicators of FDI and international production, 1982-2006

Item	Value at current prices (Billions of dollars)				Annual growth rate (Per cent)						
	1982	1990	2005	2006	1986-1990	1991-1995	1996-2000	2003	2004	2005	2006
FDI inflows	59	202	946	1 306	21.7	22.0	40.0	-9.3	31.6	27.4	38.1
FDI outflows	28	230	837	1 216	24.6	17.3	36.4	3.6	56.6	-4.6	45.2
Inward FDI stock	637	1 779	10 048	11 999	16.9	9.4	17.4	20.6	16.9	5.0	19.4
Outward FDI stock	627	1 815	10 579	12 474	17.7	10.6	17.3	18.1	15.6	4.2	17.9
Income on inward FDI	47	76	759	881	10.4	29.2	16.3	37.5	33.2	28.9	16.0
Income on outward FDI	46	120	845	972	18.7	17.4	11.8	38.0	38.4	24.7	15.1
Cross-border M&As[a]	..	151	716	880	25.9[b]	24.0	51.5	-19.7	28.2	88.2	22.9
Sales of foreign affiliates	2 741	6 126	21 394[c]	25 177[c]	19.3	8.8	8.4	26.6	15.0	3.0[c]	17.7[c]
Gross product of foreign affiliates	676	1 501	4 184[d]	4 862[d]	17.0	6.7	7.3	21.1	15.9	6.3[d]	16.2[d]
Total assets of foreign affiliates	2 206	6 036	42 637[e]	51 187[e]	17.7	13.7	19.3	26.0	-1.0	9.3[e]	20.1[e]
Exports of foreign affiliates	688	1 523	4 197[f]	4 707[f]	21.7	8.5	3.3	16.1[f]	20.5[f]	10.7[f]	12.2[f]
Employment of foreign affiliates (in thousands)	21 524	25 103	63 770[g]	72 627[g]	5.3	5.5	11.5	5.7	3.7	16.3[g]	13.9[g]
Memorandum											
GDP (in current prices)	12 002	22 060	44 486	48 293[h]	9.4	5.9	1.3	12.3	12.4	7.7	8.6
Gross fixed capital formation	2 611	5 083	9 115	10 307	11.5	5.5	1.0	12.6	15.5	4.8	13.1
Royalties and licence fee receipts	9	29	123	132	21.1	14.6	8.1	12.4	19.2	9.6	7.2
Exports of goods and non-factor services	2 124	4 329	12 588	14 120	13.9	8.4	3.7	16.1	20.5	10.7	12.2

Source: UNCTAD, based on the FDI/TNC database (www.unctad.org/fdi statistics), UNCTAD GlobStat database, and IMF, 2007b.

a Data are available only from 1987 onwards.
b 1987-1990 only.
c Data are based on the following regression result of sales against inward FDI stock (in $ million) for the period 1980-2004: sales=1,853+1.945* inward FDI stock.
d Data are based on the following regression result of gross product against inward FDI stock (in $ million) for the period 1982-2004: gross product=679+0.349* inward FDI stock.
e Data are based on the following regression result of assets against inward FDI stock (in $ million) for the period 1980-2004: assets= -1,523+4.395* inward FDI stock.
f For 1995-1997, data are based on the regression result of exports of foreign affiliates against inward FDI stock (in $ million) for the period 1982-1994: exports=285+0.628*inward FDI stock. For 1998-2006, the share of exports of foreign affiliates in world exports in 1998 (33.3%) was applied to obtain the values.
g Based on the following regression result of employment (in thousands) against inward FDI stock (in $ million) for the period 1980-2004: employment=18,021+4.55* inward FDI stock.
h Based on data from the IMF, *World Economic Outlook*, April 2007.

Note: Not included in this table are the values of worldwide sales of foreign affiliates associated with their parent firms through non-equity relationships and the sales of the parent firms themselves. Worldwide sales, gross product, total assets, exports and employment of foreign affiliates are estimated by extrapolating the worldwide data of foreign affiliates of TNCs from Austria, Canada, the Czech Republic, Finland, France, Germany, Italy, Japan, Luxembourg, Portugal, Sweden and the United States for sales; those from the Czech Republic, Portugal, Sweden and the United States for gross product; those from Austria, Germany, Japan and the United States for assets; those from Austria, the Czech Republic, Japan, Portugal, Sweden and the United States for exports; and those from Austria, Germany, Japan, Switzerland and the United States for employment, on the basis of the shares of those countries in the worldwide outward FDI stock.

add to the production capacity of countries in subsequent years.

Among the indicators of international production, employment in foreign affiliates is of particular interest to host countries, most of which are concerned about the impact of FDI on employment within their economies.[30] The increase in FDI in recent years has led to rising employment in foreign affiliates of TNCs. An estimated 73 million workers were employed in foreign affiliates of TNCs in 2006, nearly three times larger than in 1990 (table I.4), and their total employment accounted for an estimated 3% of the global workforce.

At the global level, changes in the employment of foreign affiliates in comparison to changes in FDI stock or foreign affiliate output may indicate changes in the composition, capital-intensity or technological sophistication of international production. Over the period 1982-2006, employment in foreign affiliates worldwide rose at a lower rate than did FDI stocks (figure I.4)[31] and the gross product of foreign affiliates (table I.4), suggesting a possible shift by TNCs towards more capital- and knowledge-intensive production.

Global trends in employment by foreign affiliates affect individual countries differently. In countries that are both home and host economies, the direct employment consequences of FDI will also depend upon what happens to employment by foreign affiliates in their economies as well as to employment in their foreign affiliates abroad. For instance, China is the host country with the largest number of employees in foreign affiliates. In 2004, around 24 million workers (3% of total employment in China) were employed in foreign affiliates in that country (table I.5)[32] compared to less than 5 million in 1991 (*WIR04*: 187). Employment in foreign affiliates of TNCs in the United States shrank by half a million between 2001 and 2004 to 5 million as the United States economy underwent an economic downturn. FDI inflows to the United States during this period were only two fifths of those in 2000.

The United States has by far the largest stock of outward FDI, and this is reflected in the employment of foreign affiliates of United States-based TNCs: nearly 9 million employees in majority-owned foreign affiliates in 2004, a larger number of employees abroad than in TNCs from any other home country (table I.5 and annex table B.10). The workforce employed in majority-owned foreign affiliates of United States TNCs increased significantly from the 1950s to the 1980s. In 1985, nearly 5 million employees worked in such affiliates. The growth in their workforce over the subsequent two decades (at an annual average rate of 2.9%) was, however, much lower than that in the foreign affiliates of several other countries' TNCs (figure I.5). In Europe, employment in foreign affiliates of TNCs based in countries like Austria (with an average annual growth rate of foreign-affiliate employment of 13.1%), the Czech Republic (19.5%) and Finland (17.9%), in particular, has expanded much more rapidly. German and Japanese TNCs have the second and third largest number

Table I.5. Employment related to inward and outward FDI and total employment in selected economies, most recent year

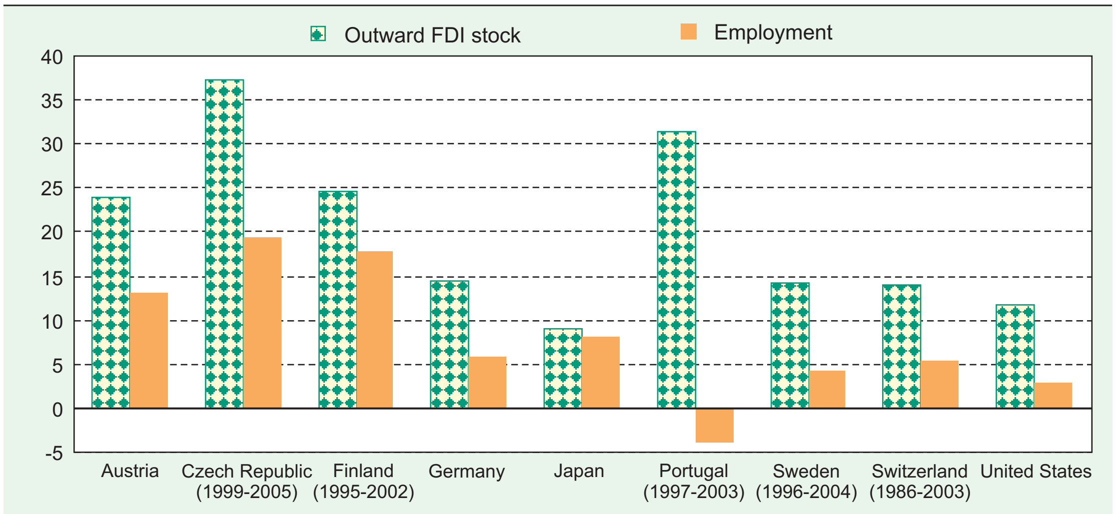
(Thousands of employees)

Economy	Year	Host economy employment of foreign affiliates (A)	Foreign employment of home-based TNCs (B)	Difference (A-B)	Total paid employment in the economy (C)	Share of foreign affiliates' employment in total (A/C)
Australia	2002	..	321.9[a]	..	7 959.8	..
Austria	2004	232.8	370.5	- 137.7	3 266.5	7.1
Belgium	2003	..	209.7	..	3 460.6	..
Canada	2002	..	919.0[a]	..	12 996.0	..
China	2004	24 000.0	..	..	752 000.0	3.2
Czech Republic	2004	620.4	24.8	595.6	3 890.0	15.9
Finland	2001	176.1[a]	315.1[a]	- 139.0	2 060.0	8.5
France	2003	1 880.0[b]	..	..	13 460.0[c]	14.0
Germany	2004	2 280.0	4 605.0	- 2 325.0	31 405.0	7.3
Hong Kong, China	2004	543.0[a]	..	..	2 460.5	22.1
Hungary	2000	606.7	..	..	2 703.2	22.4
Ireland	2004	149.5[d]	..	..	295.8[d]	50.6
Italy	1999	560.1[e]	642.5[e]	- 82.4	4 075.0[e]	13.7
Japan	2004	430.9	4 138.6	- 3 707.7	53 550.0	0.8
Luxembourg	2001	72.9	103.3	- 30.4	258.9	28.2
Macao, China	2004	36.7	10.9	25.8	192.3	19.1
Madagascar	2003	193.8[f]	..	..	8 098.5[g]	2.4
Mozambique	2004	13.2[h]	..	..	..	..
Nepal	1999	73.5[h]	..	..	..	..
Poland	2000	648.3[a]	..	..	10 546.0	6.1
Portugal	2002	150.4[a]	23.6[a]	126.8	3 756.2	4.0
Singapore	2004	157.6[e]	..	..	335.2[e]	47.0
Slovenia	2004	64.0	..	..	798.0	8.0
Sri Lanka	2004	415.7[h]	..	..	7 394.0	5.6
Sweden	2004	544.6[a]	953.6[a]	- 409.1	3 796.0	14.3
Switzerland	2004	190.1	1 861.7	- 1 671.6	3 631.6	5.2
United Rep. of Tanzania	2000	80.6	..	..	16 914.8[i]	0.5
United States	2004	5 116.4[a]	8 617.2[a]	- 3 500.8	131 367.4	3.9
Vanuatu	2002	0.1	..	..	..	..

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics), and ILO.

a Data refer to majority-owned affiliates only.
b Employees in enterprises under foreign control.
c Employees in enterprises under foreign control + employees in enterprises under French control.
d Total permanent full-time employment in the manufacturing and internationally traded services sectors.
e Data refer only to the manufacturing sector.
f 1998.
g Total labour force in 2003.
h Approval data.
i Total employed persons in Tanzania mainland (from the Integrated Labour Force Survey 2000-2001).

Figure I.5. Outward FDI stock and employment in foreign affiliates of selected home countries: average annual growth, 1985-2004
(Per cent)



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

Note: Employment data for Finland, Portugal and Sweden are for majority-owned affiliates only.

of employees in their foreign affiliates worldwide (4.6 million and 4.1 million, respectively, in 2004).

The employment impact of FDI in host economies varies by region and industry. Generally, employment created by a given amount of FDI is larger in developing and transition economies than in developed countries, and in the manufacturing sector than in other sectors. In the case of United States outward FDI, for instance, the largest impact is observed in South-East Europe and the CIS, followed by developing countries (table I.6). Employment creation is smallest in the primary sector, including the mining and oil industry.

The effects of outward FDI on employment in the home countries are often the focus of economic and political debates in those countries. Fears of job losses at home may also induce home governments to introduce policy measures that try to prevent companies from expanding abroad or they may offer them incentives to stay and invest at home. In the United States, for example, public debate about possible job losses through expansion abroad by United States TNCs led to the introduction of the Homeland Investment Act in 2004 to encourage more investment at home (see *WIR06*: 89 for the effects of this Act on United States FDI outflows).[33] In many developed countries, jobs created abroad by their own TNCs (through outward FDI) tend to be larger than those created by foreign companies operating

Table I.6. Employment in United States foreign affiliates abroad and United States outward FDI stock, by sector, 2003

Region/sector	Employees (Thousands)	Outward FDI stock ($ million)	No. of employees per $1 million of outward FDI stock
World			
Total	9 657.5	1 769 613	5.5
Primary	199.5	85 473	2.3
Mining, quarrying and petroleum	181.0	85 473	2.1
Manufacturing	4 989.2	371 078	13.4
Services	3 973.4	1 176 957	3.4
Developed countries			
Total	5 983.1	1 266 350	4.7
Primary	56.7	42 876	1.3
Mining, quarrying and petroleum	55.5	42 876	1.3
Manufacturing	2 760.6	280 874	9.8
Services	1 755.8	835 881	2.1
Developing countries			
Total	3 550.4	489 865	7.2
Primary	107.3	37 506	2.9
Mining, quarrying and petroleum	92.1	37 506	2.5
Manufacturing	2 099.9	88 369	23.8
Services	779.6	333 917	2.3
South-East Europe and CIS			
Total	32.1	2 511	12.8
Primary	4.3	1 253	3.4
Mining, quarrying and petroleum	4.3	1 253	3.4
Manufacturing	15.1	266	56.8
Services	4.8	325	14.8

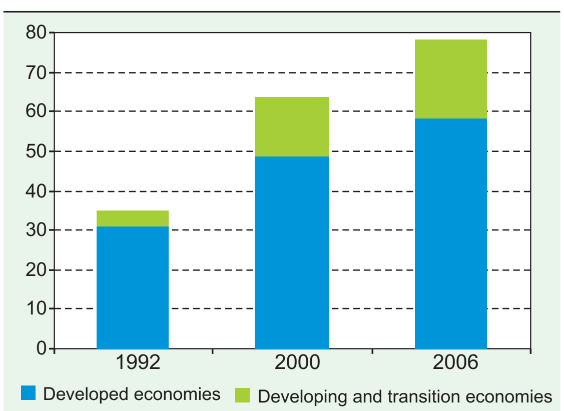
Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

in those countries (through inward FDI) (table I.5). This is largely a reflection of their position as net direct investors (with outward FDI stock exceeding inward FDI stock).[34] However, some empirical studies for the United States do not support the hypothesis that FDI abroad causes job losses at home (Hanson, Mataloni and Slaughter, 2005; Desai, Foley and Hines, 2005; Mankiw and Swagel, 2005).[35] Instead, they suggest that outward FDI has a positive or non-significant effect on employment at home. In the case of Japanese TNCs, according to a recent survey on the likely impact of outward FDI on employment in parent firms, only 6% of the surveyed firms said that they would cut labour at home while 62% said that outward FDI would not create redundant labour at home (Japan, METI, 2007: 58).

There are other instances where outward FDI has led to a reduction of employment in the home country at least in the short run. A study of German and Swedish TNCs, for instance, found that foreign-affiliate employment tends to substitute for employment of the parent firm, with significant positive employment effects for host countries that have a large wage gap with Sweden and Germany, notably the Central and Eastern European countries (Becker et al., 2005). For Italy it was found that FDI has a negative effect on labour intensity of home-country production by TNCs in the case of efficiency-seeking FDI, especially for smaller firms that invested in other developed countries. Positive home-country effects were found for market-seeking FDI in developed countries (Mariotti, Mutinelli and Piscitello, 2003).[36]

Available data suggest that TNCs responsible for the growth of cross-border production numbered at least some 78,000 parent companies with at least 780,000 foreign affiliates in 2006 (annex table A.I.5). Of these, about 58,000 parent TNCs were based in developed countries and about 20,000 in developing and transition economies (18,500 in developing countries and 1,650 in transition economies). The number of TNCs from developing and transition economies has increased more than those from developed countries over the past 15 years: 4,000 in the former and 31,000 in the latter in 1992 (figure I.6). Regarding foreign affiliates, in 2006 there were 260,000 located in developed countries, 407,000 in developing countries, and 111,000 in the transition economies. China continues to host the largest number of foreign affiliates, accounting for one third of all foreign affiliates of TNCs worldwide. Given its small share in global inward stock (only 2% in 2006), this implies that many foreign affiliates in China are very small, or are joint ventures with domestic enterprises.

Figure I.6. Number of TNCs from developed, developing and transition economies, 1992, 2000 and 2006
(Thousands)



Source: UNCTAD, based on annex table A.I.5.

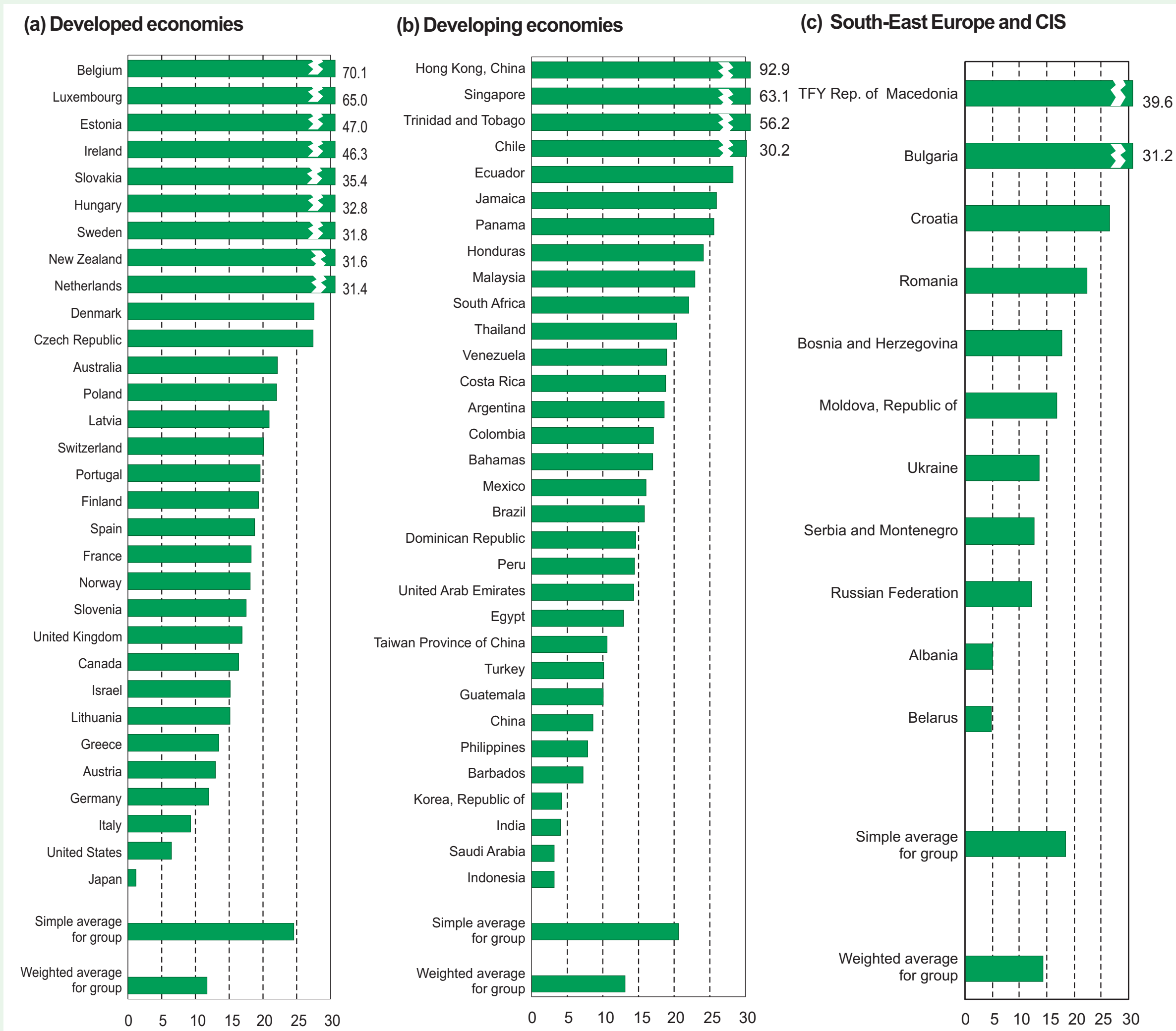
UNCTAD's Transnationality Index[37] shows that in 2004 (the latest year for which the index was compiled), the importance of international production rose in most host economies (developed and developing as well as transition), reflecting the rise of FDI flows that year (figure I.7). The transnationalization of the largest TNCs worldwide has also increased (as discussed in section C).

3. Indices of inward FDI performance and potential

The rankings of countries by UNCTAD's Inward FDI Performance[38] and Potential Indices,[39] as well as the Outward FDI Performance Index[40] for 2006 show the continuation of a number of previous patterns and some year-to-year changes. Among the top 20 listed in the Performance Index for both inward and outward FDI, some relatively small countries continued to rank high (table I.7; annex table A.I.6). Bahrain and Tajikistan entered the top 20 rankings for inward FDI performance, and Israel and Estonia, entered the top 20 for outward FDI performance. In general, however, there were few major changes in the top rankings.

There were no major changes in the Inward FDI Potential Index rankings; this index essentially reflects the country-specific structural variables affecting inward FDI that do not generally change significantly from year to year. Juxtaposing the Inward FDI Performance Indices of countries with their respective Inward FDI Potential Indices yields a matrix of the following categories: front-runners − countries with high FDI potential and performance; above potential − countries with low FDI potential but strong performance; below potential − countries with high FDI potential but low performance; and underperformers − countries with both low FDI potential and performance (figure I.8). While

Figure I.7. Transnationality Index[a] for host economies,[b] 2004
(Per cent)



Source: UNCTAD estimates.

[a] Average of the four shares: FDI inflows as a percentage of gross fixed capital formation for the past three years 2002-2004; FDI inward stocks as a percentage of GDP in 2004; value added of foreign affiliates as a percentage of GDP in 2004; and employment of foreign affiliates as a percentage of total employment in 2004.

[b] Only the above-mentioned economies for which data for all of these four shares are available were selected. Data on value added are available only for Australia (2001), Belarus (2002), China (2003), the Czech Republic, France (2003), Hong Kong (China), Ireland (2001), Japan, Lithuania, the Republic of Moldova, Singapore (manufacturing only), Slovenia, Sweden (2003), and the United States. For Albania, the value added of foreign affilialtes was estimated on the basis of the per capita inward FDI stocks and the corresponding ratio refers to 1999. For the other economies, data were estimated by applying the ratio of value added of United States affiliates to United States outward FDI stock to total inward FDI stock of the country. Data on employment are available only for Australia (2001), Austria, China, the Czech Republic, France (2003), Germany, Hong Kong (China), Ireland (2001), Japan, Lithuania, Luxembourg (2003), Poland (2000), the Republic of Moldova, Singapore (manufacturing only), Slovenia, Sweden, Switzerland, and the United States. For Albania, the employment impact of foreign affiliates was estimated on the basis of their per capita inward FDI stocks and the corresponding ratio refers to 1999. For the remaining countries, data were estimated by applying the ratio of employment of Finnish, German, Japanese, Swedish, Swiss and United States affiliates to Finnish, German, Japanese, Swedish, Swiss and United States outward FDI stock to total inward FDI stock of the economy. Data for Ireland, Sweden and the United States refer to majority-owned foreign affiliates only. Value added and employment ratios were taken from Eurostat for the following countries: Austria (value added only), Bulgaria, Estonia, Finland, Hungary, Italy, Latvia, the Netherlands, Portugal, Romania, Slovakia and Spain; the data refer to the year 2003.

there are no notable changes in the 2005 grouping of countries according to this matrix over that of the previous year (*WIR06*), several countries have improved their FDI position in performance or potential, or both, over the past decade. For example, Botswana, Croatia, Lithuania, the United Arab Emirates and Thailand significantly improved their rankings in the Performance Index or both Performance and Potential Indices (figure I.8 and annex table A.I.6), which reflects increased FDI inflows relative to their incomes as well as improved economic and other conditions for attracting FDI, relative to other countries. On the other hand, countries such as Ghana and Paraguay went into the underperformance category. Only Indonesia has fallen from a front-runner to an underperformer over the past decade.

Table I.7. Top 20 rankings by Inward and Outward Performance Indices, 2005 and 2006[a]

Inward Performance Index ranking[b]			Outward Performance Index ranking[c]		
Economy[a]	2005	2006	Economy[a]	2005	2006
Luxembourg	5	1	Iceland	1	1
Hong Kong, China	4	2	Hong Kong, China	3	2
Suriname	3	3	Luxembourg	2	3
Iceland	12	4	Switzerland	8	4
Singapore	6	5	Belgium	7	5
Malta	10	6	Netherlands	6	6
Bulgaria	8	7	Panama	4	7
Jordan	19	8	Ireland	10	8
Estonia	7	9	Azerbaijan	5	9
Belgium	11	10	Bahrain	9	10
Bahrain	23	11	Kuwait	34	11
Azerbaijan	1	12	Sweden	11	12
Gambia	14	13	Singapore	12	13
Lebanon	9	14	Spain	13	14
Georgia	16	15	Israel	23	15
Tajikistan	33	16	Estonia	21	16
Panama	25	17	France	16	17
Bahamas	21	18	Norway	14	18
Sudan	13	19	United Kingdom	15	19
Guyana	32	20	Cyprus	17	20

Source: UNCTAD, based on annex table A.I.6.

[a] Countries are listed in the order of their 2006 rankings.
[b] Rankings are based on indices derived using three-year moving averages of data on FDI inflows and GDP for the immediate past three years, including the year in question.
[c] Rankings are based on indices derived using three-year moving averages of data on FDI outflows and GDP for the immediate past three years, including the year in question.

4. Developments in FDI policies

a. Developments at the national level

Countries worldwide continue to adopt measures aimed at improving their investment climate. In 2006, according to UNCTAD's annual survey of changes in national laws and regulations relevant to the entry and operations of TNCs, a total of 184 policy changes were identified, 80% of which were in the direction of making the host-country environment more favourable to FDI (table I.8). At the same time, the survey also noted 37 changes in the opposite direction, many of which were related to the extractive industries and were concentrated in a relatively few countries.

Out of 184 identified changes, 109 were adopted in developing countries, with Africa accounting for 57, West Asia for 14, South, East and South-East Asia for 32, and Latin America and the Caribbean for 6. South-East Europe and the CIS adopted 38 of the changes and developed countries 37 (see also chapter II).

Most of the changes involved the introduction of new promotional efforts, including incentives aimed at increasing FDI in certain economic activities. As in 2005, many involved lowering corporate income taxes, a measure that affects

Figure I.8. Matrix of inward FDI performance and potential, 2005

	High FDI performance	Low FDI performance
	Front-runners	Below potential
High FDI potential	Azerbaijan, Bahamas, Bahrain, Belgium, Botswana, Brunei Darussalam, Bulgaria, Chile, China, Croatia, Cyprus, Czech Republic, Dominican Republic, Estonia, Hong Kong (China), Hungary, Iceland, Israel, Jordan, Kazakhstan, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Netherlands, Panama, Poland, Portugal, Qatar, Singapore, Slovakia, Thailand, Trinidad and Tobago, Ukraine, United Arab Emirates and United Kingdom.	Algeria, Argentina, Australia, Austria, Belarus, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Islamic Republic of Iran, Italy, Japan, Kuwait, Libyan Arab Jamahiriya, Mexico, New Zealand, Norway, Oman, Republic of Korea, Russian Federation, Saudi Arabia, Slovenia, Spain, Sweden, Switzerland, Taiwan Province of China, Tunisia, Turkey, United States and Venezuela.
	Above potential	Under-performers
Low FDI potential	Albania, Angola, Armenia, Colombia, Congo, Costa Rica, Ecuador, Egypt, Ethiopia, Gabon, Gambia, Georgia, Guyana, Honduras, Jamaica, Kyrgyzstan, Lebanon, Mali, Mongolia, Morocco, Mozambique, Namibia, Nicaragua, Republic of Moldova, Romania, Sierra Leone, Sudan, Suriname, Tajikistan, Uganda, United Republic of Tanzania, Uruguay, Viet Nam and Zambia.	Bangladesh, Benin, Bolivia, Burkina Faso, Cameroon, Democratic Republic of Congo, Côte d'Ivoire, El Salvador, Ghana, Guatemala, Guinea, Haiti, India, Indonesia, Kenya, TFY Rep. of Macedonia , Madagascar, Malawi, Myanmar, Nepal, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Philippines, Rwanda, Senegal, South Africa, Sri Lanka, Syrian Arab Republic, Togo, Uzbekistan, Yemen and Zimbabwe.

Source: UNCTAD, based on annex table A.I.6.

Table I.8. National regulatory changes, 1992-2006

Item	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Number of countries that introduced changes	43	56	49	63	66	76	60	65	70	71	72	82	103	93	93
Number of regulatory changes	77	100	110	112	114	150	145	139	150	207	246	242	270	205	184
More favorable to FDI	77	99	108	106	98	134	136	130	147	193	234	218	234	164	147
Less favorable to FDI	0	1	2	6	16	16	9	9	3	14	12	24	36	41	37

Source: UNCTAD database on national laws and regulations.

both domestic companies and foreign affiliates. For example, Egypt reduced its corporate tax to a standard rate of 20% (from a basic rate of 40% and from 32% for industrial and export activities).[41] Similar steps were taken by Ghana (which reduced its corporate income tax from 28% to 25%) and Singapore (from 20% to 18%). Other countries, including India, created new special economic zones, many offering tax holidays or other incentives. Brazil decided to implement an "accelerated growth programme" that will provide corporate tax reductions amounting to an estimated $4.7 billion.

The overall trend to provide more incentives to foreign investors goes hand in hand with the continuing opening up of a number of economic sectors to FDI in various countries. In Italy, for example, a wide ranging liberalization programme was agreed, covering a number of service industries such as professional services, pharmacies, banks and taxi transport. Many of those services have traditionally been protected by licensing regimes. Steps to liberalize the telecommunications industry were taken, for example in Botswana, Cape Verde and Kenya; the banking industry was made more open in Belarus and Mali; and the energy/electricity industry was liberalized to FDI in, for example Albania, Algeria, Bulgaria and Kyrgyzstan. While the overall policy trend in the services sector remains in the direction of greater openness to FDI, the extent to which countries restrict the entry of foreign companies to the sector still varies widely. Outside developed countries, Latin America and the transition economies are the most open to FDI in services (box I.2).

A notable exception to the liberalization trend relates to the extractive industries, where a number of new restrictions on foreign ownership were observed in 2006.[42] For example, in Algeria, the State-owned oil and gas enterprise must now hold a minimum 51% stake in exploration and production arrangements. In Bolivia, discussions relating to ownership and fiscal arrangements in the oil and gas industry were resolved by the signing of new service contracts; these substantially raise the Government's revenues from production and return ownership of all reserves to the State oil company (see also chapter VI). In Indonesia, on the other hand, the Government decided to offer subsidies and tariff reductions to extractive-industry investors in the eastern part of the country.

While the proportion of less favourable changes has remained at the peak of 20% reached in 2005, the nature and significance of those changes vary. In 2006, the majority of them concerned tax increases or the introduction of new taxes, such as withholding taxes (e.g. the former Yugoslav Republic of Macedonia), or solidarity or social taxes (e.g. Hungary, Lithuania). More far-reaching changes were observed in the Russian Federation, where in March 2006 the Government released a preliminary list of 39 "strategic sectors" in which inward FDI would be restricted, including most defence-related activities, aviation and natural resources.[43] Foreign companies will only be allowed to own minority stakes in "strategic assets" in the country's natural resources sector. In China, a similar development aimed at the protection of strategic sectors has been observed. A new policy includes "provisions for increased supervision of sensitive acquisitions" to ensure that what are termed "critical industries and enterprises" remain under Chinese control.[44] The potential negative effects of such policies stem mainly from the uncertainties relating to the definition of strategic sectors or national security (*WIR06*).

By region, as in 2005, Latin America and the Caribbean had a relatively high proportion of "less favourable" changes, which mainly reflected regulatory amendments related to the extractive industries in Bolivia, Peru and Venezuela, and to the Venezuelan programme to nationalize "strategic sectors" such as energy and telecommunications (figure I.9). FDI policy changes at the regional level are described further in the analysis of regional trends in chapter II.

In sum, while, in general, policy changes are in the direction of more liberalization and deregulation, there are some notable changes that suggest signs of a shift towards restrictions on investments in some industries. As in 2005, restrictions are still confined to a relatively small number of countries, and with notable regional differences. But the perception that such changes might trigger renewed protectionism in certain countries has prompted some concern reflected in policy-related initiatives such as the series of round tables launched in 2006 by the Organisation for Economic Co-operation and Development (OECD) on Freedom of Investment, National Security and "Strategic" Industries. Issues discussed at four such round tables so far include the role of national security considerations in present investment regulations in OECD and non-OECD countries, their treatment in international investment agreements (IIAs); regulatory approaches to foreign State-controlled enterprises, and the challenge of identifying ultimate beneficiary ownership and control in cross-border investments. The view emerging from these round tables was that investment policies should be guided by the principles of regulatory proportionality, predictability and accountability.[45] It was also suggested that restrictions on investment should not

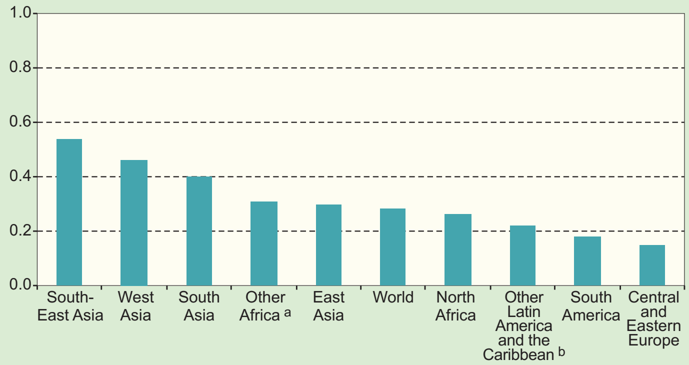
Box I.2. Developing-country openness to FDI in services varies widely

Services account for about two thirds of FDI inflows worldwide and for half of FDI inflows in developing countries (annex table A.I.10). The extent to which countries have opened up to FDI in services varies considerably. Latin America and Central and Eastern Europe are on average more open than countries in Africa and developing Asia (box figure I.2.1), but with significant intraregional variation. A recent UNCTAD study (2006a) found that among developing countries Bolivia and Uganda have the fewest restrictions on FDI in services, whereas Ethiopia, the Philippines and Saudi Arabia are at the other end of the spectrum.

Social services such as health and education are among the industries with the lowest level of explicit restrictions on FDI, followed by business services and the distribution industries. By contrast electricity, telecommunications, transport and financial industries remain highly restricted. Earlier studies (e.g. Warren, 2001; McGuire and Smith, 2001; Kemp, 2001; Kalirajan, 2000; Nguyen-Hong, 2000; and McGuire, 2002), which relied primarily on information contained in the country schedules of the WTO General Agreement of Trade in Services (GATS), tended to underestimate the extent to which countries have opened up their services to FDI. This is partly because countries have been more willing to liberalize unilaterally than multilaterally, for various reasons, including their desire to maintain policy space.

Source: UNCTAD, 2006a.

Box figure I.2.1. Openness to FDI in services in developing and transition economies, by region, 2004



Source: UNCTAD database on national laws and regulations.

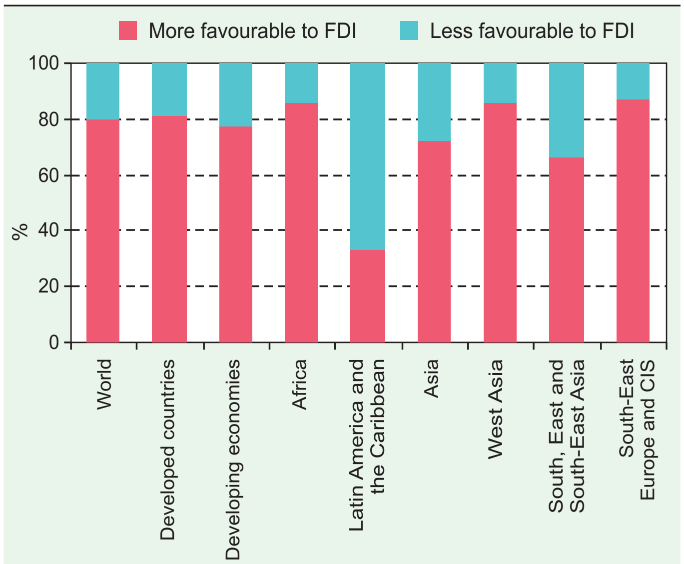
[a] Excluding North Africa.

[b] Excluding South America.

Note: Openness is measured on a scale of 0-1, with 0 representing full openness and 1 a de facto or actual prohibition of FDI. The measurement takes into account rules on ownership, screening and post-entry operational restrictions.

be more costly or more discriminatory than needed to achieve the security objectives, and that they should not duplicate what is, or could be, better dealt with by other regulations. Other guiding principles proposed were that regulatory objectives and practices should be made as transparent as feasible, and that proper mechanisms should be introduced to ensure accountability. The G-8 Heiligendamm Summit Declaration in June 2007 called for a continuation of this work.

Figure I.9. More favourable and less favourable regulatory changes in 2006, by region



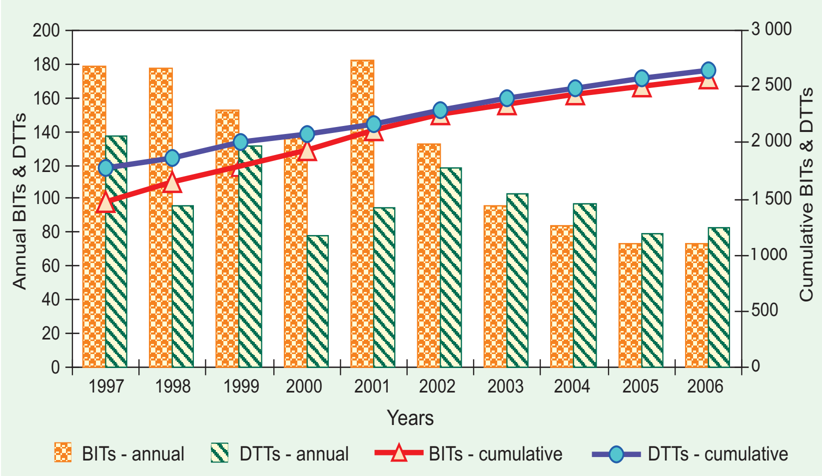
Source: UNCTAD, database on national laws and regulations.

b. Developments at the international level

The universe of international investment agreements (IIAs) continues to grow in number and complexity. In 2006, 73 bilateral investment treaties (BITs), 83 double taxation treaties (DTTs), and 18 other international agreements that deal with other economic activities (such as trade) but also contain investment provisions[46] were concluded. This brought the total number of IIAs to close to 5,500 at the end of 2006: 2,573 BITs (figure I.10), 2,651 DTTs (figure I.10), and 241 other agreements (figure I.11).

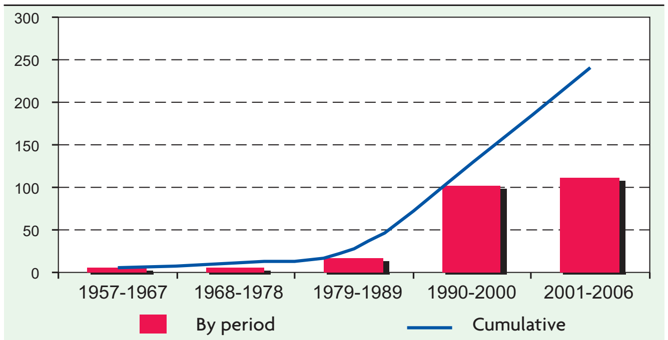
Some recent developments deserve particular attention. First, the IIA universe continues to evolve into an increasingly complex and diverse patchwork.[47] Among its key characteristics are its universality, in that nearly every country has signed at least one IIA, and its atomization, in that no single authority coordinates the overall structure or the content of the thousands of agreements that constitute the system. Moreover, it is multilayered, with IIAs existing at the bilateral, regional, sectoral, plurilateral and multilateral levels; it is also multifaceted with some IIAs including not only provisions on investment, but also – and in some cases more extensively – rules on related matters such as trade in goods and/or services, or intellectual property protection.

Figure I.10. Number of BITs and DTTs concluded, cumulative, 1997-2006



Source: UNCTAD (www.unctad.org/iia).

Figure I.11. Number of other agreements[a] concluded, by period, 1957-2006



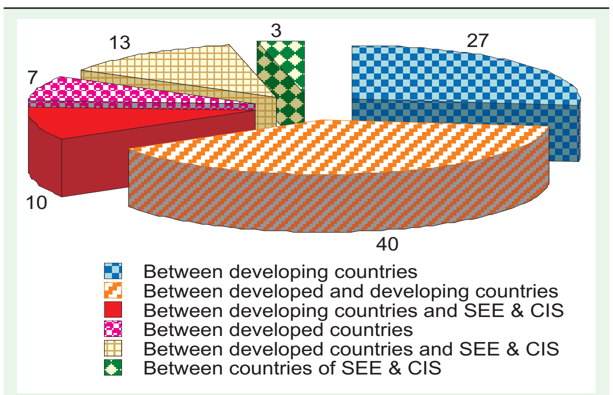
Source: UNCTAD (www.unctad.org/iia).

[a] International agreements, other than BITs and DTTs, that contain investment provisions.

Secondly, IIAs other than BITs and DTTs have proliferated. While their total number is still small compared with the number of BITs, it has nearly doubled over the past five years (figure I.11). Most of the agreements concluded in 2006 are free trade agreements (FTAs) that establish, inter alia, binding obligations of the contracting parties concerning the admission and protection of foreign investment. The scope of the protection commitments in these FTAs is comparable to those found in BITs, including with regard to dispute settlement. Furthermore, the new Central European Free Trade Agreement (CEFTA) was concluded, which consolidated over 30 bilateral FTAs. In addition, at least 68 such agreements, involving 106 countries, were under negotiation at the end of 2006.[48]

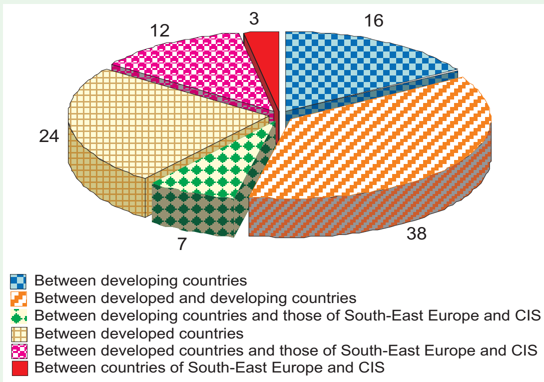
Thirdly, the role of developing countries in international investment rule-making is growing. At the end of 2006, they were party to 76% of all BITs (figure I.12), 61% of all DTTs (figure I.13), and 81% of all other IIAs. For the first time, there are now three developing countries – China, Egypt and the Republic of Korea – among the top 10 signatories of BITs worldwide (figure I.14). Least developed countries (LDCs), while host to less than 1% of global inward FDI stock, had nevertheless concluded 16% of all BITs, 7% of all DTTs and 15% of other IIAs by the end of 2006. There is also a substantial increase in the number of IIAs concluded among developing countries. By December 2006, 680 BITs had been concluded among developing countries, constituting about 27% of all BITs. There were more than 90 South–South IIAs other than BITs and DTTs at the end of 2006.[49] The

Figure I.12. BITs concluded as of end 2006, by country group
(Per cent)



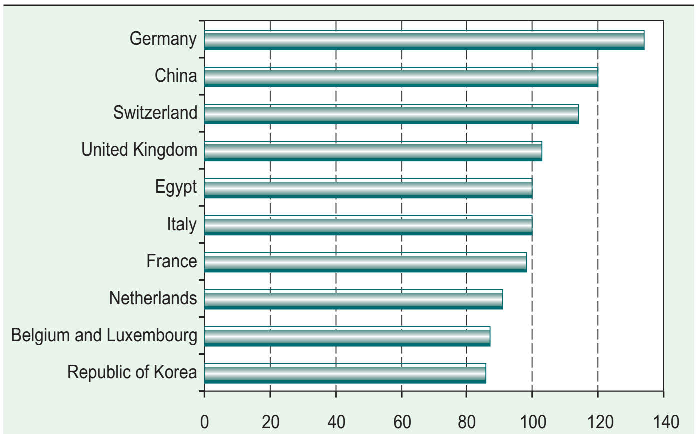
Source: UNCTAD (www.unctad.org/iia).

Figure I.13. DTTs concluded as of end 2006, by country group
(Per cent)



Source: UNCTAD (www.unctad.org/iia).

Figure I.14. Number of BITs concluded by top ten economies, end 2006



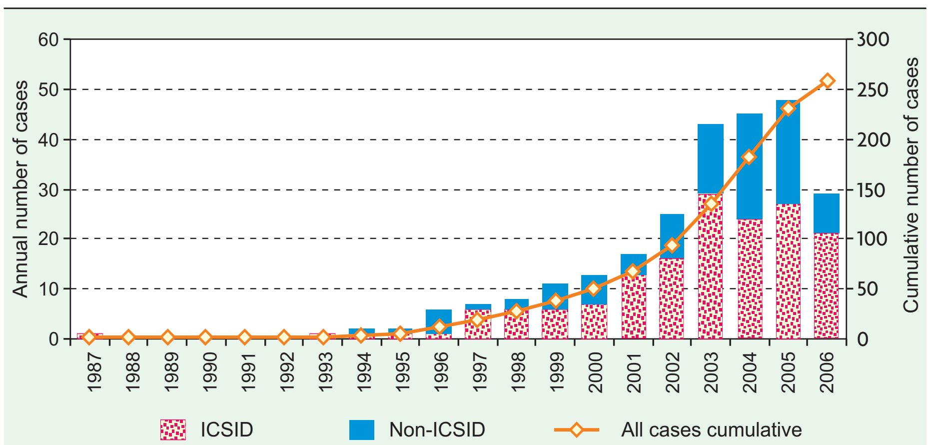
Source: UNCTAD (www.unctad.org/iia).

growth of FDI from the South means that a number of developing countries are becoming both host and home economies.

Fourthly, the number of known treaty-based investor–State dispute settlement cases further increased by 29 in 2006, bringing the total number of such cases to 259 (figure I.15).[50] However, the increase in 2006 was considerably smaller than during 2003-2005. As of end 2006, more than half (161) of all known cases had been filed with the International Centre for Settlement of Investment Disputes (ICSID). Other disputes were initiated under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) (65), the Stockholm Chamber of Commerce (18), the International Chamber of Commerce (4), ad hoc arbitration (4), and the Cairo Regional Centre for International Commercial Arbitration (1). The venues for the remaining six cases are unknown. Most of the cases (42%) involved the services sector (including electricity distribution, telecommunications, debt instruments, water services and waste management), 29% were related to mining and oil and gas exploration activities, and another 29% concerned the manufacturing sector. At least 70 governments – 44 of developing countries, 14 of developed countries and 12 of South-East Europe and the CIS – faced investment treaty arbitration, with Argentina topping the list (42 claims), followed by Mexico (18), the United States and the Czech Republic (11 each).[51] In terms of substance, in 2006 arbitration tribunals rendered significant awards relating to IIA provisions on most-favoured-nation (MFN) treatment, fair and equitable treatment, expropriation, the "umbrella clause", and a "state of necessity" exception.[52]

The evolution of the IIA universe, including investment arbitration, poses challenges of capacity and content for many developing countries. Challenges of capacity arise from the fact that many developing countries lack the resources to participate fully and effectively in the development of the IIA network that is increasing in scope, complexity and diversity.[53] Challenges of content arise in several respects, three of which are of primary importance: policy

Figure I.15. Known investment treaty arbitrations, cumulative and new cases, 1987 to end 2006



Source: UNCTAD (www.unctad.org/iia).

coherence, balancing private and public interest in IIAs, and strengthening the development dimension of these agreements, as discussed below.

Policy coherence. The increasingly complex universe of IIAs raises concerns related to coherence among different IIAs, with implications for the formulation of effective development policies. Due to capacity constraints and weaker bargaining positions, developing countries may find it more difficult than developed countries to establish coherent development polices that are consistent with IIAs or that conform with the requirements/ principles of IIAs and consistently reflect them in IIAs. On the other hand, the possible effects of inconsistency might be mitigated by the MFN clause that is a standard feature in practically all IIAs. It has, in principle, the effect of harmonizing the different degrees of investment protection granted by a country in its IIAs at a level that is the most favourable for the investor, thereby enhancing coherence. Also, international jurisprudence can make an important contribution to harmonizing understanding of the interpretation of core principles of investment protection. However, some recent contradictory awards have created uncertainty as to the circumstances under which the MFN clause actually applies and how far-reaching its effects might be (UNCTAD, 2005a).

Balancing private and public interests in IIAs. The rise in investor-state disputes over the past few years has triggered a discussion on what should be the proper counterweight to investors' rights in IIAs. Three approaches have emerged in recent treaty-making. First, some developed countries have clarified individual IIA provisions to prevent overly broad interpretations. This has occurred, for example, with regard to provisions guaranteeing fair and equitable treatment of investment and the definition of indirect takings.[54] Secondly, numerous recent IIAs place a stronger emphasis on public policy concerns, for example by including general exceptions to maintain national security, preserve the public order, and protect public health, safety or the environment. These provisions may become particularly relevant for investments in extractive industries (chapter VI). Thirdly, some IIAs have strengthened the public role in investor-State dispute resolution, for example, by allowing individuals or entities not involved in the dispute to make written submissions to a tribunal (UNCTAD, 2007a). Most of the three approaches mentioned above have so far been limited to a small, but growing number of countries.[55] It remains to be seen whether they will become a more commonly used feature in future IIAs. Finally, in April 2007, three countries in Latin America, Bolivia, Nicaragua and Venezuela, announced plans to withdraw from the World Bank's arbitration court, ICSID. So far, only Bolivia formally notified its withdrawal to the World Bank (chapter II).

Strengthening the development dimension of IIAs. It might be useful for IIAs to include provisions for strengthening their development dimension. Apart from provisions aimed at allowing regulatory flexibility for host countries (UNCTAD, 2004), they could also include specific investment promotion provisions, such as transparency and exchange of investment-related information, fostering linkages between foreign investors and domestic companies, capacity-building and technical assistance, granting of investment insurance and other incentives, easing informal investment obstacles, joint investment promotion activities, and the setting up of an institutional mechanism for coordination and monitoring purposes (UNCTAD, forthcoming a). The issue of incorporating a development dimension into an IIA also raises the question of what kind of IIA best advances development objectives. This may vary for different countries. The development dimension thus requires not only selecting the type of instrument to be negotiated, but also the drafting of specific provisions for incorporating into the agreement.

B. Changing patterns of FDI

1. Geographic patterns

The geographic pattern of FDI has changed in various ways during the past decade, with new countries having emerged as significant host and home economies. Shifts in the patterns of bilateral FDI relationships have occurred among developed countries, as well as in the relative importance of developed versus developing and transition economies. The rise of FDI from developing and transition economies and the growth of South-South FDI, as discussed in *WIR06*, are examples of recent trends. In order to assess the strength of FDI links between different home and host economies and its development over time, the value of bilateral FDI stocks for 72 countries for which data are available is examined below.

In 2005, the largest bilateral outward FDI stock was that of the United Kingdom in the United States, amounting to $282 billion (table I.9). In comparison, the stock of FDI of the United States in the United Kingdom was valued at $234 billion – the third largest bilateral FDI relationship. Twenty years earlier, the situation had been the reverse, with the FDI stock of the United States being larger in the United Kingdom. Whereas the bilateral link between these two economies, together with those of United States-Canada and Netherlands-United States, dominated the global picture in 1985,

Table I.9. Top 50 bilateral FDI relationships, 1985, 1995, 2005
(Billions of dollars)

Rank	Home economy	Host economy	1985[a]	1995[a]	2005[a]
1	United Kingdom	United States	44	116	282
2	Hong Kong, China	China	..	120	242
3	United States	United Kingdom	48	85	234
4	Japan	United States	19	105	190
5	Germany	United States	15	46	184
6	United States	Canada	49	83	177
7	Netherlands	United States	37	65	171
8	China	Hong Kong, China	0.3	28	164
9	British Virgin Islands	Hong Kong, China	..	70	164
10	Canada	United States	17	46	144
11	France	United States	7	36	143
12	Switzerland	United States	11	27	122
13	Luxembourg	United States	0.3	6	117
14	Netherlands	Germany	5	34	111
15	Netherlands	France	10	31	102
16	United Kingdom	France	9	26	96
17	Netherlands	United Kingdom	17	27	93
18	Germany	United Kingdom	3	14	86
19	United States	Netherlands	8	25	84
20	France	United Kingdom	5	13	80
21	United States	Switzerland	..	14	79
22	United States	France	12	36	79
23	Germany	France	6	21	79
24	Netherlands	Ireland	..	..	76
25	Belgium	France	..	17	73
26	United States	Germany	14	41	68
27	United Kingdom	Netherlands	4	18	67
28	France	Germany	2	15	59
29	Germany	Netherlands	2	12	58
30	United States	Australia	..	33	54
31	Belgium	Netherlands	1	11	50
32	United Kingdom	Germany	3	11	49
33	United States	China	..	18	48
34	Japan	China	..	19	47
35	Luxembourg	France	..	2	44
36	Australia	United States	3	10	44
37	United States	Japan	..	15	44
38	Netherlands	Switzerland	..	10	43
39	Netherlands	Hong Kong, China	..	16	42
40	United Kingdom	South Africa	..	..	40
41	Netherlands	Italy	..	6	40
42	Luxembourg	Germany	0.3	3	40
43	Taiwan Province of China	China	..	18	40
44	Switzerland	France	5	19	39
45	United States	Sweden	1	6	39
46	United Kingdom	Australia	..	25	38
47	Virgin Islands	China	..	3	37
48	Belgium and Luxembourg	Ireland	..	..	37
49	Netherlands	Sweden	1	6	36
50	United Kingdom	Sweden	..	2	35

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).
[a] Or latest year available.
Note: Countries are ranked by the value of inward FDI stock in 2005 as reported by the host economy.

today, the situation is considerably more multifaceted, reflecting the involvement of many more countries in international production.

For example, in 2005, the second strongest relationship was between Hong Kong (China) and China. Other bilateral links that have grown significantly in importance since 1985 include Japan-United States, Germany-United States, China-Hong Kong (China) and the British Virgin Islands-Hong Kong (China) (table I.9). Out of the top 50 home-host economy FDI relations in 2005, 41 were among only developed countries and 9 involved developing economies, and especially China and Hong Kong (China). Reflecting its position as the largest FDI recipient in the world, the United States appears eight times among the 20 destinations with the largest stock of FDI from another country in 2005. Geographical proximity has become more important over time for partners.[56] For example in Europe in 2005, out of the top 50 pairs of countries with the strongest FDI links in terms of bilateral inward FDI stock, 22 were from Europe, compared to 17 in 1995 (table I.9; annex table A.I.7 ranks the next 50 pairs by inward FDI stock of host partner economy).

The above analysis can be taken a step further by comparing the actual volume of bilateral FDI stocks with what could have been "expected" by considering the respective shares of each economy in global outward and inward FDI. [57] A comparison of the actual value with the "expected value" of the bilateral FDI stock provides a measure of the intensity of the FDI relationship between a home economy and a host economy (box I.3).

An analysis of the intensity of the FDI relationship of major developed home economies with various host economies produces the following patterns (annex table A.I.8):

- The FDI intensities of the United States with its main traditional developed host-country partners, such as Canada, Japan and the United Kingdom, were all larger than one in 2005. And the intensity of its FDI relationship with some European host countries (e.g. Sweden and Switzerland) has increased. The analysis further shows the growing importance of Asian host economy partners with the United States than would be expected given their shares in global inward FDI: out of 10 economies with a strong relationship, four were in developing Asia. For example, in 1995, the United States-Malaysia FDI stock was only about half of the expected value (an FDI intensity of 0.5), and by 2005, it had increased to 1.3. Conversely, the United States' actual FDI stock in Latin America has fallen more than expected, given that region's importance in global inward FDI.
- Reflecting the strong geographical dimension of FDI, Japan's FDI intensity with respect to

Box I.3. Analysing the intensity of FDI relationships

Similar to the trade intensity index (Srivastava and Green, 1986), it is possible to assess the intensity of the FDI relationship between a home country (i) and a host country (j) by using a ratio that compares the actual value of the stock of country i in country j with what might be expected given the world position of each of them as home and host countries respectively.

FDI intensity ratio (R) = $FDI_{ij} / ExpFDI_{ij}$

FDI_{ij} = Actual amount of FDI stock from country $_i$ to $_j$.

$ExpFDI_{ij}$ = Expected value of FDI stock from country $_i$ to country $_j$

$$= \frac{FDI_{wj}}{FDI_{ww}} * \frac{FDI_{iw}}{FDI_{ww}} * FDI_{ww}$$

where,

FDI_{wj} = Total inward stock in the j country;

FDI_{iw} = Total outward FDI stock of i country in the world; and

FDI_{ww} = Worldwide inward or outward FDI stock.

If the intensity ratio is greater than 1, the FDI relationship is stronger than would be expected based on the relative importance of the two economies as home and host; if it is less than 1 it is weaker than expected.

For example, considering United States FDI in France: in 2004, the United States outward FDI stock accounted for 20% of the world outward stock. France's stock of inward FDI accounted for 7% of the world inward stock. The "expected value" of the United States FDI stock in France would then be 1.4% (0.2*0.07) of world FDI stock.[a] In the case of United States and France, the actual FDI stock in 2004 was $79 billion and the "expected value" about $140 billion (1.4% of world FDI stock in 2004). Accordingly, the FDI intensity was 79/140, or 0.56 – a weaker than expected relationship.

Source: UNCTAD.

[a] A similar assessment of FDI intensity, proposed by several researchers (Petri, 1994; Dunning, Fujita and Yakova, 2007) in the context of regional flows, measures the relative importance of a host region for a particular home country by looking at the ratio of the share of the host region in outward FDI stock of that country to the share of the host region in worldwide stock.

Asian developing countries has been not only stronger than with other developing countries, it has also increased over the past decade. The main exception was its bilateral FDI relationships with Hong Kong (China) and Indonesia, which have weakened. The intensity of Japan's FDI in such developed host countries as Australia and the United States have increased over the past decade.

- The intensity of the bilateral FDI relationships of major EU home countries have generally increased with other European countries, suggesting increased regional integration through FDI. For example, the FDI intensity of the United Kingdom as a home country, with Sweden rose from 0.6 to 1.6 between 1995 and 2005, and from 0.4 to 0.9 with Austria. Among non-European countries, its FDI intensity with Panama and Singapore has increased. The FDI intensity of France has increased with Japan and the United States, but fallen with Latin American host countries (e.g. Argentina and Brazil). Germany's FDI intensity has risen with host countries such as France, the United States and the United Kingdom, as well as with some Asian host countries (notably Malaysia and the Republic of Korea). However, the FDI intensity of Germany and France with new EU member countries as hosts has weakened significantly over the past decade.

Home developing economies have established stronger than expected FDI links with other developing host economies, especially in the regional context of Asia, China, Malaysia and the Republic of Korea (annex table A.I.8). A number of their developing-country partners rank higher than those from developed countries in terms of FDI intensity. Bilateral links are particularly strong with countries within the region, such as China-Hong Kong (China), Malaysia-Cambodia and the Republic of Korea-China. Malaysia is an exception in that its FDI intensity with home developing countries such as China and the Republic of Korea declined between 1995 and 2005, while it increased with home developed countries such as the United States and Japan.

Overall, the analysis suggests that geographical proximity is associated with stronger FDI intensities between certain home and host countries than between others. The geographical dimension has become more important for Asian home and host countries, especially for Japan as a home country. For the United States, FDI flows have increasingly spread beyond traditional recipients in Canada and Latin America. A similar phenomenon can be observed for the EU, as witnessed by its declining FDI intensity with many of its traditional developing-country partners. A number of home developing countries have developed stronger than expected FDI relationships, especially with other developing countries, highlighting the scope for increasing South-South investments.

2. Sectoral and industrial distribution of FDI

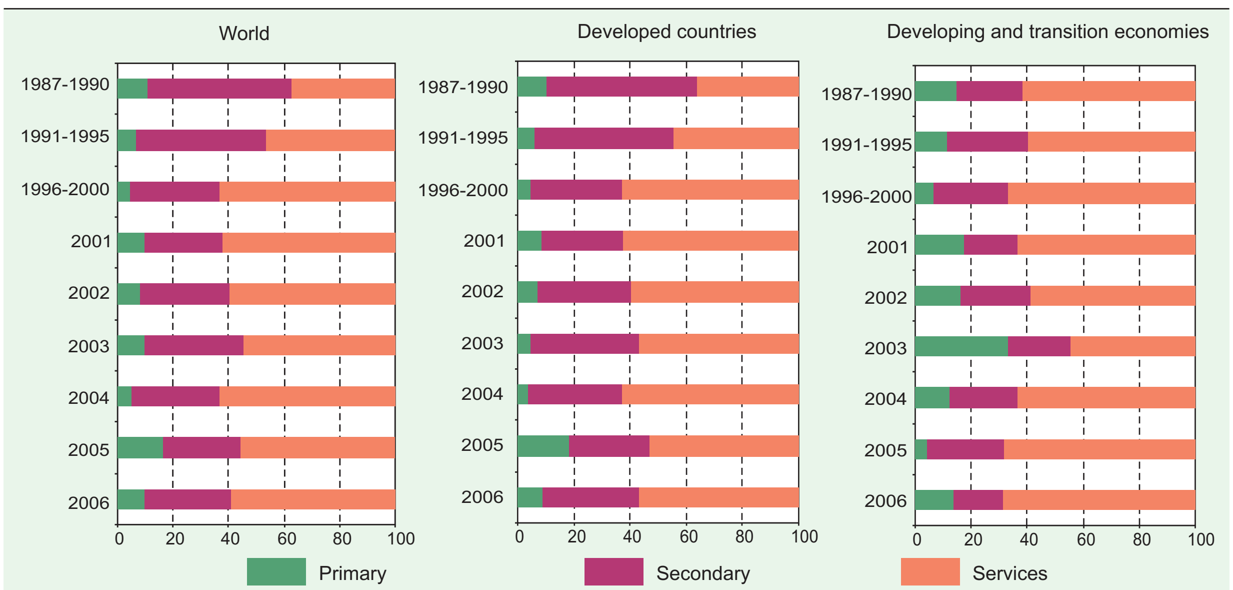
The most important change in the sectoral and industrial pattern of FDI over the past quarter century has been the shift towards services (*WIR04*), accompanied by a decline in the share of FDI in natural resources and manufacturing. Recently, however, FDI in the extractive industries of resource-rich countries has rebounded (Part Two), and its importance in infrastructure services is also rising.

Over the past 25 years, FDI has increased significantly in absolute terms in all three major sectors: primary, manufacturing and services. However, the shares of the primary and manufacturing sectors in world inward FDI stock have declined. In 2005, FDI stock in the primary sector accounted for less than one tenth of total world inward FDI stock, only slightly lower than its share in 1990, while manufacturing accounted for slightly less than a third of total FDI stock (30%), a noticeable drop from its share of 41% in 1990 (annex tables A.I.9-A.I.12). Services represented nearly two thirds of the global FDI stock (61%) in 2005, up from 49% in 1990. FDI flow data for recent years suggest that the share of the primary sector is partly recovering and could eventually reach its 1990 level, possibly even surpassing it if current trends continue. The sector accounted for 12% of world FDI inflows in 2003-2005, compared with 7% in 1989-1991.

Data on cross-border M&As confirm the growing importance of services. This sector's share in worldwide cross-border M&As rose from 37% in 1987-1990 to 58% in 2002-2006 (figure I.16), while that of the primary sector was halved, from 11% to 5% between 1987-1990 and 1996-2000, but it recovered to 11% in 2002-2006 (figure I.16). The share of manufacturing fell from 52% of global cross-border M&As in 1987-1990 to 31% in 2002-2006.

The estimated share of the primary sector in total inward FDI stock is lower in developed countries than in developing countries and in the transition economies of South-East Europe and the CIS (annex table A.I.9). Its decline in total inward FDI stock during 1990-2005 was largely confined to developed countries. In South-East Europe and the CIS, the primary sector's share has been particularly high. In 2005, it accounted for almost a quarter of their total inward FDI stock. The decline in the share of manufacturing in FDI was slightly larger in developing countries – where it reached 31% in 2005 – than in developed countries where it was 29%. On the other hand, the share of services in total inward stock (annex table A.I.9) in developed

Figure I.16. Sectoral distribution of cross-border M&As, by industry of seller, 1987-2006
(Per cent)



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

and in developing countries rose at a similar rate in the two regions, reaching 62% and 58% of their respective inward FDI stocks in 2005.

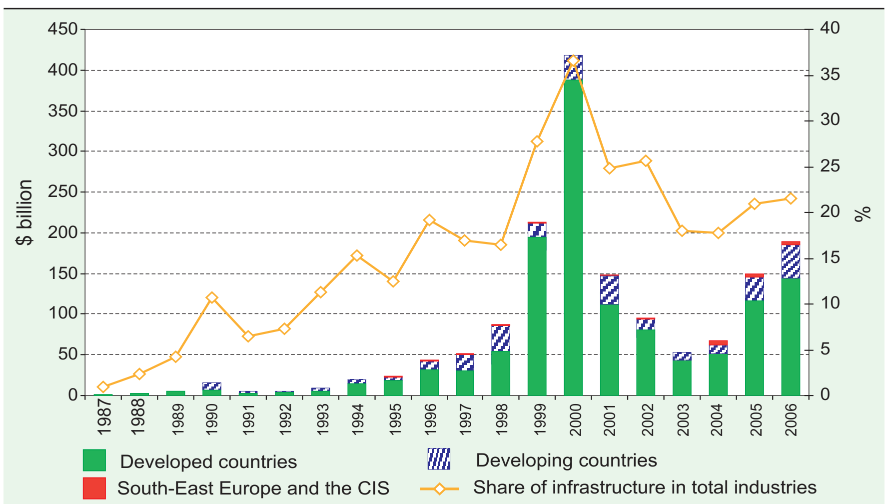
By far the highest share of FDI in the primary industries has been in mining (grouped along with quarrying) and petroleum. While FDI stock and flow estimates are not available for mining and petroleum separately, data on cross-border M&As suggest that both these industries have attracted increasing volumes of investment in recent years. During 2005 and 2006, the value of cross-border M&As in petroleum (representing an annual average of $63 billion) was nearly twice that in mining. Two of the five largest cross-border M&A deals in 2006 were in the mining sector (annex table A.I.3): one was the acquisition of Falconbridge, a Canadian copper and nickel mining company, by Xstrata of Switzerland for $17 billion, and the other was the $17 billion acquisition of Inco, also Canadian, by CVRD of Brazil (see also Part Two, chapter IV).

FDI stock estimates as well as data on cross-border M&As suggest that nearly all manufacturing industry groups have experienced a declining share in FDI over 15 years (annex table A.1.9-A.I.12). That includes industries that have been the largest recipients of FDI in manufactures: chemicals and chemical products, motor vehicles and other transport equipment, food, beverages and tobacco, electrical and electronic equipment, and machinery and equipment.[58] With the exception of chemicals and chemical products, and motor vehicles and other transport equipment, in developed countries during the period 1990-2005, the share of all manufacturing industry groups in global inward FDI stock declined in both developing and developed countries.

In the services sector, estimated inward FDI stock data for 1990 and 2005 and data on cross-border M&As for 1987-2006 suggest that there has been a relatively steady increase in the shares of electricity, gas and water distribution, and transport, storage and communications in global FDI (annex table B.6). The share of construction has declined, but FDI in infrastructure services as a group has risen in both absolute and relative terms.[59] As infrastructure development requires vast amounts of financing, it is almost impossible to meet such requirement from public sources alone in particular in developing countries. TNCs have therefore been increasingly involved in infrastructure development through FDI (both greenfield investments and M&As) as well as through non-equity forms of participation (such as build-operate-transfer and other modalities). For example, infrastructure-related industries accounted for 22% of worldwide cross-border M&As in 2006 (figure I.17), and for 30% in the developing and transition economies (figure I.18) – with both sets of shares rising recently. Private equity firms are also entering this market, and accounted for more than half of the worldwide M&A deals (both domestic and cross-border) in infrastructure in 2006, compared with only 2% in 1998.[60]

Regarding financial services, estimates show that its share in global inward FDI stock between 1990 and 2005 appears to have fallen slightly (annex table A.I.9), as also its share in total cross-border M&As over the past decade (annex table B.6 for the last three years).[61] There are noticeable differences between regions with respect to the relative

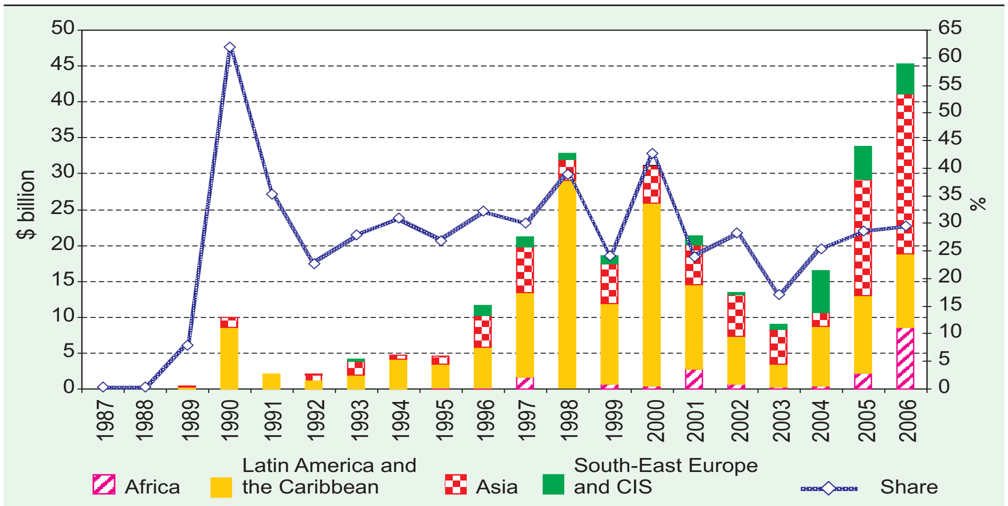
Figure I.17. Cross-border M&As in infrastructure, by value and share in total M&As in all industries, 1987-2006



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

Note: Includes electricity, gas, and water distribution; construction; transport, storage and communications; educational services; and health and social services.

Figure I.18. Cross-border M&As in infrastructure in developing and transition economies, by value and share in total M&As in all industries, 1987-2006



Source: UNCTAD cross-border M&A database.

Note: Includes electricity, gas, and water distribution; construction; transport, storage and communications; educational services; and health and social services.

importance of inward FDI in financial services. This industry accounted for a larger share of the estimated inward FDI stock of developing countries than that of developed countries in 1990 (26% compared to 19%); however, this was reversed in 2005 when it accounted for 20% in developed countries and 15% in developing countries.

The broad sectoral and industrial patterns discussed above conceal changes in the sectoral composition of FDI at the regional, subregional and country levels. A discussion of industrial patterns of FDI and differences in them among the major regions is included in chapter II.

C. The largest TNCs

The composition of the 100 largest TNCs worldwide changed moderately in 2005 (the latest year for which data on the top TNCs are available), as did their foreign activities as measured by sales and employment. The foreign activities of the largest 100 TNCs from developing countries grew more noticeably; however, the importance of foreign operations in their total activities remained relatively stable.

This section looks at developments among the largest TNCs, including the 100 largest non-financial TNCs worldwide and the 100 largest non-financial TNCs from developing economies, ranked by foreign assets. The current UNCTAD lists of largest TNCs, however, exclude many TNCs (such as family-owned and State-owned firms) that are not publicly listed, due to non-availability of comparable information for such companies. If data were available, it is likely that a number of them would feature in the list.[62] This section also includes an analysis of the 50 largest financial TNCs ranked by the Geographical Spread Index.

1. The world's 100 largest TNCs

The world's 100 largest TNCs play a major role in international production. In 2005, they accounted for 10%, 17% and 13% respectively of the estimated foreign assets, sales and employment of all TNCs worldwide. Following a slowdown in their rate of expansion in 2000, they have increased their activities significantly since 2002. Overall, the rankings in the first half of the list have remained relatively stable compared to those in 2004, with General Electric, Vodafone and General Motors at the top (annex table A.I.13). The top 10, with about $1.7 trillion in foreign assets (i.e. almost 36% of the total foreign assets of the top 100), include four TNCs in petroleum and three in automobile production.

There were only 10 new entrants to the list in 2005, originating from seven different countries. By origin, 84 of the companies had their headquarters in the Triad (the EU, Japan and the United States), the United States dominating the list with 24 TNCs. Five countries (the United States, the United Kingdom, France, Germany and Japan) had 72 of the top 100 firms. The most significant change over the past two years has been the increase in the number of firms from developing economies, from five to seven (six of which were from Asia and one from Mexico), in line with the rise of TNCs from several developing countries (*WIR06*). There is a large disparity in size (as measured by foreign assets) between the largest firms and those ranked in the second half of the list. However, the level of concentration of foreign assets within the largest TNCs has remained relatively stable over the past 10 years.[63]

Although their foreign assets remained almost the same as in the previous year, the activities of the largest TNCs increased significantly in 2005, with foreign sales and employment increasing faster than those of their domestic counterparts by almost 10% and 9% respectively (table I.10). In addition, the ratio of foreign sales and employment to total sales and employment increased again in 2005.[64]

Table I.10. Snapshot of the world's 100 largest TNCs, 2004, 2005
(Billions of dollars, thousands of employees and per cent)

Variable	2004	2005	% change
Assets			
Foreign	4 728	4732	0.1
Total	8 852	8 683	-1.9
Share of foreign in total (%)	53.4	54.5	1.1[a]
Sales			
Foreign	3 407	3742	9.8
Total	6 102	6623	8.5
Share of foreign in total (%)	55.8	56.5	0.7[a]
Employment			
Foreign	7 379	8025	8.8
Total	14 850	15107	1.7
Share of foreign in total (%)	49.7	53.1	3.4[a]

Source: UNCTAD/ Erasmus University database.
[a] In percentage points.

Of the top 100 TNCs, 58 belonged to six industries: motor vehicles (11), petroleum (10), electrical and electronic equipment (10), pharmaceuticals (9), telecommunications (9), and electricity, gas and water services (9).

If ranking were to be based on foreign sales or foreign employment they would yield different results (UNCTAD, forthcoming b). Ranking by sales would move the petroleum TNCs into the top four positions on the list and another four motor vehicles TNCs into the top 10. The largest TNC in terms of foreign sales (ExxonMobil) is 10 times larger than the firm ranked 55 in the list. Ranking the companies by foreign employment would present yet another picture, placing three retail TNCs in the top positions. On average, the largest TNCs had affiliates in 39 foreign countries. Deutsche Post (Germany) was the leader in this regard, with value-added activities in 103 host economies,[65] followed by Royal Dutch/Shell (United Kingdom/Netherlands) with 96. (annex table A.I.16).

2. The 100 largest TNCs from developing economies[66]

In 2005, the foreign assets of the 100 largest TNCs from developing economies amounted to $471 billion. The five largest TNCs accounted for one third of the foreign assets of the top 100. With foreign assets of $62 billion, Hutchison Whampoa (Hong Kong, China) remained the leader, accounting for as much as one eighth of all foreign assets of the top 100 developing-country TNCs. Petronas (Malaysia), Cemex (Mexico), Singtel (Singapore) and Samsung Electronics (the Republic of Korea) remained in the next four positions (annex table A.I.14).

Table I.11. Snapshot of the world's 100 largest TNCs from developing economies, 2004, 2005
(Billions of dollars, thousands of employees and per cent)

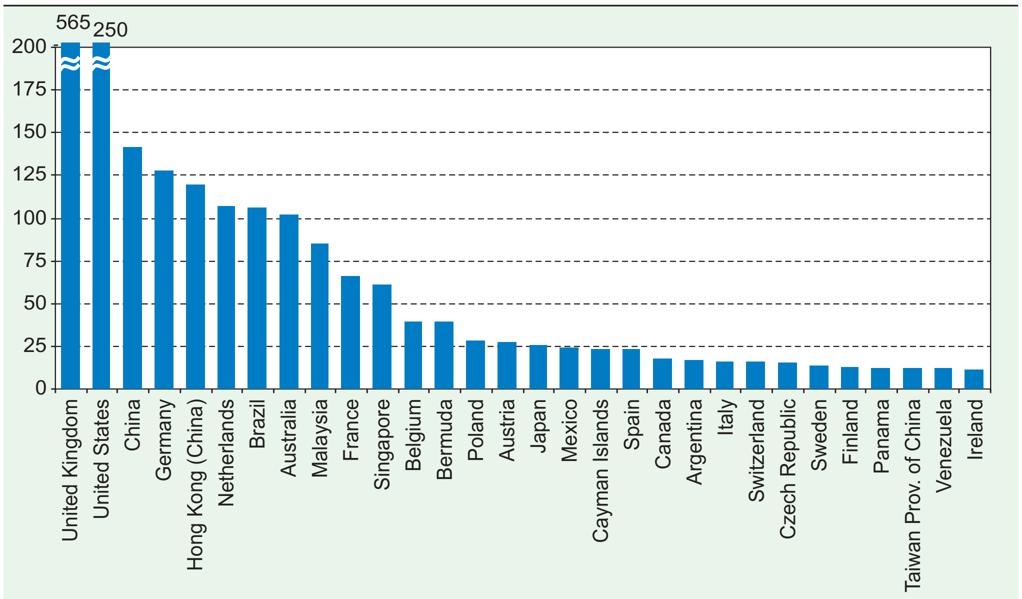
Variable	2004	2005	% change
Assets			
Foreign	336.9	471	39.8
Total	1073.2	1 441	34.3
Share of foreign in total (%)	31.4	32.7	1.3[a]
Sales			
Foreign	323.0	477	47.6
Total	738.2	1 102	49.3
Share of foreign in total (%)	43.8	43.2	-0.5[a]
Employment			
Foreign	1109	1 920	73.2
Total	3364	4 884	45.2
Share of foreign in total (%)	33.0	39.3	6.4[a]

Source: UNCTAD/ Erasmus University database.
[a] In percentage points.

The regions and countries of origin of the top 100 developing-country TNCs have changed little over the past 10 years, and 78 of them originate in South, East and South-East Asia. Other companies are headquartered in Latin America (11) and Africa (11). By home economy, Hong Kong (China) and Taiwan Province of China dominate with 25 and 18 TNCs respectively of the top 100. China has gained in importance with 10 companies listed. Other important home developing countries of TNCs in the top 100 are Singapore with 11, South Africa with 10, Mexico with 7 and Malaysia with 6. In 2005, their foreign assets and foreign sales increased significantly over the previous year, by 40% and 48% respectively (table I.11). But their foreign operations, as reflected in the ratio of foreign to total assets and foreign to total sales, remained relatively stable compared with 2004. By contrast, foreign employment increased more than domestic employment and the ratio of foreign to total employment rose by 6%.

The top 100 TNCs from developing economies operate in a broader range of industries than do the world's largest TNCs. In 2005, apart from the large number of diversified groups, the single most important industry for the top firms remained electrical/electronic equipment and computers, with a large number of companies from Asia. This was followed by petroleum, which gained in importance in 2005, accounting for 10 companies on the list. Other relatively well-represented industries in the top 100 were food and beverages (8), transportation and storage (7), telecommunications (6), and metal and metal products (5).

Figure I.19. The top 30 locations for foreign affiliates of the 100 largest TNCs from developing economies, 2005
(Number of foreign affiliates)



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

With respect to the geographical spread of foreign operations and the number of host countries for foreign affiliates, compared to the average of 39 host countries for the 100 largest TNCs worldwide, the largest ones from developing economies each had affiliates in 28 foreign countries on average. The preferred locations for their foreign affiliates were the United Kingdom and the United States (figure I.19), followed by China, Germany, Hong Kong (China), the Netherlands and Brazil.

3. Transnationality of the largest TNCs

The Transnationality Index (TNI), a composite of three ratios – foreign assets/total assets, foreign sales/total sales and foreign employment/total employment – is higher for the 100 largest TNCs worldwide than for the 100 largest TNCs from developing economies. Another measure of transnationality, the Internationalization Index (II), which is the ratio of a TNC's foreign to total affiliates, also shows that, on average, 69% of the affiliates of the world's largest TNCs are located abroad, a much higher percentage than that for TNCs from developing economies (55%) (table 1.12). However, the picture is more nuanced by industry (table I.12).

In addition to the TNI and II, *WIR06* introduced the Geographical Spread Index (GSI)[67] which seeks to capture both the number of foreign affiliates and the number of host countries in which a company has established its affiliates. Since TNCs from developing and transition economies have foreign affiliates in fewer host countries than their counterparts from developed countries, the GSI indicates much lower levels of internationalization by developing-country TNCs (annex table A.I.16) in keeping with their relatively recent expansion internationally.

Table I.12. Comparison of II and TNI values for the top 100 TNCs[a], by industry, 2005

Industry	Largest TNCs II	Largest TNCs TNI	TNCs from developing countries II	TNCs from developing countries TNI
Motor vehicles	62.1	55.5	71.3	24.7
Electrical/electronics	76.2	53.9	67.1	53.6
Petroleum	60.5	55.5	21.0	24.6
Pharmaceuticals	81.9	60.2	..	..
Telecommunications	71.6	61.6	52.2	35.8
Utilities	53.1	52.3	31.4	41.0
Metals and metal products	77.7	62.0	35.9	41.5
Food and beverages	77.8	73.3	38.3	59.2
Transport and storage	62.9	50.6	56.5	60.7
Computer and related activities	..	..	68.5	50.9
All industries	69.5	59.9	54.5	50.6

Source: UNCTAD/Erasmus University database.
[a] Annex tables A.I.13 and A.I.16.

4. The world's 50 largest financial TNCs

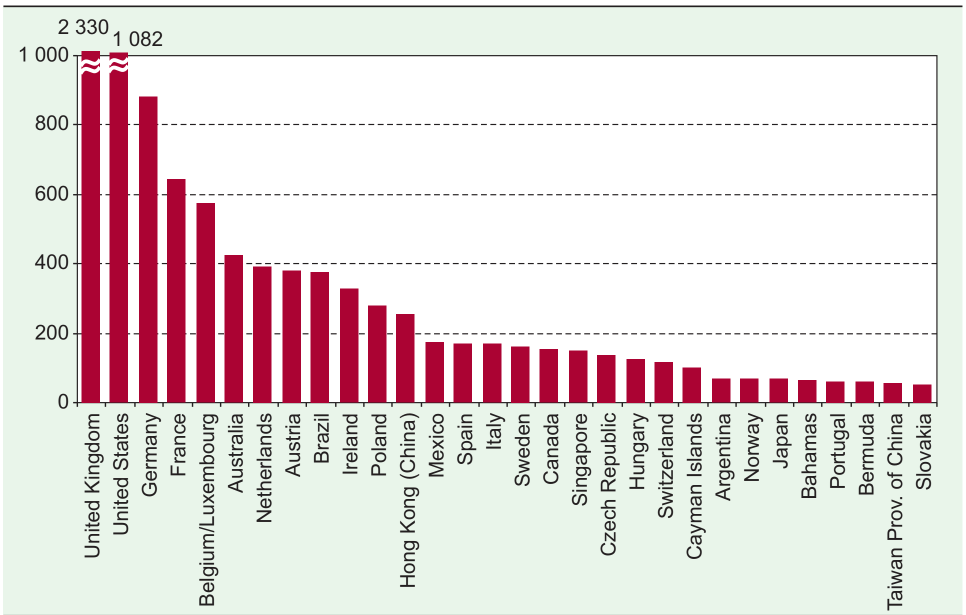
Large TNCs that have grown mainly through M&As dominate world financial services, not only in terms of their total assets but also the number of countries in which they operate. The 50 largest financial TNCs are ranked in this Report by the GSI (annex table A.I.15) and not, as in the case of the largest non-financial TNCs by foreign assets, as data on foreign assets as well as on foreign sales and foreign employment of financial TNCs are not available. The GSI is significantly higher for the largest financial groups, and for financial firms from Switzerland due to that country's small home market. The top 50 financial TNCs have, on average, affiliates in 28 host countries, whereas the five largest have affiliates in 51 host countries, on average.

Information on the location of foreign affiliates suggests that the most favoured host country for the largest financial TNCs is the United Kingdom followed by the United States and Germany (figure I.20). Among developing economies, Brazil hosts the largest number of affiliates of the world's largest financial TNCs, followed by Hong Kong (China) and Mexico. It is noteworthy that tax havens such as the Cayman Islands, Bermuda and the Bahamas are also favoured as locations.

The rise in the value of assets of TNCs in the insurance industry, including reinsurance (box I.4), may be attributed to growth through M&As. At the end of the 1990s, many European life insurance companies had established a presence in the United States by acquiring United States companies. The fact that nearly all the acquisitions were by European companies was no coincidence, as European insurers are larger than their United States counterparts: ING (Netherlands), AXA (France), Allianz (Germany) and Fortis (Belgium) were ranked 13th to 18th in the *Fortune Global 500* in 2006.

These companies have been looking for growth opportunities in the United States market and their presence there enables them to become global players. Two thirds of the world's retirement assets

Figure I.20. The 30 most favoured locations for foreign affiliates of the top 50 financial TNCs, 2005
(Number of foreign affiliates)



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

Box I.4. Globalization in the reinsurance market

Globalization and consolidation are changing the composition of the largest reinsurance TNCs. Although three countries (Germany, Switzerland and the United States) have dominated the reinsurance business worldwide over the past 10 years, with more than 60% of total reinsurance premiums, Bermuda has in recent years emerged as a major reinsurance centre. At the same time, the consolidation of the reinsurance market in the 1990s has significantly increased the market share of the largest companies. In 2005, the three largest groups wrote 54% of all net reinsurance premiums for the 20 largest companies in this industry. In 2006 Swiss Re completed its acquisition of GE Insurance Solutions in a deal estimated at $7.5 billion (including $1.7 billion of debt), to become the world's largest reinsurance group.

In 1985, 8 of the 20 largest reinsurance groups in the world were from the United States, five were German and three were Japanese, and the others were from other European countries. Twenty years later, according to Standard & Poor's, five were from the United States, only two were German, another two were from Japan, but four were companies established in Bermuda for tax reasons and they have grown rapidly over

/...

Box I.4. Globalization in the reinsurance market (concluded)

the past decade. Compared with the largest financial companies, reinsurance firms are still small in terms of assets and employment, but the average number of host countries in which they operate (14 to date) is on the rise due to the globalization of the reinsurance business. In terms of the GSI, more than half of the firms would rank among the 50 largest financial TNCs (box table I.4.1).

Box table I.4.1. The world's largest reinsurance groups, ranked by the Geographical Spread Index, 2005
(Millions of dollars and number of employees)

				Assets	Sales	Employees	Affiliates		
Rank 2005	GSI	TNC	Home country	Total	Net premiums	Total	Number of host countries	Foreign	Total
1	47.9	Swiss Re [a]	Switzerland	166 552	21 204	8 882	24	179	187
2	41.4	Munich Re	Germany	259 087	22 603	37 953	37	138	298
3	40.3	ACE Tempest Re	Bermuda	61 126	1 546	10 061	20	82	101
4	38.4	Mapfre Re	Spain	29 540	1 082	..	29	86	169
5	30.5	SCOR Re	France	4 440	2 692	994	14	20	30
6	30.3	QBE Insurance Group	Australia	13 929	1 190	7 800	13	36	51
7	30.1	XL Re	Bermuda	58 137	5 013	3 600	13	62	89
8	29.5	Hannover Re (Talank)	Germany	39 624	9 191	1 989	21	53	128
9	27.3	White Mountains Re	Bermuda	8 458	1 304	..	8	27	29
10	26.8	Berkshire Hathaway	United States	198 325	10 041	..	23	148	473
11	25.8	PartnerRe	Bermuda	13 744	3 616	943	10	8	12
12	23.9	Mitsui Sumitomo Insurance Co.	Japan	69 203	1 713	16 432	9	26	41
13	23.1	Millea (Tokio Marine&Fire)	Japan	108 430	2 789	..	10	23	43
14	22.7	Odyssey Re	United States	8 620	2 302	592	8	9	14
15	22.0	Transatlantic Holdings Inc.(AIG)	United States	4 242	3 466	485	12	141	349
16	19.8	Reinsurance Group of America	United States	16 140	3 863	..	14	22	78
17	16.9	Axis Capital Holdings	Bermuda	11 926	1 491	441	4	5	7
18	15.8	Sompo Japan Insurance Group	Japan	54 913	1 804	14 705	5	10	20
19	15.8	Aioi Insurance Co.	Japan	25 265	1 152	9 085	5	8	16
20	13.4	Converium Re	Switzerland	10 983	1 816	579	3	3	5

Source: UNCTAD, based on Standard & Poor's, Global Reinsurance Highlights; companies' websites; Dun & Bradstreet, *Who Owns Whom* database; and Thomson Financial database.

[a] In June 2006, Swiss Re completed its acquisition of GE Insurance Solutions, a process which started in Nov. 2005, with a deal estimated at $7.4 billion.

Note: The Geographical Spread Index (GSI), is calculated as the square root of the Internationalization Index multiplied by the number of host countries. The internationalization Index (II), is calculated as the number of foreign affiliates divided by the number of all affiliates (majority-owned affiliates only).

From an operating performance perspective, and given the high degree of volatility inherent in the reinsurance business, out of the past 18 years, global reinsurers only managed to achieve underwriting profitability in 2003 and 2004. The operating difficulties encountered in this market have reduced the number of reinsurers, and only large diversified reinsurers such as Munich Re and Swiss Re managed to close 2005 with operating profits. In contrast with this picture, most United States-based and Bermuda-based reinsurers reported significantly weaker results for 2005.

Source: UNCTAD.

are in the United States, and the annuity market is expected to double over the next decade (KPMG, 2006). There are likely to be more M&As due to the fragmented nature of the United States market. Driving this activity are the ever-increasing capital demands by rating agencies and regulators on these companies. However, the lack of attractive targets and excessive price expectations are factors that could work in the opposite direction (KPMG, 2006).

In the banking industry, over the past three years, the largest cross-border deals (over $10 billion each) were concluded among European banks. In 2004, Santander (Spain) acquired Abbey National (United Kingdom) for $15.8 billion. In 2005, one of the largest deals was the acquisition by Unicredito (Italy) of the German Bayerishe Hypo Bank and the Bank of Austria Creditanstadt for a total of $21.6 billion. In 2006, this trend continued with the acquisition of Banca Nazionale del Lavaro (Italy) by BNP (France) for about $11 billion. European banks are also expanding rapidly in South-East Europe.

D. Prospects

Various surveys point to continued growth of FDI flows in 2007 and beyond, although the increase in global flows in 2007 is likely to be at a slower rate than in 2006. Inflows in 2007 are forecast to reach $1,400–$1,500 billion, which would imply a new record level. Many factors that drive FDI activity have developed favourably during the course of 2007, but there could also be some hindrances responsible for the slower rate.

Global economic growth in 2007 is projected to slow down moderately, but to remain robust nonetheless, and above its long-term trend (IMF, 2007a; World Bank, 2007b; and OECD, 2007).

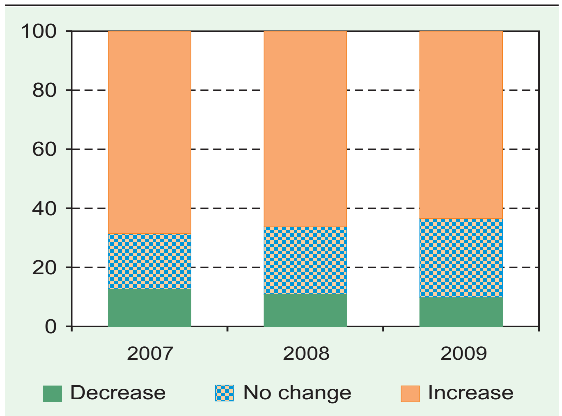
- World trade is expected to be robust.
- The continuing expansion of the world economy – now into its fifth year – should stimulate FDI.
- Corporate profits and external financing conditions are likely to remain positive in 2007.
- M&A activity is forecast to continue its upward trend in 2007, boosted by ample global liquidity, strong growth, low inflation and high corporate profitability. In the first half of 2007, cross-border M&As had increased by 54% over the same period in 2006, to reach $581 billion.
- Private equity and hedge funds, many in collaboration with minority shareholders, were responsible for several high-value M&As in the first half of 2007.[68]

UNCTAD's *World Investment Prospects Survey* for 2007-2009 provides strong support for the projection that FDI flows are set to increase in 2007 and beyond (UNCTAD, 2007b).[69] An average of 63% of the companies surveyed expressed optimism regarding FDI prospects for the period 2007-2009 (figure I.21), and 66% expect an increase in FDI flows in 2007. These results are also broadly supported by the worldwide survey of foreign affiliates of TNCs conducted jointly by UNCTAD and the World Association of Investment Promotion Agencies (WAIPA).[70] Some 76% of the responding CEOs of foreign affiliates expected their investment in host economies to increase over the next three years (figure I.22). Several international organizations and research institutes (IMF, 2007a; IIF, 2007; World Bank, 2007a) also predict higher FDI in 2007.[71]

In terms of preferred regions and country groups for FDI location, East, South and South-East Asia remains the most favourable region, followed by North America, the EU-15, and the new EU-12 (countries that joined the EU in 2005 and 2007) (UNCTAD, 2007b). China is the most preferred investment location, according to the UNCTAD survey responses, followed by India and the United States (table I.13), and then the Russian Federation and Brazil. Viet Nam is ranked higher than the United Kingdom and Germany as an attractive location. Many other recent assessments and surveys concur with these broad results of preferred regions and countries for TNC location (Ernst & Young, 2007; IIF, 2007; JBIC, 2007; JETRO, 2007; McKinsey, 2007b; World Bank, 2007a). FDI prospects by region are discussed in more detail in chapter II.

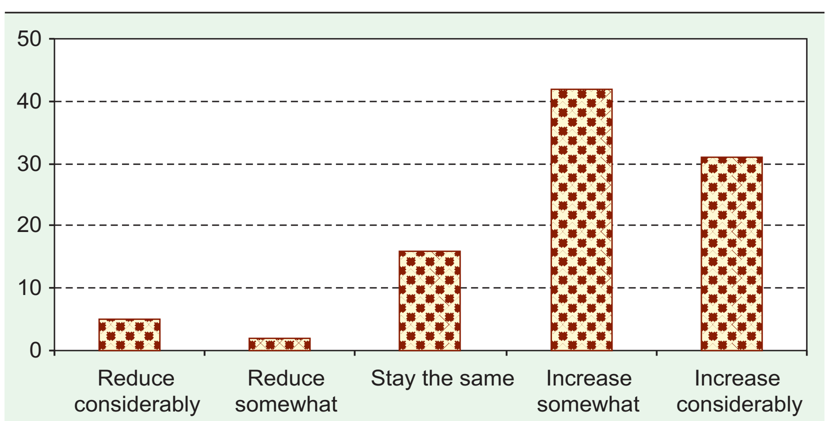
These preferences are undoubtedly swayed by the specific strategies of TNCs. For example, in contrast to the UNCTAD survey, a recent survey of CEOs on M&A trends suggests that developed countries continue to be the favourite M&A destination: 43% prefer Western Europe for M&As, followed by Asia (31%) and North America (25%), with the majority of CEOs targeting countries in their own region or traditional trading partners (PricewaterhouseCoopers, 2007a).

Figure I.21. Prospects for global FDI flows for 2007-2009
(Per cent of survey responses)



Source: UNCTAD, 2007b.

Figure I.22. FDI plans by foreign affiliates in host countries for 2007-2009
(Per cent of survey responses)



Source: UNCTAD-WAIPA Worldwide Survey of Foreign Affiliates, 2007.

The UNCTAD survey did not cover prospects by industry in detail, but the general consensus is that current trends will continue, with large-scale M&As already occurring or in the offing in the *primary sector*,[72] and especially in chemicals and automotive industries in the *manufacturing sector*.[73] Further growth[74] and liberalization[75] in the *services sector* is likely to help maintain the momentum of FDI flows to this sector in the largest host developed and developing regions. In banking and other financial services the upward trend in M&A activity continued in the first half of 2007.[76]

Table I.13. The most attractive locations for FDI for 2007-2009

Economies	Percentage of respondents
China	52
India	41
United States	36
Russian Federation	22
Brazil	12
Viet Nam	11
United Kingdom	10
Poland	7
Germany	7
Australia	6

Source: UNCTAD, 2007b.

Despite the generally positive prospects, several challenges and risks face the world economy that may have implications for FDI flows in 2007 and 2008. Global current-account imbalances have grown dramatically in some developed countries. This could cause exchange-rate shifts, which may affect FDI negatively. High and volatile oil prices have caused inflationary pressures, so that a stronger-than-expected tightening of financial market conditions cannot be excluded. Increased risk exposure on financial markets, caused for example by the activities of hedge funds and carry trades,[77] as well as spillovers from the United States housing market, pose the risk of stronger corrections of highly valued stock and real estate markets. Some concerns about FDI prospects have been expressed by respondents to the UNCTAD survey, based on the possible rise of protectionism: more than four fifths of them believe there could be a significant risk of changes that are unfavourable to FDI in the short term (UNCTAD, 2007b). Many respondents also recognize that global threats such as terrorism and war are not negligible, but they consider that the probability that this type of risks might affect the level of FDI in the short term is relatively low (UNCTAD, 2007b). These considerations, nevertheless, emphasize the need for caution in assessing future FDI prospects.

Notes

1 Real world GDP rose by 4.9% in 2005 and 5.4% in 2006 and is projected to grow by 4.9% in 2007 (IMF, 2007a).

2 In the period 2000–2006, FDI inflows accounted for 56% of all net capital flows into developing countries, whereas the shares of portfolio, other capital transactions (e.g. bank loans) and official flows were 16%, 19% and 10% respectively (World Bank, 2007a).

3 The Monterrey Consensus was adopted by the International Conference on Financing for Development, a summit level meeting sponsored by the United Nations to address key financial and related issues pertaining to global development, held on 21-22 March 2002, in Monterrey, Mexico. It calls, among other things, for mobilizing and increasing the effective use of financial resources needed to fulfil internationally agreed development goals in the context of a holistic approach to the challenges of financing for development (United Nations, 2002).

4 See *Fortune 500*, 15 April 2007.

5 Current profits of listed firms have been rising already for four years in a row, the longest period since 1980. The current profit ratio in fiscal year 2006 was 6.5% for all listed firms (*Nikkei*, 10 February 2007).

6 Data collected by UNCTAD, based on inward FDI, are limited to 132 countries for 2006.

7 Several stock market indices in 2006 exceeded their previous records reached in 2000 (e.g. the Dow Jones in September 2006). In 2006, the blue chip indices in 48 out of 51 of the world's most important stock exchanges rose, 40 with a double-digit percentage increase and 4 with a triple-digit increase (World Federation of Exchanges, 2007: 113).

8 Market capitalization in 49 of 51 major stock exchanges increased in 2006; 41 stock exchanges recorded double-digit growth rates and 3 triple-digit growth rates (World Federation of Exchanges, 2007: 66).

9 In 2000, cross-border M&As of over $1 billion accounted for more than three quarters of the value of total cross-border M&As. This was due to several very large deals like the Vodafone-Mannesmann deal which alone accounted for 18% of the value of cross-border M&As in that year.

10 The observations in this and subsequent paragraphs on the changes in M&A values in various countries/regions are based on data from UNCTAD's cross-border M&A database.

11 O2 (telecoms) and BAA (airport services) were bought by the Spanish companies Telefónica and Ferrovial, respectively for $32 billion and $22 billion. BOC, an industrial gas company, was acquired by its German competitor Linde for $14 billion (annex table A.I.3).

12 In an environment of low interest rates and ample funds, many firms have increased their proportion of debt to capital to optimize their capital structure (IMF, 2007c: 11).

13 *Nikkei*, 18 October 2006.

14 These are funds controlled and managed by private equity firms (i.e. firms that collect funds from private investors (asset holders that are not publicly listed) and buy majority or entire ownership stakes in companies and/or business units with a view to restructuring the management and organization, and thereby raising the stock value of the latter for resale. Acquired firms are usually delisted (unless already unlisted), held privately and restructured over a certain period of years, and then resold to other parties or again listed through an initial public offering (IPO).

15 Because of data constraints and given the dominance of private equity funds, the analysis concentrates on the activities of private equity funds, which are the most active in cross-border M&As. But different kinds of funds increasingly act together, and the boundaries between private equity funds, hedge funds, other collective investment funds and even investment banks are fading away.

16 According to Dealogic, quoted in "M&A in 2006 beats tech boom", *Financial Times*, 21 December 2006; and *Nikkei*, 18 November 2006.

17 Several private equity firms raised an impressive amount of funds in 2006. For example, Blackstone Group (United States) raised $15.6 billion, 2.4 times larger than its previous highest raising of $6.5 billion in 2002. Apollo Management (United States) raised $10.1 billion, Permira (United Kingdom) $14 billion and Texas Pacific Group (United States) $15 billion "Blackstone quickens pace with $15.6 bn fund", *Financial Times*, 12 July 2006; and *Nikkei*, 13 July 2006. Investment banks or commercial banks (such as Morgan Stanley, Citigroup, Deutsche Bank, Credit Suisse and Royal Bank of Scotland) have also entered the private equity market by establishing or strengthening their investment arms, and are now heavily engaged in private equity buyouts (complete acquisition of firms through private equity funds).

18 For example, KKR raised $5 billion with its IPO in Euronext (Amsterdam) in 2006.

19 KKR, Bain Capital, Silver Lake Partners, Apax and AlpInvest Partners NV were involved in this acquisition. The new company has been named NXP.

20 This firm, a pharmaceutical arm of Altana AG (Germany) with its stock listed in Frankfurt, was acquired by Nycomed (Denmark) with the involvement of the private equity firm Avista Capital Partners (United States) and others.

21 However, on an announcement basis, the acquisition of VNU (Netherlands) by six private equity firms for $11.3 billion was the largest deal in 2006.

22 In addition to Philips Semiconductor and Altana Pharma, a number of publicly quoted companies are currently being pursued by private equity firms, including, for example, Adidas (Germany), Alliance Boots (United Kingdom), Altaria (Italy), Iberia (Spain), Sapporo Holdings (Japan), Valeo (France).

23 For example, see "The trouble with private equity" and "The business of making money", *The Economist*, 7 July 2007, "Les fonds LBO risquent une bonne correction", *Challenge*, 19 July 2007: 34.

24 For example, see "Private equity growth hitting tax revenues", *Financial Times*, 13 October 2006 and "Blackstone's blues", *The Economist*, 15 June 2007.

25 The significantly increased credit-financed share of deals can be interpreted as a sign of growing risk for the financial system as a whole. Even if banks are less exposed and less involved, because these risks are ultimately taken by other parties, especially hedge funds, the rest of the financial sector also bears a higher risk (IMF, 2007c: 11f). For acquired firms, there is also the possibility that corporate balance sheets could come under strain owing to the excess of debt financing in takeover activity (ECB, 2006a).

26 *Financial Times*, 24 April 2007, Special Report on Private Equity Funds.

27 However, it is not certain whether job cuts have been larger than job creation. According to an FT/Harris poll undertaken in five EU countries (France, Germany, Italy, Spain and the United Kingdom) in March/April 2007, out of a total of 6,587 adults surveyed, about one third of respondents (34%) believed that the industry created jobs, but almost the same percentage (32%) believed it destroyed them ("Public lacks awareness of private equity, says survey", *Financial Times*, 24 April 2007). In a separate survey on 400 managed buyouts (MBOs) and managed buyins (MBIs) conducted during 1999-2004 in the United Kingdom by the Centre for Management Buyout Research of Nottingham University, employment levels typically fell 2%-3% in the year of the MBOs, but then they rose significantly, by an average of 26% five years after the MBOs. In the case of MBIs, employment levels were lower even after five years. Overall, this survey shows a positive growth of employment ("Buyouts good for jobs, says study", in Fund Management, *Financial Times*, 26 February 2007).

28 For instance, the private equity firm Lone Star (United States) bought Korea Exchange Bank in 2003 for $1.3 billion, and was trying to sell its 50% stake to Kookmin (Republic of Korea) to make almost $4 billion in profits, according to press accounts (*source*: "S. Korea rebuffs Lone Star reproach", *Financial Times*, 25 May 2006; "Lone Star close to scuppering $7.3bn deal", *Financial Times*, 22 November 2006). The Government of the Republic of Korea charged Lone Star with stock manipulation and illegal profits. This case was still pending in June 2007.

29 Based on data on the estimated gross product of foreign affiliates and on world GDP in table I.4.

30 Starting with this report, *WIR* plans to analyse periodically one important variable indicating an aspect of international production or activities of foreign affiliates. This begins with *WIR07* focusing on the employment variable.

31 It should be noted that FDI stock is measured in nominal terms (current value), while employment is measured in real terms (number of employees). For a strict comparison, FDI data should be deflated by an appropriate price indicator.

32 Source: Ministry of Commerce, China. According to the data from National Bureau of Statistics of China (*China Statistical Yearbook*), employment in affiliates with independent accounting systems in China's urban areas was only 6.7 million in 2001. No employment data have been available from this source for subsequent years.

33 In the United Kingdom and the United States, two traditional home countries of large TNCs, the issue of export of jobs has been widely discussed. In these countries, the immediate loss of jobs at home was generally compensated by an increase in employment as a result of enhanced competitiveness of the investors (Dunning, 1993). In France and other European countries, debates surfaced in the early 1990s over the issue of *delocalization*, or the shifting of manufacturing production to other countries, and its employment consequences. This issue continues to be of concern (for a discussion, see *WIR94*, chapter IV).

34 However, in some countries, such as Australia, Belgium, Greece, Ireland, Israel, Luxembourg and New Zealand, inward FDI stock is larger than outward stock.

35 Some earlier studies rejected this hypothesis (see *WIR94*).

36 In considering home-country effects, it is important to consider the counterfactual, that is whether a company would have had a given level of employment or not in the home country if it had not been able to invest abroad.

37 The index is calculated as the average of four shares for a country: FDI inflows as a percentage of gross fixed capital formation, FDI inward stock as a percentage of GDP, value added of foreign affiliates as a percentage of GDP, and employment of foreign affiliates as a percentage of total employment.

38 The UNCTAD Inward FDI Performance Index is a measure of the extent to which a host country receives inward FDI relative to its economic size. It is calculated as the ratio of a country's share in global FDI inflows to its share in global GDP. For the detailed methodology, see *WIR02*.

39 The UNCTAD Inward FDI Potential Index is based on 12 economic and structural variables measured by their respective scores on a range of 0-1 (raw data available on: www.unctad.org/wir). It is the unweighted average of scores on the following: GDP per capita, the rate of growth of real GDP, the share of exports in GDP, telecoms infrastructure (the average no. of telephone lines per 1,000 inhabitants, and mobile phones per 1,000 inhabitants), commercial energy use per capita, share of R&D expenditures in gross national income, share of tertiary level students in the population, country risk, exports of natural resources as a percentage of the world total, imports of parts and components of electronics and automobiles as a percentage of the world total, exports of services as a percentage of the world total, and inward FDI stock as a percentage of the world total. For the methodology for building the index, see *WIR02*: 34-36.

40 The UNCTAD Outward FDI Performance index is calculated in the same way as the Inward FDI Performance Index: it is the share of a country's outward FDI in global FDI outflows as a ratio of its share in world GDP.

41 Oil companies, however, will continue to pay a 40.5% rate.

42 A total of five policy changes relating to the extractive industries were identified in UNCTAD's annual survey of policy changes – in Algeria, Bolivia, Peru, the Russian Federation and Venezuela.

43 In addition, it has compiled a list of more than 1,000 "strategic enterprises" that cannot be privatized. Apart from defence-

related enterprises, the list includes Transneft, the pipeline monopoly; Svyazinvest, a telecoms company; Alrosa, a diamond producer; and the world's largest gas producer, Gazprom (Liuhto, 2007).

44 *OECD Investment Newsletter,* February 2007.

45 Information from the OECD secretariat.

46 In the discussion here, such agreements with investment provisions are categorised as IIAs.

47 The UNCTAD secretariat is currently preparing a study on the evolution of the IIA system over the last 60 years, and its development implications (UNCTAD, forthcoming a). Various investment-related aspects of international economic agreements other than BITs and DTTs are also discussed in UNCTAD, 2006c.

48 These included FTAs signed by the United States with Colombia, Oman, Panama and Peru, and the Economic Partnership Agreement between Japan and Malaysia, and between Japan and the Philippines.

49 Recent examples of such agreements include the ASEAN agreements for the establishment of free trade and investment areas with China (2002), India (2003) and the Republic of Korea (2005), the FTA between Panama and Singapore (2006), and the FTA between China and Pakistan (2006).

50 This number does not include cases where a party signalled its intention to submit a claim to arbitration but had not yet commenced arbitration (notice of intent).

51 UNCTAD, "Latest developments in investor-state dispute settlement", *IIA Monitor*, No. 4, 2006.

52 Idem.

53 In this context, see UNCTAD, 2006b.

54 For instance, the 2004 United States Model BIT clarifies that the concept of fair and equitable treatment does "not require treatment in addition to or beyond that which is required" by the customary international law minimum standard of treatment of aliens, and that, "except in rare circumstances, non-discriminatory regulatory actions that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations."

55 These are primarily Canada and the United States, but also Colombia, Japan and the Republic of Korea.

56 Empirical evidence suggests that the worldwide sales and investments of TNCs are heavily concentrated in their home country or one other major region (e.g. Rugman and Verbeke, 2004; Dunning, Fujita and Yakova, 2007).

57 Assuming that world outward FDI equals world inward FDI (as it should in principle), this implies that the share of the host country's total inward FDI that comes from the home country is the same as its share in total world inward FDI that comes from that home country.

58 The one exception may be metals and metal products: although estimated FDI stock data show a slight decline in their share in total world inward FDI during 1990-2005, data on cross-border M&As worldwide indicate a modest rise of their share in total sales through much of the period 1987-2006.

59 Infrastructure has been defined as social overhead capital, including public utilities (e.g. power, telecommunications, sewage and sanitation), public works (e.g. roads, dams), transportation (e.g. railways, postal systems and airports) and social services such as education and health (World Bank, 1994).

60 "Infrastructure deals soar to $145 bn", *Financial Times*, 13 October 2006.

61 For time-series data, see UNCTAD's FDI/TNC database (www.unctad.org/fdistatistics).

62 For example, the two largest private industrial corporations in the United States, Koch Industries and Cargill Inc., Boehringer-Ingelheim (one of the world's largest pharmaceutical firms) and Bertelsmann (media) in Germany, and Japan's Shiseido (the largest Japanese cosmetics TNC) and Suntory (the largest in cosmetics and alcoholic beverages) , are not included in UNCTAD's lists.

63 The relative importance of the 5, 10 and 20 largest TNCs among the world's top 100 has remained relatively stable over time (UNCTAD, forthcoming b).

64 The ratio of foreign assets to total assets also rose in 2005, but this was mainly due to the decline in total assets.

65 Its wide geographical coverage is partly explained by its control of DHL.

66 If there were a combined list of the top 100 TNCs from developing and transition economies, two Russian firms would be included: Lukoil and Norilsk Nickel.

67 It is defined as the square root of the II multiplied by the number of host countries, and was termed simply the Spread Index (SI) in *WIR06*. In this report, it is termed the Geographical Spread Index (GSI).

68 For example in April 2007, the private equity fund KKR (United States) acquired the pharmaceutical company Alliance Boots (United Kingdom) for $22 billion, the biggest ever leveraged buyout made by a private equity fund ("Le private equity pulvérise ses records", *Le Temps*, 16 May 2007).

69 The UNCTAD survey on FDI prospects by large TNCs is conducted worldwide on an annual basis. It was undertaken during March–June 2007 on a sample of 1,500 companies, chosen from among the 5,000 TNCs. A total of 191 responses were received, representing a 13% response rate. Simultaneously, an ad hoc group of international location experts has been set up to provide a more qualitative and global analysis on medium-term business opportunities, risks and uncertainties affecting international investment. The results of its analysis are included in a separate survey report (UNCTAD, 2007b).

70 The UNCTAD/WAIPA Worldwide Survey of Foreign Affiliates of TNCs conducted in February–April 2007 aimed at obtaining the views of foreign affiliates of companies worldwide with regard to investment prospects and local business environments in their respective host economies. The survey questionnaire was sent to chief executive officers (CEOs) of 850 foreign affiliates. A total of 96 foreign affiliates in 42 host countries completed the questionnaire, yielding a response rate of 11%.

71 The IMF's *World Economic Outlook* has estimated an increase in net FDI inflows (the balance between FDI inflows and FDI outflows) in emerging market economies to an estimated $284 billion, from $266 billion in 2006 (IMF, 2007a). Estimates of net FDI inflows for 2007 by the Institute of International Finance for 30 emerging economies are $194 billion in 2007, compared with $167 billion in 2006 (IIF, 2007). The World Bank projects a rise in FDI inflows to developing countries (including Central and Eastern Europe) from $325 billion in 2006 to $377-$420 billion in 2009, depending on the world economic growth rate (World Bank, 2007a).

72 For example, Rio Tinto (United Kingdom) offered a $38 billion bid for the acquisition of Alcoa (United States) in July 2007.

73 For example, 82% of Japanese companies in manufacturing plan to strengthen or expand overseas business operations over the next three years (JBIC, 2007). Eastern Europe is set to continue to receive FDI inflows in the automotive industry. Several car makers are also building plants in the Russian Federation ("Suzuki announces plan to build car plant in Russia with Itochu", *Japan Today*, 9 June, 2007; www.japantoday.com/).

74 For example, in the United States, the Institute for Supply Management's Index, which includes new orders, inventories, exports and employment by non-manufacturing businesses, including banks, builders and retailers, rose to 59.7, the highest since April 2006. ("U.S. May ISM services index rises to the highest of year", *Bloomberg*, 5 June 2007).

75 For example, agreements on the EU's Services Directive in 2006 and commitments by ASEAN member States to liberalize FDI in 70 out of 83 service industries by 2015 are likely to boost FDI.

76 For example, three major deals took place in the first half of 2007: Danske Bank (Denmark) acquired Sampo Bank (Finland) and Crédit Agricole (France) purchased Cassa di Risparmio di Parma (Italy), each for $5 billion, while Citibank (United States) acquired Akbank (Turkey) for $3 billion.

77 Transactions in which investors borrow low-yielding currencies in countries with low interest rates and lend them in other countries with high exchange rates (for a further discussion on carry trade, see UNCTAD's *Trade and Development Report 2007*).

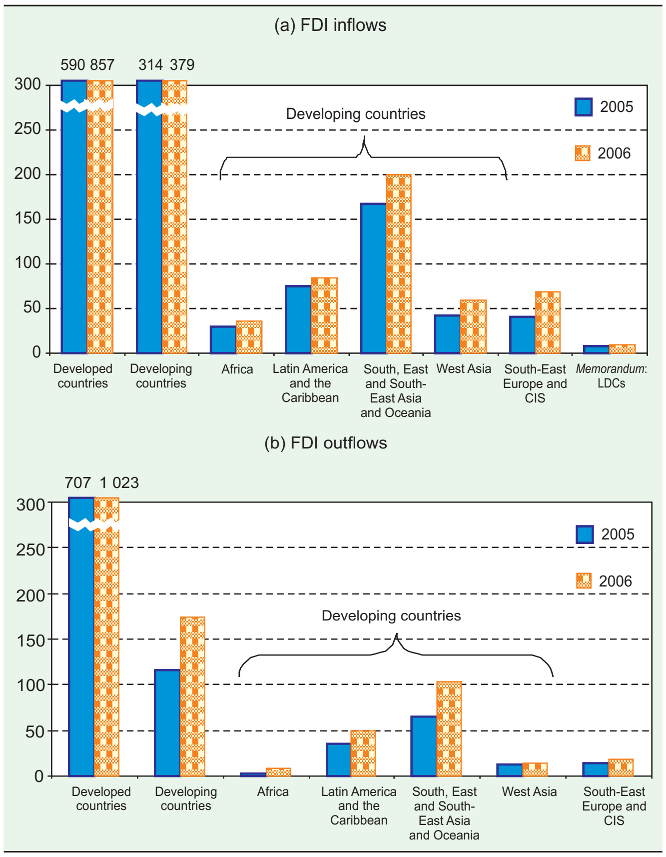
CHAPTER II

REGIONAL TRENDS

INTRODUCTION

Inward FDI flows in 2006 rose in all regions (figure II.1), though their rates of growth differed and some new trends emerged. FDI inflows to developing countries grew at a slower rate than those to developed countries, but all developing regions except Latin America and the Caribbean registered record flows. FDI inflows to the transition economies of South-East Europe and the Commonwealth of Independent States (CIS) also reached record levels. Flows to all developing and transition economies remained at more than one third of the world total, but their share in global FDI inflows fell somewhat in 2006 due to higher rates of increase in flows to developed countries. At the same time, the share of developing and transition economies in global FDI outflows has risen continuously since 2003, and reached nearly 16% in 2006. Compared to other types of capital flows to developing economies, FDI inflows have been the largest component of total resource flows since 1994, and their share in 2006 was 51% (figure II.2; chapter I).[1]

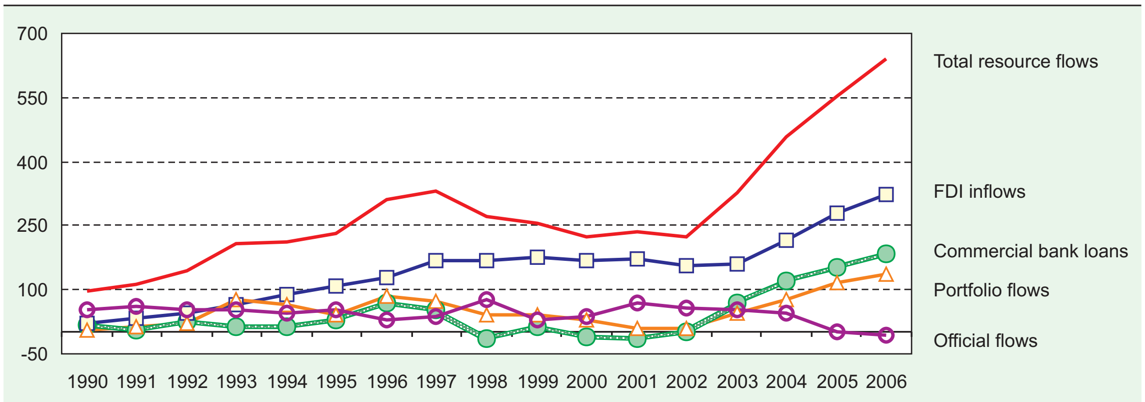
Figure II.1. FDI flows by region, 2005 and 2006
(Billions of dollars)



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

In terms of sectoral distribution, judging from data on cross-border M&As (as data on FDI flows by sector for 2006 were not available at the time of writing this Report), FDI in the services sector grew in all economies in 2006, while the primary and manufacturing sectors experienced uneven patterns of growth, which also differed by region (table II.1). The pattern confirms not only the increasing importance of services in FDI (*WIR04*) over the past several years, but also the recent re-emergence of the primary sector in developing and transition economies due to a significant rise in FDI in mining, quarrying and petroleum – extractive industries that are the focus of Part Two of this *WIR*.

Figure II.2. Total net resource flows[a] to developing countries,[b] by type of flow, 1990-2006
(Billions of dollars)



Source: UNCTAD, based on World Bank, 2007a.
[a] Defined as net liability transactions or original maturity of more than one year.
[b] The World Bank's classification of developing countries is used here. It differs from UNCTAD's classification in that it includes new EU member States from Central and Eastern Europe, and excludes high-income countries such as the Republic of Korea and Singapore under developing countries.

Table II.1. Cross-border M&A sales, by sector and by group of economies, 2005-2006
(Millions of dollars)

	2005				2006			
Group of economies	All industries	Primary	Manufacturing	Services	All industries	Primary	Manufacturing	Services
World	716 302	115 420	203 730	397 152	880 457	86 133	274 406	519 918
Developed economies	604 882	110 474	171 020	323 388	727 955	65 119	247 233	415 602
Developing economies	94 101	2 858	25 963	65 280	127 372	16 639	22 603	88 130
Transition economies	17 318	2 088	6 747	8 483	25 130	4 374	4 570	16 185

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

This chapter examines the trends and patterns of FDI in 2006 by major regions. The discussion in the following sections focuses on recent trends in FDI flows to and from each region, as well as their subregions and countries, and provides a picture of the changing geographical, sectoral and industrial patterns of FDI flows by region. Policy developments underlining these patterns, and prospects for FDI flows to and from each region are also analysed.

A. Developing countries

1. Africa

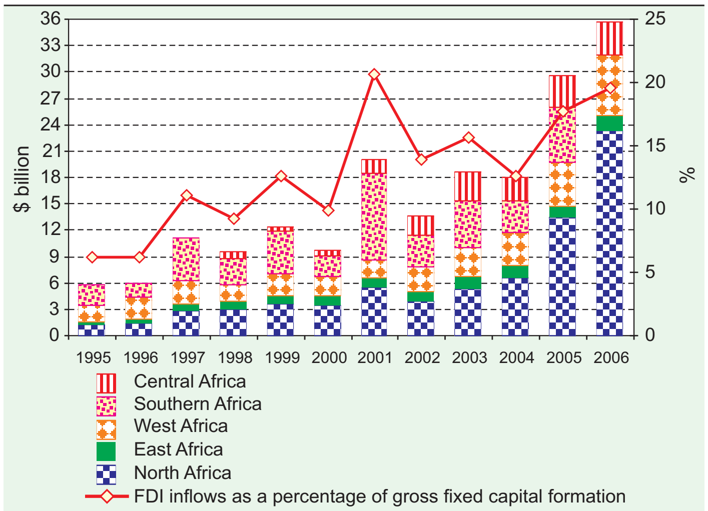
FDI to Africa amounted to $36 billion in 2006 – a new record level. The surge was in large part related to investments in extractive industries, but FDI also rose in various service industries. As a result, inflows as a percentage of the region's gross fixed capital formation increased to 20% in 2006, from 18% in 2005 (figure II.3). As in other years, there were wide variations among the different African countries. FDI inflows rose in 33 countries and fell in 21. Some Asian developing countries have become major sources of cross-border M&As and other forms of FDI in Africa. Outward FDI from Africa also reached a record level in 2006, largely driven by TNCs from South Africa. Policy developments indicate a further opening up to foreign investment, although some countries have also made changes in their regulatory frameworks with a view to securing greater benefits from inward FDI.

a. Geographical trends

(i) Inward FDI: natural resources drove the surge

In 2006, FDI inflows to Africa rose by 20% to $36 billion (figure II.3), twice their 2004 level. Following substantial increases in commodity prices, many TNCs, particularly those from developed countries already operating in the region, significantly expanded their activities in oil, gas and mining industries. TNCs from Asia expanded even more rapidly, through both greenfield investments and cross-border M&As (table II.2). At the same

Figure II.3. Africa: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

time, the services sector continued to attract considerable FDI, in particular in transport, storage and communications. An estimated 442 greenfield investments were undertaken in Africa in 2006, 258 by developed-country TNCs, particularly Europe (161), 175 by developing economies (134 from Asia and the remaining from within Africa), and a few from South-East Europe and the CIS.[2] The value of cross-border acquisitions of African enterprises reached a record level ($18 billion) in 2006, almost half of this in the form of M&As by Asian TNCs, which represents a huge expansion of activity since the start of the decade (table II.2), particularly in oil, gas and mining activities. Despite the increased FDI inflows, however, Africa's share in global inflows fell, from 3.1% in 2005 to 2.7% in 2006.

FDI inflows contributed to a strengthening of the balance of payments in several African countries. In 2006, foreign reserves in the region as a whole grew by some 30%, and by even more in some major oil-exporting countries such as Nigeria and the Libyan Arab Jamahiriya.[3] Income on inward FDI grew by 14%, which was more than in Asia and Oceania (9%) but much less than in Latin America and the Caribbean (36%) (section A.3).[4]

The extractive industries accounted for most of the increase in inflows to Africa in 2006.[5] While such investments can help boost exports and government revenues, concerns have arisen in several mineral-rich countries about the impact on exchange rates and the prospects for other export-oriented activities (EIU, 2007a). In Zambia, for instance, a tenfold increase in copper exports since 2000 to $2.7 billion in 2006 led to an appreciation of the real exchange rate.[6] As a consequence, Zambia's attractiveness for FDI suffered in export-oriented clothing and horticulture, as well as in those products that are entitled to preferences under the African Growth and Opportunity Act (AGOA)[7] and the Euro-Mediterranean Partnership. Similar concerns have been raised for Algeria, the Libyan Arab Jamahiriya, Mauritania, Nigeria, South Africa, Swaziland and Uganda. Moreover, the appreciation of the real exchange rate exacerbated the situation even further in countries with already high costs of production, capacity shortage or low competitiveness. This may have led to the closure of some foreign-owned production facilities in garments and other manufactures, for example in Kenya, Lesotho, Mauritius and Swaziland.[8] These disinvestments were partly offset in some cases by higher inflows into new natural resource exploration activities, particularly in some least developed countries (LDCs) (box II.1).

The top 10 FDI recipients in Africa accounted for $32 billion (or nearly 90%) of the region's inflows in 2006, up from $20 billion in 2005 (annex table B.1). Eight of them attracted FDI in excess of $1 billion in 2006, the same as the previous year; and in four of them such flows were higher than $3 billion: Egypt, Nigeria, Sudan and Tunisia

Table II.2. Distribution of cross-border M&A purchases in Africa by home region, 1999-2006
(Millions of dollars)

Acquiring regions	1999	2000	2001	2002	2003	2004	2005	2006
World	3 117	3 199	15 524	4 684	6 427	4 595	10 509	17 569
Developed economies	2 534	2 380	14 964	3 668	3 156	2 571	9 564	7 173
Developing economies	583	819	559	1 016	3 270	2 024	476	9 721
Africa	52	769	520	809	569	1 849	360	746
Latin America and the Caribbean	373	-	-	67	166	-	-	125
Asia	158	50	39	141	2 536	175	116	8 850

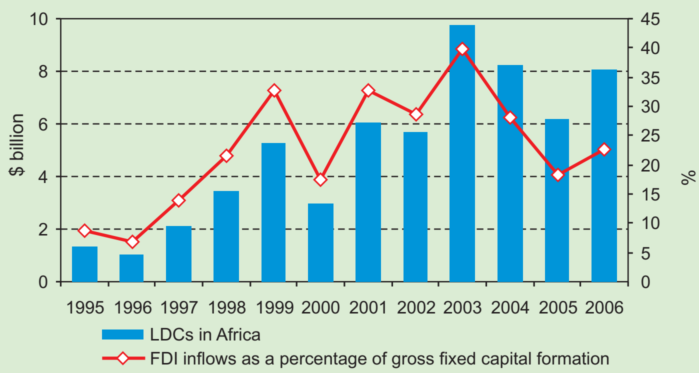
Source: UNCTAD cross-border M&A database.

Box II.1. FDI flows to African LDCs[a] rise, led by investment in extractive industries

FDI flows to African LDCs increased from $6 billion in 2005 to $8 billion in 2006 (box figure II.1.1) following two consecutive years of decline. The increase was driven by investors seeking new mining locations in response to rising global demand and high commodities prices. As a result, the share of LDCs in FDI to Africa rose from 21% in 2005 to 23% in 2006, and, as with many other African host economies, such investment was mainly from developed countries and Asian developing countries. TNCs in telecommunications activities have also started to invest in African LDCs, especially those LDCs that were previously considered risky due largely to conflicts, leading to a small but positive improvement in inflows to these countries.[b]

The 10 major recipients of FDI among African LDCs in 2006 were (in declining order): Sudan, Equatorial Guinea, Chad, the United Republic of Tanzania, Ethiopia, Zambia, Uganda, Burundi, Madagascar and Mali. FDI grew particularly fast (by 50% or more) in Burundi, Djibouti, Guinea-Bissau, Somalia, Madagascar, Ethiopia, Cape Verde, Gambia and Sudan. CNOOC (China), Ophir Energy (South Africa), Soma Petroleum (Canada), Range Resources and Woodside (both Australia) were among the TNCs that contributed to FDI in natural resource exploration in these countries.

Box figure II.1.1. African LDCs: FDI inflows and their share in gross fixed capital formation, 1995–2006



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

In contrast, Angola and Liberia registered negative FDI inflows in 2005 and 2006. In Angola, this was because of acquisitions by the State-owned oil company, Sonangol, of ongoing oil exploitation and refinery projects owned by foreign TNCs. In Liberia, while the negative inflows of $82 million in 2006 were reduced from the previous year's negative level of $479 million, investor confidence is recovering at a slow pace following the end of a series of civil wars and the establishment of a democratically elected government in that country. Inflows stagnated in Lesotho, mainly due to a slowdown in the textile industry and the withdrawal of a number of TNCs involved in that industry.

Source: UNCTAD.

[a] The 34 African LDCs are: Angola, Benin, Burkina Faso, Burundi, Cape Verde, the Central African Republic, Chad, Comoros, the Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Somalia, Sudan, Togo, Uganda, the United Republic of Tanzania and Zambia.

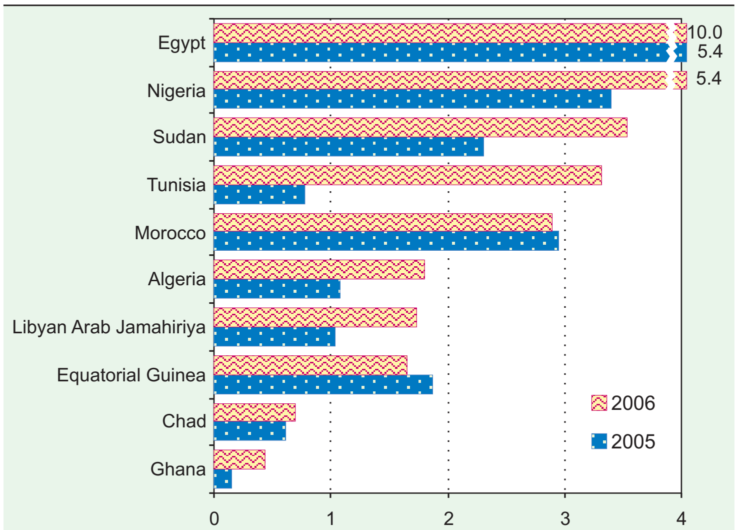
[b] Examples include MTN of South Africa in Guinea-Bissau and Liberia, Maroc Télécom in Burkina Faso and Burundi, Telsom Mobile of the United Kingdom in Somalia, Portugal Telecom in Angola and MTC Kuwait in Sudan.

(figure II.4, table II.3). Both cross-border M&As and greenfield investments contributed to increased inflows to several of the top host countries, particularly Egypt, Nigeria, Sudan, Tunisia and Morocco.[9] While most of the FDI to the region as a whole went to extractive industries, in Egypt – the top FDI recipient in 2006 – 80% of the more than $10 billion of its inflows were in non-oil activities such as agriculture, manufacturing, banking and tourism.

FDI inflows to the five subregions of Africa in 2006 were uneven, reflecting the influence of different factors, particularly the availability of natural resources, as discussed below.

North Africa.[10] North African countries received record FDI inflows (partly from Asian TNCs) that were fairly diversified. All countries in the subregion, except Morocco (where flows remained relatively large), received increased inflows, most of which were concentrated in agriculture, communications, construction, manufacturing[11] and tourism; they were driven partly by investments for expansion and privatizations. As a result, FDI flows to the subregion surged to a record level of $23 billion in 2006, accounting for 66% of inflows to Africa. Egypt attracted an exceptional level of inflows, amounting to 43% of the total to the subregion,[12] but the share of investments in oil and gas activities, though still large, declined from 60% in 2005 to 21% in 2006. In the Libyan Arab Jamahiriya, FDI inflows rose by 67% over those of 2005, to reach $1.7 billion, the highest level since the end of international sanctions imposed on that

Figure II.4. Africa: top 10 recipients of FDI,[a] 2005-2006
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranking based on FDI inflows in 2006.

country. In Tunisia, inflows more than quadrupled, mainly as a result of privatizations in the telecommunications industry.[13] Algeria, Sudan and Tunisia also received more FDI in the petroleum and telecommunication industries, mainly from China, India, Kuwait and Malaysia. In contrast to other North African countries, FDI inflows to Morocco declined due to fewer privatization sales.

West Africa.[14] FDI inflows to West Africa rose to $7 billion in 2006, following larger investments in all sectors by European and Asian TNCs. The subregion's share in FDI inflows to Africa rose to 19% from 17% in 2005. Nigeria was the main destination in West Africa, accounting for 80% of the FDI to the subregion, dominated by FDI in its oil industry, mostly from China. In Ghana, inflows tripled to $435 million, largely as a result of investment by two United States firms: Newmont Gold Company and Alcoa (in an aluminium company, Valco). Most of the other inflows into the subregion went to the services sector. Cape Verde saw a major disinvestment, with the Government re-acquiring a majority stake in the country's electricity and water utility, Empresa Pública de Electricidade e Água de Cabo Verde, thereby reversing a controversial privatization. On the other hand, FDI in tourism in the country experienced strong growth.[15]

Central Africa.[16] In Central Africa, Asian TNCs made significant investments in many sectors, nudging FDI inflows up to $4 billion in 2006. The subregion accounted for 11% of Africa's total inflows, most of it going to the primary and services sectors, including infrastructure. Equatorial Guinea, Chad, Congo and Cameroon (in that order) were the destinations. A large part of the increase in investment to the subregion reflected greater spending by TNCs on oil and mining exploration. In Cameroon, investments by Total (France) and Pecten Cameroon were the major cause of the surge in its FDI inflows.[17]

East Africa.[18] East African countries recovered from a decline in their FDI inflows as a result of new oil exploration activities in non-traditional producer countries and privatizations. FDI inflows to the subregion rose to about $2 billion

Table II.3. Africa: distribution of FDI flows among economies, by range, 2006

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

in 2006 compared with $1 billion the previous year. However, this subregion still ranks low in FDI inflows to Africa. Four countries (Djibouti, Ethiopia, Kenya and Madagascar) that had registered a decline in their inward FDI in 2005 saw increased inflows in 2006. The United Republic of Tanzania had the highest inflows in the subregion, amounting to $377 million in 2006 (most of it due to investment for expansion in the mining industry). FDI into Uganda rose by 19%, partly as a result of investments from Australia (e.g. by Hardman Resources) in the oil industry and from Egypt, India, Kenya, South Africa and the United States in services and agro-processing. In Kenya, FDI increased due to large privatization sales in the telecommunications industry and investments in railways. The recovery of FDI to Ethiopia in 2006 was a result of increased oil exploration activities in the Ogaden region.

Southern Africa.[19] A significant decline in FDI inflows, particularly to the two principal host countries (Angola and South Africa) in the subregion led to negative inflows amounting to $195 million in 2006. This contrasted with the high growth experienced in 2005 when inflows reached $6 billion. Although South Africa experienced negative FDI inflows, caused by the sale of a foreign equity stake in a domestic gold-mining company to a local firm, there were a number of cross-border M&A deals in the country. For instance, Vodafone (United Kingdom) paid $2.9 billion to raise its stake in Vodacom of South Africa, Tata (India) bought a 26% stake in InfraCo (a telecommunications company), valued at $60 million, and some other Asian TNCs (such as Istithmar, the investment arm of the Government of Dubai) bought V&A Waterfront (South Africa) for more than $1 billion.[20] In Angola, Sonangol's takeover of major oil-related projects from foreign companies, such as the Lobito oil refinery, also resulted in an overall negative FDI inflow, though some foreign investments took place in banking, telecommunications and mining.

(ii) Outward FDI hit new heights

FDI outflows from Africa hit record levels in 2006, to reach $8 billion, nearly four times those of 2005, and more than twice the previous peak in 1997 (annex table B.1).[21] Investors from South Africa accounted for four fifths of these. Other source countries, including Morocco, Liberia, Nigeria, Egypt and the Libyan Arab Jamahiriya, in that order, recorded their highest level of outflows. A large proportion of FDI by South African TNCs in 2006 was in natural resource exploration and exploitation. For example, AngloGold Ashanti invested in a gold-mining expansion project in Brazil (in Cuiaba) and in underground gold extraction development in Australia (at Sunrise Dam); and Ophir Energy invested in offshore oil exploration in the United Republic of Tanzania. AngloGold also established an alliance worth $58 million with Trans-Siberian Gold of the Russian Federation.[22]

A number of African TNCs in services (many of them from South Africa) also expanded abroad, including into Europe. Outward FDI in telecommunications involved, for example, Orascom (Egypt), MTN (South Africa), Maroc Telecom (Morocco), Naguib Sawiris (Egypt) and Telkom (South Africa).[23] Significant cross-border acquisitions by African firms took place in industries as diverse as health-care services, printing and media, and construction.

b. Sectoral trends: primary sector's share rose

There was a surge of FDI flows to Africa in the primary sector, mainly in oil and gas (table II.4). In addition, the growing services sector, particularly transport, storage and communications, continued to attract FDI, as reflected by the data on cross-border M&As in 2006. However, it grew at a lower rate than the primary sector.

Inflows into the manufacturing sector continued to grow in North African countries at a slow but stable rate, while in sub-Saharan Africa, no significant manufacturing FDI took place. Conversely, disinvestments occurred in textile processing. Limited production capabilities continue to be a major factor behind the relatively low FDI inflows in manufacturing and the difficulties faced by African countries in seizing the opportunities offered by preferential market access initiatives such as AGOA, Everything but Arms (EBA) and the Cotonou Agreement between the European Commission (EC) and the African Caribbean and Pacific group of countries.

c. Policy developments

The rapid growth of inflows to Africa partly reflects the steps taken by countries of this region to open up their economies to foreign investment. UNCTAD's annual survey on changes to national laws and regulations shows that in 2006, 40 African countries introduced 57 new measures affecting FDI, of which 49 encouraged inward FDI.

Of these measures, 14 were related to sectoral liberalization, more specifically:

- Botswana, Burkina Faso, Burundi, Cape Verde, Ghana, Kenya and Namibia allowed partial or full foreign ownership of their telecommunications industries;
- Congo, Egypt and Nigeria wholly or partially opened up their banking industries;

Table II.4. Africa: distribution of cross-border M&As, by sector and main industry, 2005-2006
(Millions of dollars)

	Sales		Purchases	
Sector/industry	2005	2006	2005	2006
Total industry	10 509	17 569	15 505	11 208
Primary	908	4 788	249	356
Mining, quarrying and petroleum	908	4 788	249	356
Mining and quarrying	873	524	237	335
Petroleum	34	4 265	12	21
Secondary	1 676	2 017	35	159
Food, beverages and tobacco	17	1 136	3	-
Chemicals and chemical products	12	3	-	120
Stone, clay, glass, and concrete products	967	-	29	-
Metals and metal products	12	783	3	-
Machinery	545	-	-	39
Electrical and electronic equipment	-	8	-	-
Motor vehicles and other transport equipment	3	13	-	-
Services	7 925	10 763	15 221	10 693
Electricity, gas, and water distribution	58	307	-	-
Hotels and restaurants	32	10	-	-
Trade	312	1 001	47	87
Transport, storage and communications	1 534	8 321	1 307	698
Finance	5 398	1 086	13 787	9 315
Health and social services	587	-	-	-

Source: UNCTAD cross-border M&A database.

- Ethiopia approved foreign concessions to its railway company and Mauritius opened its legal professional services industry to FDI;
- Morocco permitted foreigners to own vast areas of land; and
- Swaziland opened up to FDI in insurance.

A number of African countries introduced measures aimed at improving the admission and/or establishment processes applied to foreign investors. For example, Burkina Faso created a one-stop shop for new businesses; Kenya strengthened its investment promotion agency (IPA); several countries eased or improved registration and fiscal procedures for various business start-ups.[24] For example, Nigeria cut the average property registration time from 274 to 80 days.

Many countries introduced various other measures to promote foreign investment. These mainly involved tax reductions (Algeria, Egypt, Ghana, Lesotho, Mozambique, Tunisia, Uganda and the United Republic of Tanzania), the establishment of specialized investment zones or parks (Botswana, Eritrea, Morocco, the United Republic of Tanzania and Zambia), or the setting up of advisory councils for investment promotion (Ethiopia).

In some countries, however, governments adopted policies that were less favourable to foreign investment. For example, in Algeria, Egypt, Equatorial Guinea and Zambia, Governments raised various taxes or royalties that may affect foreign investment. Algeria ended majority foreign ownership in its oil and gas industries; Lesotho extended State monopoly over its fixed-line telephone services for a further 12 months; Swaziland closed its retail sector to foreign investors, and Zimbabwe prohibited money transfer operations by foreign or domestic agencies and main banking institutions. In the Libyan Arab Jamahiriya, new measures were adopted, requiring foreign investors to give priority to Libyan nationals in the manufacturing and agricultural sectors, and in construction, electricity, transport and communications in the services sector, as well as to provide training to locals, and ensure equal payments between Libyan and foreign staff.

At the international level, the region's development partners under the umbrella of the fourth Africa-Asia Business Forum (AABF) and the Tokyo International Conference for Africa's Development (TICAD) implemented measures to boost the region's FDI inflows. The Forum sought to boost the expansion of investments by Asian firms, including small and medium-sized enterprises (SMEs), in Africa (box II.2).

However, changing regulatory frameworks and improving the business climate may not be enough to attract greater FDI into manufacturing and to benefit from such investments. In countries with small domestic markets, FDI in manufacturing depends particularly on export markets and on the international competitiveness of African products in terms of unit factor costs relative to other countries (Golub and Edwards, 2003). Natural resources are attractive assets for export-oriented production, but they may not provide a sufficient basis for sustainable economic growth (Part Two). Moreover, natural resources provide rents only for as long as the resources last and are in demand; without technological and skills upgrading and development of downstream industries resource-exporting countries may eventually face stagnant prices and the risk of specializing in products that may become outdated (Nwokeabia, 2007). Accordingly, it is important for host countries to adopt policies that help improve their local capacities, and in particular their labour skills and technological capabilities.

d. Prospects: moderate growth expected in 2007

Prospects for FDI inflows into Africa in 2007 and beyond are expected to remain positive – albeit moderately – due to high commodity prices, particularly of oil. UNCTAD's *World Investment Prospects Survey* (UNCTAD, 2007b)[25] shows that only 20% of the investors interviewed planned to increase investment in Africa between 2007 and 2009, with no significant differences by subregion

Box II.2. A renewed push for Asian FDI in Africa

In 2006, TNCs from developing Asia accounted for over half of the cross-border M&As to Africa, worth close to $9 billion, up from $0.1 billion in 2005 (table II.2). This followed previous but slower growth in Asian FDI to Africa, which averaged $1.2 billion annually during the period 2002-2004. Singapore, India and Malaysia are the top Asian sources of FDI to the region, with a combined investment stock estimated at $3.5 billion (i.e. of cumulative approved flows from 1996 to 2004), followed by China, the Republic of Korea and Taiwan Province of China. Malaysia's FDI was the most diversified, by country and by industry, while about 3% of China's total outward FDI stock was spread over some 500 FDI projects in 48 African countries. Moreover, FDI from China to Africa has been increasing rapidly in recent years (UNCTAD, 2007d).

As part of efforts by the Government of Japan to boost trade and investment flows between the two regions, the fourth Africa-Asia Business Forum (AABF IV) took place in Dar es Salaam, United Republic of Tanzania in February 2007. The forum aims at increasing trade opportunities available to Asian TNCs in Africa taking into account the various trade agreements in place, such as AGOA and various new economic programmes for Africa's development (e.g. the New Partnership for Africa's Development (NEPAD)). It also aims to encourage the transcontinental exchange of knowledge and expertise and foster stable and sustainable economic growth and development between the regions within a South-South framework. The sectors targeted by AABF IV are: agro-industry and food processing, building materials, construction and engineering, information and communication technologies, medical equipment and pharmaceuticals, and textiles, garments and leather products.

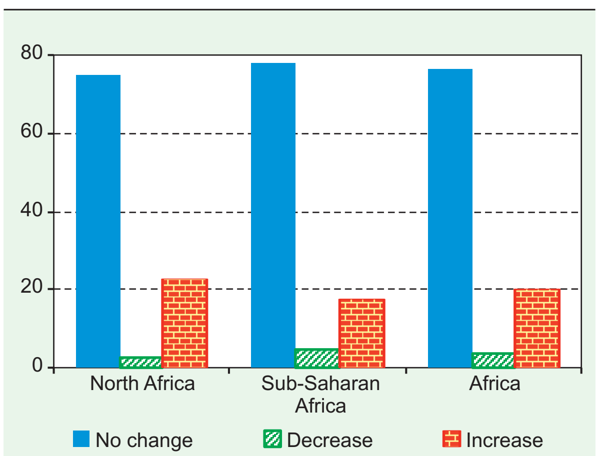
Participation in AABF IV was open to businesses from African and Asian countries.

Source: UNCTAD, based on information from AABF IV.

(figure II.5). Returns on capital in the region are expected to remain strong. While FDI in oil and gas and other minerals is likely to remain robust in the medium term, in manufacturing it is likely to fall further, due to tough international competition in garment exports and to the removal of trade preferences. But in the long-term it should revive as new initiatives, such as the African Investment Incentive Act (AIIA) by the United States Government, are implemented.[26]

FDI inflows into Africa in 2007 are likely to remain unevenly distributed by sector/industry and subregion and country, especially because most new investments will be in oil, gas and natural resources which are geographically concentrated. In *North Africa,* prospects for the region as a whole are bright under initiatives being negotiated or concluded with the EU (box II.3), with significant new investments expected in Algeria and the Libyan Arab Jamahiriya. In *West Africa, Central Africa* and *Southern Africa* FDI inflows will also be concentrated in a few countries, for example, in oil exploration in Nigeria, in mining and associated activities in South Africa, and in oil and related infrastructure development in Equatorial Guinea. FDI inflows into countries with few natural resources are likely to remain slow, including in almost the entire *East African* subregion, though even here there will be relatively higher flows to countries such as Mauritius because of privatizations and other M&A activity.

Figure II.5. FDI prospects in Africa, 2007-2009, by subregion: responses to UNCTAD survey
(Per cent of respondents)



Source: UNCTAD, 2007b.

Prospects are also good for larger FDI outflows from Egypt, Morocco, Nigeria and South Africa, as TNCs from these countries (in particular in mining and services) are set to continue expanding abroad.

2. Asia and Oceania

FDI inflows to Asia and Oceania reached a record of $260 billion, marking the fourth consecutive year of growth and representing more than two thirds of inflows to developing countries. Outward flows from this region grew by 50%, to $117 billion. Six out of the seven developing-country TNCs listed in the world's top 100 non-financial TNCs are from this region. This section examines South, East and South-East Asia, West Asia and Oceania.

Box II.3. North Africa: EU initiatives aimed at boosting FDI inflows and industrial growth

The North Africa subregion is a vital trade and investment partner of the EU, and the flow of FDI is in both directions: TNCs from the EU have purchased significant assets, particularly in Morocco and Egypt, in the context of privatizations that started in the 1980s, while more recently North African investors have begun to acquire EU firms. In 2005, for instance, Orascom Telecom (Egypt) acquired Wind Telecommunicazioni (Italy) for $12.8 billion (*WIR06*). FDI flows between North African countries and the EU are set to grow further as a result of the conclusion or negotiation of some recent free trade agreements between the EU and countries in the region. These agreements include the outcomes of the Barcelona Process[a] and a network of association agreements such as the Euro-Mediterranean Partnership and the Euro-Mediterranean Free-Trade Area.[b] The Euro-Mediterranean Partnership specifically aims at constructing a zone of shared prosperity through the gradual establishment of a free-trade area. The funding priorities of the MEDA programme of the Euro-Mediterranean Association Agreement focus on support for SMEs, privatization and trade facilitation.

The agreement on the Euro-Mediterranean Free Trade Area aims at assisting private sector development including improvement of the business environment, facilitating privatization, support for SMEs, promotion of investment and industrial cooperation. It can thereby assist in attracting FDI to stimulate industrial and commercial competitiveness in the North African region.

Source: UNCTAD, based on information from Euromed (europa.eu.int/comm./external relations) and other sources.

[a] The Barcelona Process is the result of the Euro-Mediterranean Conference of Ministers of Foreign Affairs, held in Barcelona on 27-28 November 1995. It marked the starting point of the Euro-Mediterranean Partnership, a wide framework of political, economic and social relations between the Member States of the European Union and 10 country partners of the Southern Mediterranean.

[b] The Mediterranean Partnership and Euro-Mediterranean Free Trade area include four North African countries: Algeria, Egypt, Morocco and Tunisia, with the Libyan Arab Jamahiriya as an observer.

a. South, East and South-East Asia

FDI inflows into South, East and South-East Asia maintained an upward trend in 2006. The bulk of these flows went to East Asia, with growth particularly pronounced in the inflows to South and South-East Asia. In East Asia, FDI flows are shifting towards more knowledge-intensive and high value-added activities, reflecting an increasing emphasis on the quality of FDI in investment promotion. Outward FDI from the region also soared. China has consolidated its position as an important source of investment, and India is rapidly catching on. Resource-seeking FDI from the two countries continued to increase, as did large acquisitions by their firms in developed countries.

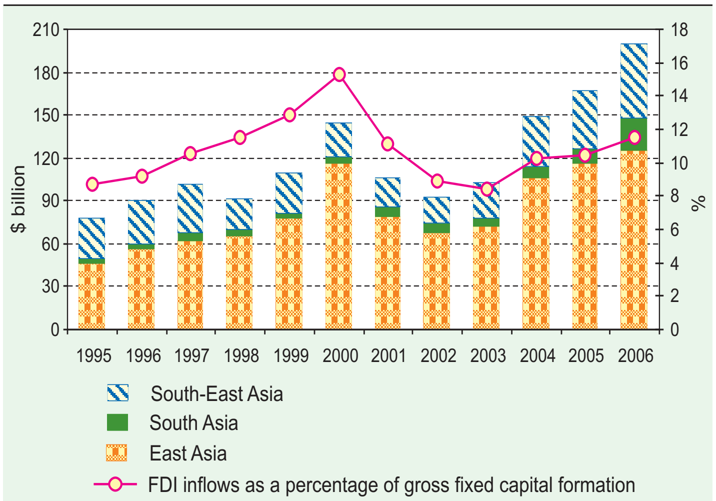
(i) Geographical trends

(a) Inward FDI: continued shift in favour of South and South-East Asia

FDI inflows to South, East and South-East Asia rose by 19% to $200 billion. At the subregional level, FDI continued to grow at a faster rate in South and South-East Asia than in East Asia (figure II.6). Nevertheless, the East Asian economies of China and Hong Kong (China) remained the largest FDI recipients among all developing economies, attracting $69 billion and $43 billion in 2006 respectively. Singapore was the third largest destination in the region with $24 billion worth of inflows, followed by India, which registered a substantial increase in FDI, amounting to $17 billion (figure II.7).

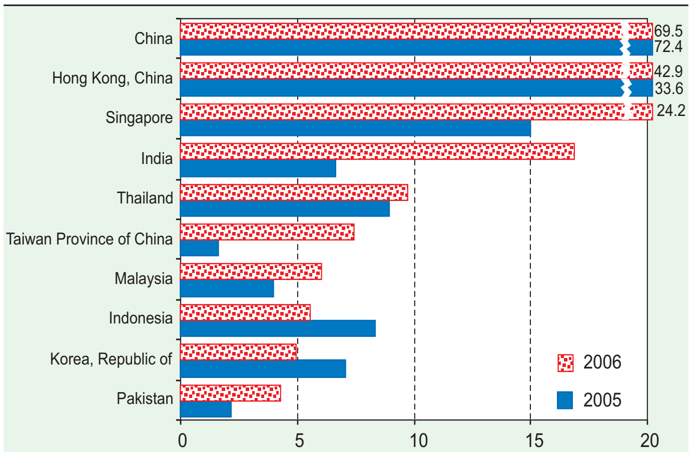
The value of cross-border M&As in the region rose by 19%, to $54 billion (annex table B.4), driven partly by large intraregional deals. In 2006, 47% of cross-border M&As in South, East and South-East Asia were intraregional, compared to 43% in 2005 and 32% in 2004. Meanwhile, the number of recorded greenfield projects climbed by

Figure II.6. South, East and South-East Asia: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

Figure II.7. South, East and South-East Asia: top 10 recipients of FDI inflows, 2005-2006
(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 FDI inflows in 2006.

19%, reaching a peak of 3,515 projects (annex table A.I.1).

East Asia

FDI inflows to East Asia[27] rose by 8% in 2006. Despite slower investment growth over the past two years, this subregion still accounted for about two thirds of total FDI flows to South, East and South-East Asia. China was East Asia's largest FDI recipient, followed by Hong Kong (China), Taiwan Province of China and the Republic of Korea.

Inward FDI flows to *China* declined for the first time in seven years. The modest decline (by 4% to $69 billion) was due mainly to reduced flows to financial services.[28] Rising production costs and labour shortages in China's coastal regions,[29] as well as policy measures for promoting the development of the inner areas, have begun to influence the geographic distribution of FDI. Some provinces in the middle and western regions of the country received higher FDI inflows than in previous years, while in the more advanced areas, such as the Pearl River and Yangtze River Deltas, investments have been shifting towards higher value-added activities such as computer peripherals, telecom equipment and semiconductors.

FDI flows to *Hong Kong (China)* rose to $43 billion, its second highest level ever. *Taiwan Province of China* saw the highest growth rate of FDI in the subregion in 2006, with inflows jumping by about 360% to $7 billion. FDI increases recorded for both economies were driven by rising cross-border M&As. In Taiwan Province of China, private equity firms from the United States, such as Carlyle Group and Newbridge, were involved in some of the largest M&As, including the acquisitions of Eastern Multimedia for $1.5 billion and of some banks.

Inflows to the *Republic of Korea* declined considerably in 2006, due mainly to a significant fall in the value of cross-border M&As (annex table B.4) and divestment by foreign investors. There were a number of large divestments from the country by foreign investors, particularly retailers such as Carrefour of France (about $1.6 billion) and Wal-Mart of the United States (about $900 million). New flows were nevertheless directed into high value-added activities in fields such as parts and materials, research and development (R&D) centres and distribution centres. For example, FDI in the parts and materials industry rose by 50% to $3.2 billion (on a notification basis).[30]

South-East Asia

FDI inflows into South-East Asia (comprising the 10 ASEAN member States[31] and Timor-Leste) registered a 25% increase in 2006, to reach their highest ever level of $51 billion. In particular, FDI flows to *Singapore* rose by 61%, representing a new high of $24 billion. As a distribution hub and financial centre in the subregion, the country accounts for almost half of total inflows to South-East Asia and continues to receive most of its FDI in services (mainly trade and finance). FDI inflows to *Thailand* continued to rise, by 9% in 2006, reaching a record $10 billion and consolidating the country's position as the second largest FDI recipient in South-East Asia. Large intraregional M&A deals, particularly the acquisition of Shin Corp. by Temasek Holdings (Singapore), accounted for a large part of the total inflows. Inflows to *Malaysia* and *the Philippines* rose substantially: by 53% in the former, to its highest level since the Asian financial crisis ($6 billion), and by 26% in the latter to its highest level ever ($2.3 billion). The Philippines' potential to attract FDI has been highlighted by the decision of Texas Instruments (United States) to invest around $1 billion in the country over 10 years in a new testing and assembly facility.[32] *Indonesia* saw a substantial decline (33%) in FDI inflows, thus breaking the positive trend from 2005.

The performance of other ASEAN member countries in attracting FDI in 2006 was generally good. The *Lao People's Democratic Republic* witnessed a sixfold growth, the highest among countries in the subregion, while inflows to *Cambodia* also rose. In *Viet Nam* they rose by 15% to reach $2.3 billion, and the country is increasingly considered an attractive location for efficiency-seeking FDI and some view it as an alternative destination to countries such as China.[33] With its accession to the World Trade Organization (WTO) in 2007, market-seeking FDI is likely to increase.

South Asia

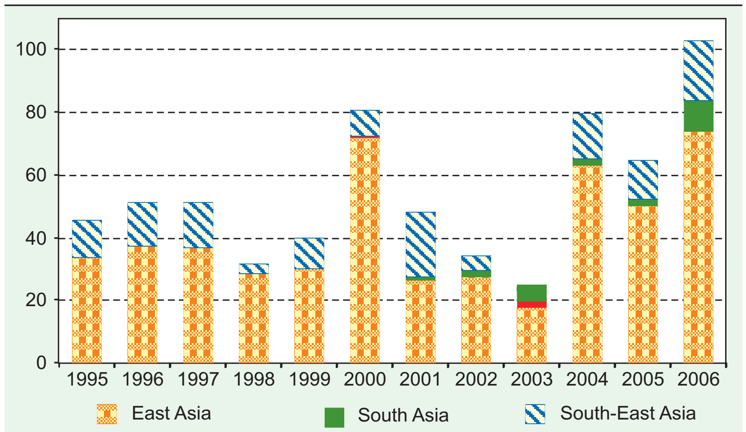
FDI inflows to South Asia[34] surged by 126%, amounting to $22 billion in 2006, mainly due to investments in *India*. The country received more FDI than ever before ($17 billion, or 153% more than in 2005), equivalent to the total inflows to the country during the period 2003-2005. Rapid economic growth has led to improved investor confidence in the country. According to the Government of India, the country's economy is expected to grow by 9.2% in the 2006/07 fiscal year. The sustained growth in income has made the country increasingly attractive to market-seeking FDI. Indeed, foreign retailers such as Wal-Mart have started to enter the Indian market. At the same time, a number of United States TNCs, such as General Motors and IBM, are rapidly expanding their presence in the country, as are several large Japanese TNCs, such as Toyota and Nissan. Private equity firms are also playing a role. For instance, Kohlberg Kravis Roberts & Co. (United States) acquired a controlling stake (85%) of Flextronics Software Sys Ltd. with an investment of $900 million.

Other important recipients of FDI in the subregion include Pakistan, Bangladesh and Sri Lanka. The performance of *Pakistan* in attracting FDI ($4.3 billion in 2006) has been promising. Strong economic growth and an aggressive privatization programme have led to booming FDI inflows during 2004-2006. In terms of sources of FDI, there has been a shift from developed countries to West Asian countries, particularly the United Arab Emirates and Saudi Arabia. After playing a leading role in a number of large M&A deals in Pakistan's privatization process, West Asian companies announced a series of large greenfield projects in the country.[35] Inflows to *Sri Lanka* rose significantly, reaching a record high of $480 million. However, *Bangladesh* has not yet realized its potential: the country is still categorized as an underperformer according to UNCTAD's *Inward FDI Potential and Performance Indices* (figure I.8), with FDI inflows of $625 million in 2006 (10% less than in 2005). Despite liberalization in some sectors (such as telecommunications) and recent efforts in establishing itself as an attractive location for FDI in South Asia, political uncertainty, poor infrastructure and a weak business environment tend to deter investors (World Bank, 2006).

(b) Outward FDI increased substantially from all subregions

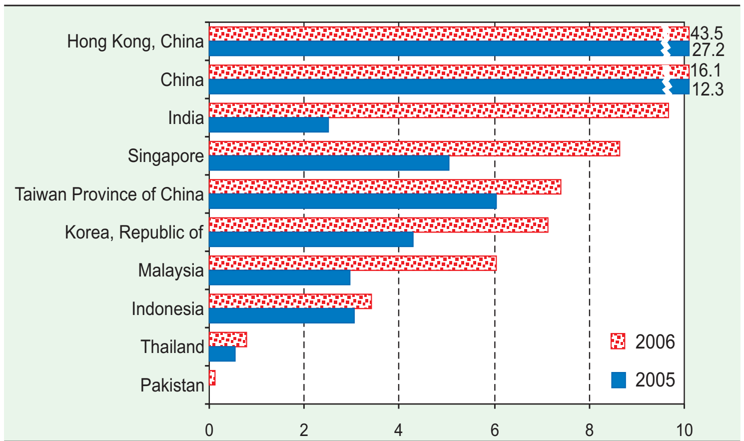
Outward FDI from South, East and South-East Asia soared by 60% to $103 billion, increasing from all three subregions (figure II.8), and particularly from Hong Kong (China), China, India, Singapore and the Republic of Korea (figure II.9). The total value of cross-border M&As undertaken by TNCs based in the region rose to $47 billion. Outflows from *Hong Kong (China)*, the largest FDI source in the region, rose by 60%, to $43 billion. The rebound in outflows from *Singapore* was

Figure II.8. South, East and South-East Asia: FDI outflows, 1995-2006
(Billions of dollars)



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

Figure II.9. South, East and South-East Asia: top 10 sources of FDI outflows, 2005-2006
(Billions of dollars)



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

[a] Ranked by magnitude of FDI outflows in 2006.

driven by large M&As within the region as well as in developed countries,[36] while increased outward FDI from the *Republic of Korea* was driven more by greenfield investments, prompting some concerns of a hollowing out.[37] FDI outflows from the region are targeting mainly offshore financial centres, but investments in developed countries as well as intraregional investments are also on the rise.

Rising outflows from China and India

China and India are beginning to challenge the dominance of the Asian newly industrializing economies (NIEs) – Hong Kong (China), the Republic of Korea, Singapore and Taiwan Province of China – as the main sources of FDI in developing Asia. Since 2004, their share of the total outflows from the Asian region as a whole has risen from 10% to 25%.

China's outflows increased by 32% to $16 billion in 2006, and its outward FDI stock reached $73 billion, the 6th largest in the developing world. Part of this overseas expansion involves considerable investment in other developing and transition economies. For example, China is establishing the first group of eight overseas economic and trade cooperation zones[38] in the following countries: in Nigeria, Mauritius and Zambia in Africa, in Mongolia, Pakistan and Thailand in Asia and in Kazakhstan and the Russian Federation in South-East Europe and the CIS. With a total investment of $250 million, for example, the zone in Pakistan is a joint venture between Haier (China) and Ruba Group (Pakistan). According to China's Ministry of Commerce, 50 similar zones will be established over the next few years, facilitating more FDI from China into other developing and transition economies.

In addition, China established in 2007 a government investment company to manage a $200 billion fund drawn from the country's huge foreign currency reserves.[39] This follows the example of the proactive approach to reserves management implemented in countries such as the Republic of Korea and Singapore. Although the investment strategy and policy of this company has not yet been clarified, it is expected to invest in foreign companies, partly through direct investment. In May 2007, for example, the company, though not yet formally established, invested $3 billion for a 9.9% stake in the private-equity firm Blackstone (United States).

India's outflows were almost four times higher than those of 2005. Compared to China, where FDI outflows are driven by the international expansion of State-owned enterprises encouraged by proactive government policies, booming outflows from India have been dominated by privately owned conglomerates, such as the Tata Group. With a total investment of $11 billion, for example, Tata Steel acquired Corus Group (United Kingdom and the Netherlands) in early 2007, creating Tata-Corus, the world's fifth largest steel maker (by revenue). It is one of a series of large cross-border M&As undertaken by Tata Steel and other members of the Tata Group in the past two years,[40] and by far the second largest deal ever made by a company from a developing country, the largest being the CVRD (Brazil)-Inco (Canada) deal in 2006 (section A.3).

The emergence of China and India as important sources of FDI, coupled with active M&A activities by investors based in the Asian NIEs (particularly Singapore), has led to increased FDI flows from Asia to developed countries. Asian investors have become a driving force in the M&A boom in Europe, in particular, in 2006. According to Think London (the local IPA of London in the United Kingdom), FDI in the city from Asia, particularly India, has risen significantly in recent years.[41]

Intraregional FDI

Intraregional FDI flows are important for many economies in the region, and a few of the bilateral FDI stocks are among the largest in the world (table II.5). The past two years have seen a rise in intraregional flows, as highlighted by data on cross-border M&As: in 2005 and 2006, about 55% of cross-border M&As undertaken by TNCs based in the region were intraregional, as compared to 40% in 2004.

Intraregional FDI flows take place both within and between subregions. Within subregions, two clusters stand out: intra-Greater-China FDI – flows among China, Hong Kong (China), Taiwan Province of China and Macao (China) – and intra-ASEAN FDI. Within the former cluster, bilateral FDI stocks between Hong Kong (China) and China are the second largest in the world (table II.5), after those between the United Kingdom and the United States (chapter I). Mutual flows between the two economies have grown significantly since the mid-1990s, but round-tripping FDI as well as trans-shipping FDI account for a large share of these flows (*WIR06*:12-13). FDI flows from Taiwan Province of China into China have increased since the early 2000s. Accordingly, a number of affiliates established by electronics companies based in Taiwan Province of China now rank among the largest foreign affiliates in China.[42] Within the intra-ASEAN cluster, Singapore is the leading investor (table II.5), while Malaysia has also become an important source of FDI. Further economic integration driven by the common objective of achieving an ASEAN Investment Area by 2015 has been stimulating stronger intra-ASEAN FDI flows.

Table II.5. Intraregional FDI in South, East and South-East Asia: largest bilateral flows and stocks, 2005, ranked by FDI flows

		FDI flows in 2005			FDI stock in 2005[c]	
Rank	Home country - host country	Amount ($ million)[a]	Share in home economy outflows[b] (%)	Share in host economy inflows[a] (%)	Amount ($ million)[d]	Rank in the world
1	Hong Kong (China) - China	17 949	61.6	24.8	241 573	2
2	China - Hong Kong (China)	9 373	27.9	27.9	164 063	8
3	Republic of Korea - China	5 168	46.0	7.1	25 936	63
4	Thailand - Hong Kong (China)	3 613	..	10.7	4 282	e
5	Singapore - China	2 204	43.8[f]	3.0	25 539	65
6	Taiwan Province of China - China	2 152	35.7[f]	3.0	39 604	43
7	Singapore - Hong Kong (China)	1 414	28.1[f]	4.2	10 874	123
8	Hong Kong (China) - Singapore	771[b]	2.8	5.1[g]	5 160	e
9	Malaysia - Singapore	627	2.2	3.1	4 046	e
10	Macao (China) - China	600	8.0	0.8	6 337	e
11	Singapore - Malaysia	575	11.4[f]	14.5	7 623	159
12	Malaysia - China	361	3.6	0.5	3 833	e
13	Singapore - Thailand	301	6.0[f]	7.5	6 150	194
14	India - Singapore	289	11.6[f]	1.4	1 101	e
15	Hong Kong (China) - Thailand	238	1.2	5.9	2 737	e

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

a Based on data on FDI inflows as reported by the host economy.
b Based on data on FDI outflows as reported by the home economy.
c Or latest year available.
d Based on data on inward FDI stock as reported by the host economy.
e >200.
f Estimated share, based on data on inward flows from the home economy to the reporting host economy (numerator) and total outward flows of the reporting home economy (denominator).
g Estimated share, based on data on outward flows from the reporting home economy to the host economy (numerator) and total inward flows of the reporting host economy (denominator).

Chinese FDI in ASEAN is also rising fast, complementing the traditionally large investors from Hong Kong (China) and Taiwan Province of China. Chinese companies have focused on energy, infrastructure and related services in a number of ASEAN member States.[43] Rising inflows to low-income countries such as Cambodia and the Lao People's Democratic Republic have also been driven mainly by FDI from China, which has become the largest source of FDI inflows to those countries.

(ii) Sectoral trends

(a) Inward FDI increased in primary and services sectors

Judging by the data on cross-border M&A sales, in 2006, the primary and services sectors in South, East and South-East Asia received significantly higher FDI inflows in 2006, while M&A sales in manufacturing dropped (table II.6).

Extractive industries. In comparison with Africa and Latin America, extractive industries and related activities account for a relatively small share of total FDI to South, East and South-East Asia, but they nevertheless continue to be resilient in attracting FDI. For example, high oil prices have been encouraging investment by TNCs in large projects in coal mining and processing in China.[44] In the region as a whole, the value of cross-border M&As in extractive industries rose nearly fivefold to $1.7 billion in 2006, and the number of recorded greenfield projects in the sector also increased significantly.

Manufacturing. In 2006, cross-border M&As in the region soared in textiles and clothing, machinery and chemicals, but declined considerably in food, beverages and tobacco, electrical and electronic equipment and motor vehicles and other transport equipment (table II.6). Greenfield investments also rose significantly in textiles and clothing. China remains the region's top recipient of FDI in manufacturing, and it is climbing up the value chain.[45] An increasing number of TNCs have established regional headquarters in Chinese cities such as Beijing and Shanghai. IBM has even relocated its global procurement headquarters to Shenzhen. India is gaining strength in attracting FDI in traditional manufacturing industries such as steel and petrochemicals. Its FDI inflows in manufacturing rose from $11 billion in the 2004/05 fiscal year to $17 billion in the 2006/07.[46] POSCO (Republic of Korea) announced in 2006 that it would invest $12 billion in a steel plant in India. Automobile manufacturing TNCs have been rapidly expanding their presence in India's automotive industry (box II.4).

Services. The shift towards services (*WIR04*) continues in the region, particularly on account of investments in communications, real estate, retailing and financial services. Intraregional M&A deals in service industries such as telecommunications and transportation (annex table A.I.3 for large deals) have been one of the driving forces behind this shift, and the growth of FDI in financial services has been particularly significant in recent years. In the banking industry, a new wave of liberalization in economies such as China, India, Pakistan, Taiwan Province of China and Viet Nam – often linked to WTO commitments – has resulted in significant flows of FDI. Investors are from Asian countries with existing thriving banking industries (e.g. the Overseas Union Bank of Singapore, which recently expanded into Viet Nam) as well as from outside the region (e.g. the Standard Chartered Bank of the United Kingdom, which acquired a bank in Taiwan Province of China; and Dubai Islamic Group of the

Table II.6. Sector/industry breakdown of cross-border M&As in South, East and South-East Asia, 2005-2006
(Millions of dollars)

Sector/industry	2005	2006	Growth rate (%)
Primary	469	1753	273.5
Agriculture, forestry and fisheries	120	89	-25.7
Mining, quarrying and petroleum	350	1664	376.0
Mining and quarrying	3	63	1926.8
Petroleum	347	1601	362.1
Secondary	13 300	12 906	-3.0
Food, beverages and tobacco	6 256	3 099	-50.5
Textiles, clothing and leather	100	1720	1624.8
Woods and wood products	997	419	-57.9
Chemicals and chemical products	659	970	47.1
Stone, clay, glass and concrete products	401	734	83.0
Metals and metal products	812	856	5.4
Machinery	432	2 640	510.9
Electrical and electronic equipment	2 368	1 462	-38.2
Motor vehicles and other transport equipment	1 047	275	-73.8
Services	31 363	39 063	24.6
Electricity, gas and water distribution	932	161	-82.7
Construction firms	108	58	-45.9
Hotels and restaurants	1 845	1 387	-24.8
Trade	1 863	786	-57.8
Transport, storage and communications	6 604	16 139	144.4
Finance	14 529	11 645	-19.9
Business activities	4 804	5 048	5.1
Health and social services	294	140	-52.5
Community, social and personal service activities	371	3172	754.0
Total	45 132	53 723	19.0

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

United Arab Emirates, which is expanding into Pakistan). Private equity firms from the United States, such as Carlyle Group and Newbridge, are also actively investing in the banking industry in the region. In the retailing industry, China and India have large potential to attract both equity and non-equity investments from TNCs. In India the retail market has begun to open up to foreign retailers.[47] In China, this industry has already become an important FDI recipient, with accumulated flows of $5 billion. Based on a first-mover strategy, Carrefour (France) has become the fifth largest retailer in China, while Wal-Mart (United States), which ranked the 14th largest, recently expanded its presence in China through the acquisition of Trust-Mart.[48] In contrast to their expansion in China and India, as noted, Carrefour and Wal-Mart divested from the Republic of Korea.[49]

(b) Outward FDI: resource-seeking FDI continued to rise

Resource-seeking FDI from South, East and South-East Asia rose again in 2006, driven by large M&As involving oil and gas companies from China and India (annex table A.I.3 for large deals). Chinese and Indian oil companies have jointly acquired companies in several countries,

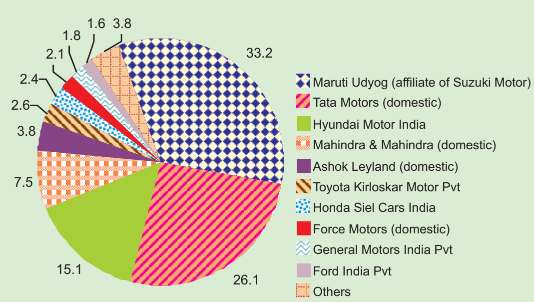
Box II.4. Market-seeking FDI in India's automotive industry is booming

Production of motor vehicles by India's automotive industry reached 1.7 million vehicles in 2005/06. Suzuki Motor (Japan) was the leading investor in India in this industry, ranking first in market share, followed by the domestic firm Tata Motors and then Hyundai Motor (Republic of Korea) (box figure II.4.1). Other significant foreign players in India's automotive industry include Toyota Motor (Japan), Honda Motor (Japan), General Motors (United States) and Ford Motor (United States). Driven by market-seeking motives, these car-manufacturing TNCs have started or are planning large-scale investment projects in India. Accordingly, the landscape of the country's automotive industry is likely to witness a dramatic change in the next few years.

- To strengthen its leading position, Suzuki Motor has announced an expansion plan of $1.65 billion, which will help to increase its annual production capacity to a million vehicles by 2010.
- General Motors is investing $300 million in a car-assembly plant in Maharashtra. The plant will start production in the fourth quarter of 2008, producing 100,000 compact cars annually. The capacity of General Motors' factory in neighbouring Gujarat is also being expanded.
- Cooperating with Mahindra & Mahindra, an Indian jeep and tractor producer, Nissan (Japan) and Renault (France) are planning to invest $908 million in a car-assembly plant in Chennai. With an annual capacity of 400,000 vehicles, the plant will start production in 2009.
- In order to double its market share to 10% in four or five years, Toyota Motor is preparing to invest $500 million in quadrupling the capacity of its plant in Bangalore (from 50,000 vehicles in 2006 to 200,000 by 2010).

Source: UNCTAD, based on various newspaper accounts.

Box figure II.4.1. Market shares[a] of automobile producers in India, 2005/06
(Per cent)



Source: UNCTAD, based on the Automotive Component Manufacturers Association of India.

[a] Calculated based on production.

such as Colombia, Sudan and the Syrian Arab Republic. By actively investing abroad, these State-owned companies are spearheading their Governments' drive to secure overseas energy sources (chapter IV).

In manufacturing, FDI from South, East and South-East Asia has been largely driven by the international expansion of firms in their bid to acquire created assets such as brands and technologies, which has become an important motive for their FDI. Aggressive acquisitions have placed some of these Chinese and Indian companies onto a fast track of internationalization. However, the experience of some Chinese companies highlights the risks inherent in this approach towards international expansion.[50]

In the services sector, Chinese banks have started to take serious steps in recent years to go global, through both cross-border M&As and greenfield investments. Despite policy restrictions in some host countries such as the United States,[51] the total foreign assets of China's State-owned banks had reached $28.4 billion by the end of 2006 and are expected to grow rapidly in the coming years.

(iii) Policy developments

A number of policy measures favourable to FDI were introduced in South, East and South-East Asia in 2006. For example, Mongolia introduced a package of tax reforms that may help improve the investment climate by reducing the corporate tax rate. In India, new legislation on special economic zones came into force. Companies that choose to invest in those zones are offered tax concessions such as a 15-year direct tax holiday and full exemption of import duties. In 2007, the Indonesian Government is in the process of promulgating a new law on energy under which foreign firms in oil and gas and coal mining will be provided incentives for investment (chapter VI). A number of countries also took steps to liberalize inward FDI in services. For example, the Lao People's Democratic Republic introduced a new banking law, and Viet Nam deregulated its banking industry to allow FDI in that industry.

Some policy measures have been adopted with a view to prioritizing various objectives related to FDI. For instance, the Chinese Government is increasingly emphasizing the quality rather than the quantity of FDI as a policy objective.[52] In addition, it has unified two income tax systems for foreign affiliates and domestic enterprises, respectively, which will take effect in 2008.[53] New policy measures have also been introduced to address various concerns related to inward FDI. For example, potential FDI in such industries as telecommunications has given rise to national security concerns for the Government of India, leading to more restrictive measures.[54] The Chinese Government has implemented new policy measures on M&As by foreign firms and on the foreign purchase of real estate,[55] and has formulated a list of industries over which the State will maintain control.[56]

Some countries have adopted new measures to encourage the internationalization of their enterprises. The Chinese Government has abolished quotas on the purchase of foreign exchange for overseas investment since 1 July 2006 and has strengthened its support for overseas investments by Chinese enterprises. The Republic of Korea also plans to relax foreign exchange regulations, including a complete removal of the investment ceiling for outward FDI by individuals (currently $10 million). In recent years, dependence on imported oil has increased significantly in some countries in the region. Therefore, energy security concerns have played an increasingly important role in their policies concerning outward FDI in extractive industries (chapter IV). In the Republic of Korea, for example, it was announced that investment in large overseas resource development projects would be backed by increased financial support by the Export-Import Bank of Korea.

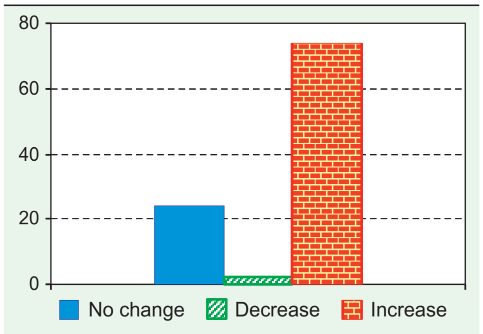
Countries in South, East and South-East Asia concluded 31 new BITs and 39 new DTTs in 2006. Among the most important developments in international agreements in 2006 were the conclusion of free trade agreements between the Republic of Korea and the United States and between China and Pakistan; as well as the Trade and Investment Framework Agreement between the United States and ASEAN, and the Economic Partnership Agreements between Japan and the Philippines and between Japan and Malaysia (chapter I).

(iv) Prospects: most-favoured region for FDI

Rapid economic growth in South, East and South-East Asia is likely to continue, underpinned by the strong performance of China and India (ADB, 2006; IMF, 2007a). Growth in market-seeking FDI to the region should keep pace with rapid economic growth in the next few years. In addition, the region may become more attractive to efficiency-seeking FDI, owing to the plans of several countries such as China, India, Indonesia and Viet Nam to develop their infrastructure.[57] During the first half of 2007, the value of cross-border M&As increased by nearly 20% over the corresponding period in 2006. FDI outflows from the region are also expected to keep growing, with the internationalization efforts of some Chinese State-owned enterprises and Indian privately owned conglomerates set to continue.

According to UNCTAD's *World Investment Prospects Survey*, South, East and South-East Asia is the region most favoured by TNCs, followed by North America and the EU (UNCTAD, 2007b). Of the TNCs interviewed in the survey, 65% already have FDI stocks in the region, and over 74% of respondents anticipate increasing investments to it (figure II.10). In terms of the investment locations, China (52% of respondents) and India (41%) rank numbers one and two, respectively, among the five most attractive sites (table I.14). The respondents who mentioned the two countries are mainly attracted by the size and growth of their domestic markets and the availability of cheap labour. Viet Nam was considered an attractive location for FDI by 11% of the respondents and is ranked number six globally.

Figure II.10. FDI prospects in South, East and South-East Asia, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)



Source: UNCTAD, 2007b.

China will remain a magnet for FDI, but is becoming more selective with respect to the quality of FDI it seeks. India has shown huge potential for market-seeking FDI, but faces a number of disadvantages that could impede progress in attaining its goal of raising annual FDI to $50 billion by 2010.[58] Viet Nam appears to be poised to become an important site for manufacturing FDI, while Thailand appears to attract high-value-added FDI. According to a 2006 survey, these four countries are also among the top five in which Japanese manufacturing TNCs expect to invest the most (JBIC, 2007). Meanwhile, investors from West Asia may continue to drive FDI to South Asian countries such as Pakistan to new heights.

b. West Asia

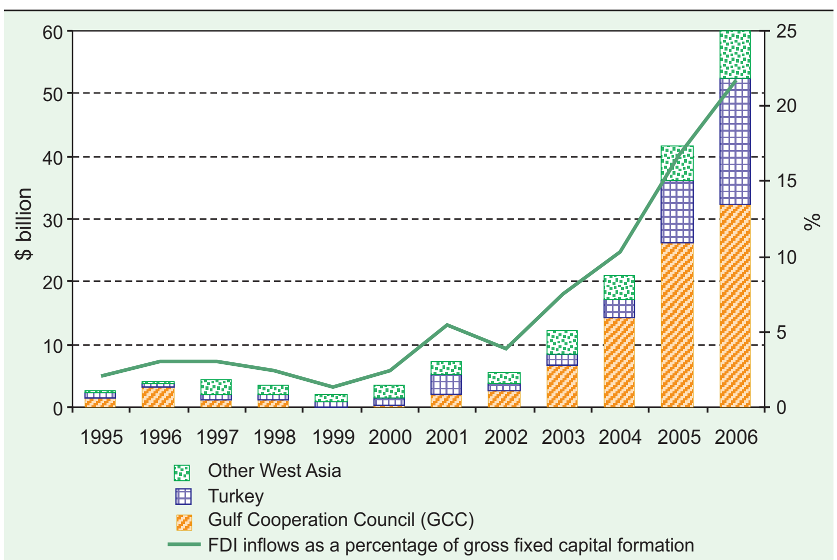
FDI flows to West Asia[59] continued their upward trend in 2006. High rates of economic growth, diversification strategies, ongoing reforms and privatizations contributed to the increase. While the services sector was by far the largest recipient of FDI in the region, inward FDI in manufacturing, especially in industries related to oil and gas, increased significantly. Outward FDI flows, driven partly by rising revenues from natural resources, remained high. Developed countries accounted for the lion's share of FDI flows to and from West Asia, but flows to and from other developing Asian countries have also been on the rise. Despite the geopolitical uncertainties that are likely to persist in the region, both inward and outward FDI can be expected to rise in 2007, judging from the record number of investor commitments. This is confirmed by UNCTAD's *World Investment Prospects Survey,* in which about one third of the respondents indicated that they would increase FDI in the region in 2007-2009.

(i) Geographical trends

(a) Inward FDI maintained its upward trend

In 2006, FDI inflows into West Asia increased by 44%, to $60 billion (figure II.11). The region's share in total FDI flows to developing countries rose from 13% in 2005 to 16% in 2006. FDI inflows as a percentage of gross fixed capital formation remained higher than in other subregions in Asia, at 22%. Inflows, as previously,

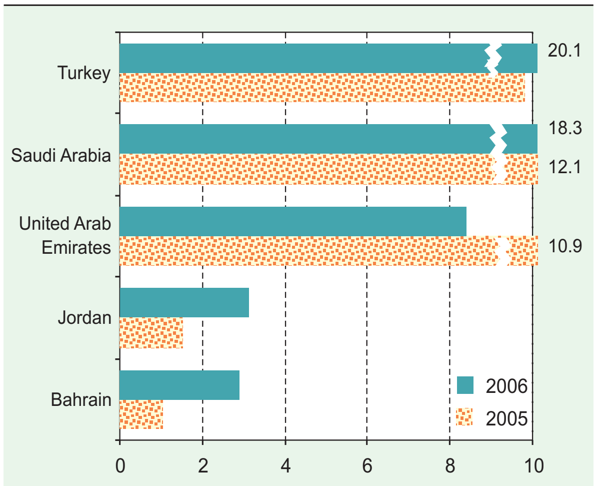
Figure II.11. West Asia: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

were concentrated in three countries: Turkey, Saudi Arabia and the United Arab Emirates, which together accounted for 78% of the total (figure II.12).

Figure II.12. West Asia: top five recipients of FDI inflows, 2005-2006[a]
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of FDI inflows in 2006.

Several factors explain this upward trend in recent years. First, regulatory frameworks for FDI are becoming more relaxed in several countries of the region, particularly in services such as finance, real estate and telecommunications (see section on policy developments below). Privatizations of these services have also attracted more investments by TNCs. Second, the business climate in several West Asian economies has improved (World Bank, 2006), and economic growth has been robust, at an average rate of 5.6% in 2005–2006 (IMF, 2007a). Third, high oil prices encouraged more FDI in oil- and gas-related manufacturing and services in 2006. Greenfield investments as well as cross-border M&As were attracted by booming local economies and prospects for continuing high prices of oil and gas.

A few mega cross-border M&As (including through privatization), particularly in financial services contributed to *Turkey* becoming the top recipient country in the region, with FDI inflows more than twice the amount registered in 2005 ($20 billion).[60]

The *Gulf Cooperation Council (GCC) member countries* – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates – attracted 54% of total FDI inflows to the subregion in 2006. Saudi Arabia was the second largest recipient in West Asia, with inflows of $18 billion, 50% more than in 2005.[61] The United Arab Emirates was the third largest, with FDI inflows going mainly to the country's 15 free trade zones. There were several cross-border M&A deals and a noticeable increase in greenfield FDI projects in the country (annex table A.I.1).

FDI inflows to the *other West Asian economies*[62] amounted to $7.3 billion. Inflows to Jordan doubled to $3.1 billion, partly owing to the acquisition of Umniah Telecom and Technologies by Batelco (Bahrain) (IMF, 2007d). However, the Islamic Republic of Iran, Iraq, the Palestinian Territory and Lebanon attracted limited FDI (table II.7), due largely to geopolitical problems.

The value of cross-border M&As in West Asia in 2006 rose by 26% over the previous year (table II.8). M&A by TNCs from developed countries jumped considerably from $3 billion to $15 billion (table II.8): Greece, the United Kingdom and Belgium, followed by the United States, were the main home countries of those TNCs, in that order, accounting for over 75% of total M&As. The value of cross-border M&As by firms from developing countries fell markedly to $3 billion from $9 billion in 2005. In consequence, developing countries' share of total M&A sales was 15% (of which 11% represented cross-border M&As within West Asia), significantly lower than in the previous year (66%).

Table II.7. West Asia: distribution of FDI flows among economies,[a] by range, 2006

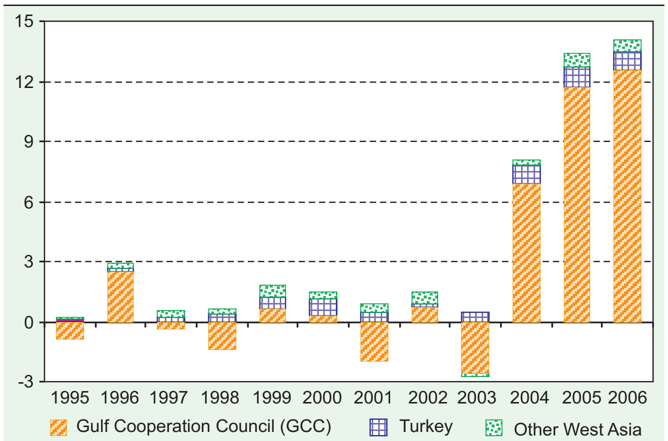
Range	Inflows	Outflows
Over $5 billion	Turkey, Saudi Arabia, United Arab Emirates	Kuwait
$3-4.9 billion	Jordan	..
$1-2.9 billion	Bahrain, Lebanon and Qatar	United Arab Emirates
$0.5-0.9 billion	Oman, Islamic Republic of Iran and Syrian Arab Republic	Bahrain, Turkey and Saudi Arabia
$0.1-0.4 billion	Iraq and Kuwait	Islamic Republic of Iran, Qatar and Oman
Less than $0.1 billion	Palestinian Territory and Yemen	Lebanon, Syrian Arab Republic, Yemen, Palestinian Territory and Jordan

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

(b) Outward FDI increased slightly

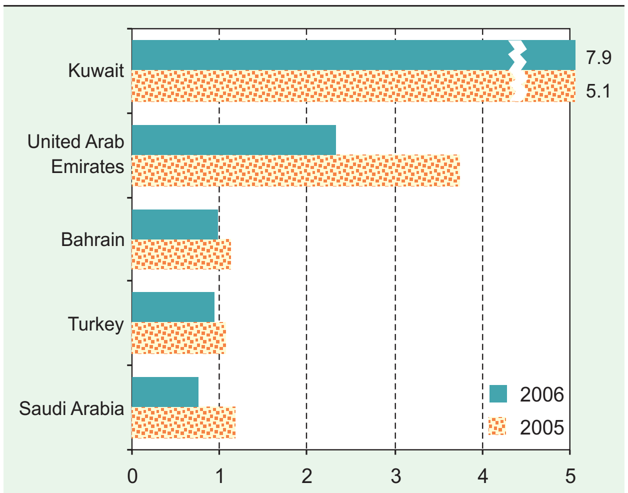
FDI flows from West Asia totalled $14 billion, a modest rise of 5% over the 2005 level (figure II.13). The GCC countries led by Kuwait accounted for 89% of this outward FDI, with about $13 billion worth of flows (figure II.14). The value of cross-border M&As by investor firms from West Asia as a whole amounted to $32 billion,[63] which corresponded to a 78% increase over that in 2005.

Figure II.13. West Asia: FDI outflows, 1995-2006
(Billions of dollars)



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

Figure II.14. West Asia: top five sources of FDI outflows, 2005-2006 [a]



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by the magnitude of FDI outflows in 2006.

The United Arab Emirates was by far the largest acquirer (annex table B.4). Acquisitions were largely targeted at developed countries, that accounted for 66% of the value of cross-border M&As by firms from West Asia (table II.8), and in particular the United Kingdom (35% by value), Canada (11%) and the United States (9%). With 8% of the value of such purchases, companies in Pakistan were also important targets in 2006.

FDI from West Asia was mainly concentrated in oil and gas and related industries, tourism, telecommunications and financial services (annex table A.I.3 for mega deals). MTC, one of Kuwait's mobile telephone companies is expanding its presence in 14 sub-Saharan countries, investing in greenfield projects in Saudi Arabia and bidding for another licence for mobile telecommunications in Qatar. The National Bank of Kuwait is engaged in deals in Jordan, Qatar and Turkey.[64]

In the case of greenfield FDI, the United Arab Emirates was also the most active investor, with more than 200 announced projects undertaken by its investors abroad out of a total of 429 by all the countries of the subregion in 2006 (annex table A.I.1). Around 40% of the outward greenfield investments from the United Arab Emirates were in the property/tourism and leisure industries, both within the region and in countries such as China, India, Morocco and Pakistan. The projects in real estate vary from offices and hotels, to marina and hub developments. Companies from the United Arab Emirates are also investing in logistical and distribution facilities mainly in the region. Saudi Arabian outward greenfield investments are concentrated in the chemical, plastic and rubber industries, including in Australia, New Zealand and Viet Nam.

Table II.8. West Asia: Cross-border M&As, by home/host region, 2005-2006
(Millions of dollars)

Home/host region	Sales 2005	Sales 2006	Purchases 2005	Purchases 2006
World	14 134	17 857	18 221	32 426
Developed countries	3 265	15 112	8 856	21 540
Europe	1 574	13 864	7 539	15 064
European Union-25	1 574	13 864	7 539	13 769
United Kingdom	97	4 811	1 564	11 407
United States	1 557	1 130	1 222	2 835
Developing countries and territories	9 276	2 723	9 363	10 590
Africa	..	55	5	4 581
Latin America and the Caribbean	..	..	50	..
Caribbean and other America	..	..	50	..
Asia and Oceania	9 276	2 669	9 358	6 009
Asia	9 276	2 669	9 358	6 009
West Asia	9 208	1 971	9 208	1 971
South, East and South-east Asia	68	697	150	4 038
South-East Europe and CIS	1 593	22	2	297

Source: UNCTAD cross-border M&A database.

(ii) Sectoral trends: all sectors attracted higher flows

Data on cross-border M&As in the region suggest that all three sectors – primary, manufacturing and services – received higher FDI inflows than in 2005 (table II.9). While West Asia's inward and outward FDI flows are highly concentrated in the services sector, the shares of primary and manufacturing sectors in cross-border M&As increased. Jordan and the United Arab

Emirates provide examples of successful cases of attracting FDI into free zones as part of efforts by their Governments to diversify FDI into the manufacturing sector (box II.5).

Few West Asian countries permit FDI in oil and gas exploration and extraction (Part Two), which explains the low levels of FDI in the region's *primary sector*. Nevertheless, the sector's share in cross-border M&As rose markedly in 2006 (table II.9). Initiatives by some countries of the region, including Qatar and Saudi Arabia, to develop their natural gas industries and to open them to foreign investment may explain part of this increase.[65]

In the *secondary sector,* manufacturing FDI in the region has been concentrated primarily in energy-related industries, including oil refining and petrochemicals.[66] FDI also continues to flow into Turkey's automotive sector, which has been a major beneficiary of outsourcing by the European motor vehicle industry over the past two decades.[67] In the United Arab Emirates following that country's economic diversification drive aimed at promoting the non-oil sector, manufacturing now accounts for about one fifth of GDP. This has been achieved mainly through the provision of incentives to attract investors to special economic zones of various kinds (box II.5). In 2006, 95% of total FDI inflows to Jordan were directed to the country's manufacturing sector.[68]

S*ervices* have remained the dominant sector for FDI in the region, often through cross-border M&As and privatizations. Continued liberalization

Box II.5. Free industrial zones in the United Arab Emirates and Jordan

As part of its diversification initiatives aimed at developing the manufacturing sector, the Government of the United Arab Emirates has been setting up free trade and industrial zones in which investors are offered special incentives and facilities for setting up industrial establishments.[a] In order to encourage foreign participation, 100% foreign ownership is allowed in the free zones. At present, there are 15 free zones in operation in the country, the largest of which is Dubai's Jebel Ali Free Zone (JAFZ), with more than 5,000 business entities from over 100 countries (box table II.5.1).In general, all of the zones are used mainly to locate warehousing and distribution facilities for local and international business operations.[b] Transnational manufacturing and distribution companies with investments in JAFZ include Black & Decker, Daewoo, Honda, Johnson & Johnson, Nestlé, Nissan, Philips, Samsung, Sony, Nokia, Daimler Chrysler and Toshiba. Another free zone, the Ras al Khaimah Free Trade Zone has attracted 2,400 companies, many of which are foreign, with $27.2 billion in total investments (including foreign and domestic). Out of the foreign entities, 623 companies are owned by Indian investors. Manufacturing companies in the zone make up about 25% of the total.[c]

Box table II.5.1. Number of foreign firms operating in Jebel Ali Free Zone, by nationality, 2005-2006

Economy	Number 2005[a]	Number 2006[b]	Growth rate (%)
Iraq	673	954	41.8
United Arab Emirates	609	856	40.6
India	530	627	18.3
Islamic Rep. of Iran	412	452	9.7
United Kingdom	367	389	6.0
United States	195	230	17.9
Germany	139	170	22.3
Pakistan	104	115	10.6
Japan	85	98	15.3
British Virgin Islands	84	96	14.3
Others	1 380	1 601	16.0
Total	4 578	5 588	22.1

Source : JETRO, 2006: 358.
[a] As of 24 May.
[b] As of 31 May.

The objective of Jordan's Qualified Industrial Zones (QIZs) is to attract investment, strengthen economic integration in the region and provide incentives for economic cooperation between Jordan and Israel.[d] They operate on joint rules of origin between Jordan and Israel, whereby products produced in the zone can be exported duty-free and quota-free to the United States.[e] These rules and incentives have been particularly helpful in attracting foreign investors wishing to benefit from the exemption of quota restrictions on textile exports to United States markets. Firms from other West Asian countries are also investing in the QIZs in Jordan. Many Turkish companies have plans to invest there to benefit from Jordan's preferential trade agreements with both the United States and Europe and the lower labour costs that prevail. By 2004, Jordan's QIZs had attracted $379 million in foreign investment, helping to create more than 40,000 jobs in 79 projects. Approximately 88% of the capital invested is classified as non-Arab (Kardoosh, 2004). In addition to QIZs, the Aqaba Special Economic Zone had already attracted more than $6 billion on an approval basis by the end of 2006.[f]

Source: UNCTAD.
[a] "JAFZA milestones", *Gulf Industry,* at: www.gulfindustryonline.com/bkArticlesF.asp?IssueID=244&Section=840&Article=5077, 2006.
[b] "Welcome Message", Jebel Ali Free Zone, at: http://www.jafza.co.ae/jafza/content/section1.asp, 2006.
[c] "Global Investment House KSCC", *Ras Al Khaimah Economic and Strategic Outlook, February* 2007.
[d] State of Israel, Ministry of Industry. Trade and Labour, "QIZ – Qualified Industrial Zones", at: www.moit.gov.
[e] Jordan and the United States concluded an FTA in 2000, the first between an Arab State and the United States. This FTA will eliminate all tariff and non-tariff barriers to bilateral trade in virtually all industrial goods and agricultural products within 10 years (*source*: Office of the United States Trade Representative, at: www.ustr.gov).
[f] "Incentives make Jordanian port a haven for investors", *Financial Times*, 21/22 October 2006.

Table II.9. West Asia: cross-border M&As, by sector/industry, 2005-2006
(Millions of dollars)

Sector/industry	Sales 2005	Sales 2006	Purchases 2005	Purchases 2006
Total industry	14 134	17 857	18 221	32 426
Primary	111	1 274	45	1 043
Mining, quarrying and petroleum	111	1 270	45	1 043
Mining and quarrying	-	112	-	-
Petroleum	111	1 158	45	1 043
Secondary	55	2 499	19	1 078
Food, beverages and tobacco	-	925	-	18
Oil and gas; petroleum refining	-	1 054	-	-
Chemicals and chemical products	-	90	-	893
Stone, clay, glass, and concrete products	-	291	-	167
Motor vehicles and other transport equipment	55	131	-	-
Services	13 968	14 084	18 157	30 305
Transport, storage and communications	8 146	5 687	11 231	13 084
Telecommunications	8 143	5 687	9 950	5 868
Finance	5 513	7 934	6 690	15 664

Source: UNCTAD cross-border M&A database.

has spurred inward FDI into real estate and financial services. In GCC countries, the latter has received the major share of the FDI in services. There are signs that FDI in Islamic finance by enterprises from within and outside the subregion is growing.[69] In the telecommunications industry, significant M&A deals have taken place, particularly in Jordan and Turkey.[70]

(iii) Policy developments

Most policy measures introduced in West Asia in 2006 were favourable to foreign investors: out of 14 regulatory changes related to FDI, 12 aimed at making the investment environment more favourable to FDI.[71] Several countries continued to liberalize sectors, but generally not the extractive industries.

For instance, the trend towards liberalization in financial services continued in 2006. In Bahrain, measures taken by the Central Bank of Bahrain and the Bahrain Monetary Agency (BMA) enable offshore banks to do business onshore for the first time. Saudi Arabia announced a plan to construct a financial district in Riyadh by 2010 at a cost of 250 billion Saudi Arabian riyal ($6.7 billion) to accommodate growing financial activities. The Qatar Financial Centre Regulatory Authority signed a memorandum of understanding with the BMA to enable the two agencies to cooperate in the supervision of financial institutions operating in both the Qatar Financial Centre (QFC) and Bahrain.[72] In Turkey, new legislation on insurance was adopted in 2007.

There are examples of liberalization in other industries as well. Oman, for example, has allowed foreign ownership of real estate, which should encourage FDI in tourism.[73] In the extractive industries, Qatar has announced several changes in contractual and tender conditions, which will facilitate the process of bidding for and securing contracts managed by Qatar Petroleum. These changes, when implemented, could have a positive impact on FDI inflows, especially in the context of Qatar's gas initiative.[74] Broader measures affecting the investment climate have also been adopted, or are being considered. For instance, Turkey in June 2006 lowered the corporate income tax rate from 30% to 20%,[75] and the Kuwaiti Government has announced plans to reduce the corporate income tax rate from 55% to 25% in order to attract more FDI into non-oil industries. Legislation to that effect is expected to be passed in 2007.

In general, the need for FDI reform in West Asia is being acknowledged and addressed (World Bank, 2006). Iraq and Jordan, for example, have either revised or are revising their investment laws. In December 2006, the United Arab Emirates decided to draft a foreign investment law aimed at improving its investment climate. However, in order to promote local employment, the Labour Ministry issued a decree in June 2006 that requires all firms – domestic and foreign – to replace within 18 months all expatriate secretaries and human resource managers with United Arab Emirates nationals.[76]

At the international level, while the FTA between Oman and the United States was the only international agreement signed in the region in 2006, several others are being negotiated. These include an FTA between Jordan and the GCC, which is set to include all commercial services and agricultural products, as well as the free movement of individuals working in construction, insurance and banking institutions. An FTA is also being negotiated between the GCC countries and India that may encourage investment from the Gulf into India, particularly in financial services; another one between the GCC and Japan is expected to be concluded in 2007. In February 2007, the EU Trade Commissioner called on members of the GCC to work on creating an FTA between the GCC and the EU.[77]

(iv) Prospects: upward trend should continue

In light of the region's high GDP growth, ongoing economic reforms, high oil prices and the conclusion of investment agreements, the upward trend in inward FDI flows to West Asia is likely to be maintained, especially in services such as finance, telecommunications and health care,[78] oil and gas (in some countries)[79] and related industries. In the first half of 2007, cross-border M&As in West Asia increased by 3% over the same period of 2006.

Nearly 66% of the respondents to UNCTAD's *World Investment Prospects Survey* expected their FDI in 2007-2009 to remain at the same level as in 2006, and about one third expected it to increase (figure II.15).

Figure II.15. FDI prospects in West Asia, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)

Source: UNCTAD, 2007b.

The geographical distribution of FDI in this subregion is likely to remain uneven, mainly due to geopolitical uncertainty in some areas. Liberalization of policies and deregulation should progress and strengthen prospects for increased inward FDI, although overregulation and trade barriers are still viewed as significant deterrents to FDI and internationalization in general (PricewaterhouseCoopers, 2007a). Moreover, continuing global external imbalances and sharp exchange-rate fluctuations, as well as political tensions and even open conflict in some parts of West Asia, pose risks that may discourage FDI inflows. Outward FDI from West Asia is likely to expand further, particularly in services, with petrodollars remaining one of the major sources of finance.

c. Oceania[80]

In 2006, FDI inflows to Oceania declined by 11%, to $339 million. Inflows remained concentrated in Fiji, New Caledonia, Vanuatu and Papua New Guinea, which together accounted for 82% of the total. Fiji was the major recipient, with $103 million in FDI inflows. Relative to their economic size, however, Fiji and Papua New Guinea have performed less well than several other economies in the region in recent years.[81]

FDI flows were mainly concentrated in the *primary sector*, in particular in nickel (in Papua New Guinea)[82] gold mining (in Fiji and Papua New Guinea), and in logging activities (in Papua New Guinea and the Solomon Islands). In *manufacturing*, FDI has been primarily in onshore fish-processing activities, while in the *services sector*, tourism remains very important. While China is increasingly becoming a significant investor in the region, in particular in mining, traditional investors such as Australia, France and New Zealand have retained a strong presence. Malaysia is a significant investor in the forestry industry of the Solomon Islands.

In Oceania, mining and tourism potential as well as the implementation of the China-Pacific Island Countries Economic Development and Cooperation Guiding Framework[83] are all factors favourable to FDI. However, in light of recent political turmoil in some countries of Oceania that are regular recipients of FDI,[84] prospects for FDI in the region seem bleak, at least in the short-term. In Papua New Guinea, on the other hand, despite persistent political uncertainty and the suspension of the project by Oil Search[85] to establish a pipeline between Papua New Guinea and Queensland, the prospects for FDI inflows in 2007 remain bright. This is mainly because of the economy's potential in the production of liquefied natural gas (LNG). Following the initial backlash from the decline in the tourism sector in Fiji, the neighbouring islands, such as Vanuatu, Samoa and Cook Islands, are now seeking to further develop their tourism industry by attracting FDI inflows.

3. Latin America and the Caribbean[86]

FDI flows to Latin America and the Caribbean rose by 11% in 2006, to reach $84 billion. However, the increase was entirely attributable to investment in the region's offshore financial centres. Excluding these centres, FDI inflows remained unchanged at $70 billion. Important changes have occurred in the mode of entry of FDI and in its components. Reinvested earnings are becoming a major component of inward FDI in South America, the result of large increases in profits. Moreover, greenfield investments have replaced cross-border M&As as the main mode of FDI. Manufacturing has overtaken services as the most important recipient sector during the past three years. Although FDI inflows to the services sector increased slightly in 2006, TNCs continued to withdraw from public utilities, especially electricity distribution. The primary sector remained attractive for foreign investors due to the high commodity prices, although regulatory changes dampened their enthusiasm in some countries and inflows in 2006 actually fell somewhat. FDI outflows from Latin American and Caribbean countries soared, reflecting the increasing capacity of local companies to internationalize their production. On the policy front, the trend towards less FDI-friendly measures continued in some countries. These policy changes – concentrated mainly in the extractive industries – are extending to other industries considered "strategic".

a. Geographical trends

(i) Inward FDI remained stable

FDI inflows to South and Central America and the Caribbean (excluding offshore financial centres) remained more or less stable, at $45 billion and $25 billion respectively. In contrast, FDI into offshore financial centres soared from $6 billion to $14 billion, reversing the decline in 2005 following the adoption of the Homeland Investment Act in the United States.[87] Mexico and Brazil, with inflows of $19 billion each, remained the region's leading FDI recipients, followed by Chile, the British Virgin Islands and Colombia (figure II.16). FDI inflows as a percentage of gross fixed capital formation fell from 16% in 2005 to 15% in 2006 (figure II.17).

Important changes have occurred in the mode of entry of FDI and in its components. First, there have been fewer M&As: the ratio of cross-border M&As to total FDI inflows was 47% in 1997-2001 and 34% in 2002-2006.[88] The 37% increase in cross-border M&As in 2006 (table II.10) was largely due to acquisitions by foreign firms of local assets owned by other foreign affiliates rather than to the acquisition of local assets owned by nationals.[89] The decline in FDI entry through cross-border M&As occurred throughout the region (excluding financial centres).

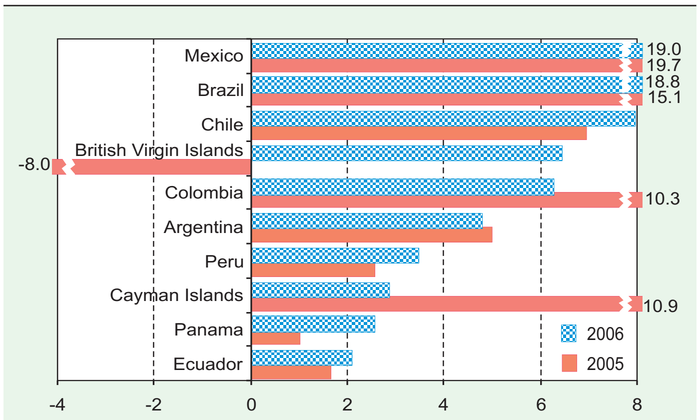
Second, in South America, income on inward FDI has grown steadily since 2003 (figure II.18). In 2006, it increased by 49% to reach $59 billion, thus exceeding total FDI inflows ($45 billion) for the first time since economic liberalization began in the 1990s (figure II.18). Income on FDI was particularly high in Brazil and Chile, at $14 billion and $20 billion respectively. The reinvested earnings – part of such income[90] – also surged, its share in total FDI inflows in South American countries for which data are available[91] soaring from 44% in 2005 to 61% in 2006, compared to a mere 10% in 2000-2003.

In South America, the stability of FDI inflows in 2006 masks variations among countries. Most of the countries (e.g. Bolivia, Brazil, Chile, Ecuador, Paraguay, Peru and Uruguay) registered high FDI growth rates, but these were offset by significant decreases in two countries: Colombia and Venezuela. Argentina was the only country where FDI inflows remained relatively stable.

The reasons for increases in FDI inflows are diverse. In Brazil, the rise was mainly in manufacturing and, within this sector, in resource-based activities (pulp and paper, and basic metallurgy). In addition, the $2.6 billion acquisition of Banco Pactual by UBS (Switzerland) in 2006 reversed the negative FDI flows registered in the financial services industry. In Chile, the main reason was the 14% increase in reinvested earnings, supported by high profits in the mining industry. Some cross-border M&A transactions also contributed to the growth in FDI. Mining-related FDI accounted for most of the increase in inflows to Ecuador and Peru, while in Uruguay it was the pulp and paper sector.

In Colombia, FDI inflows fell after an exceptional wave of cross-border M&As in 2005 (*WIR06*); still, it remained relatively high ($6.3 billion) due to the resumption of the privatization

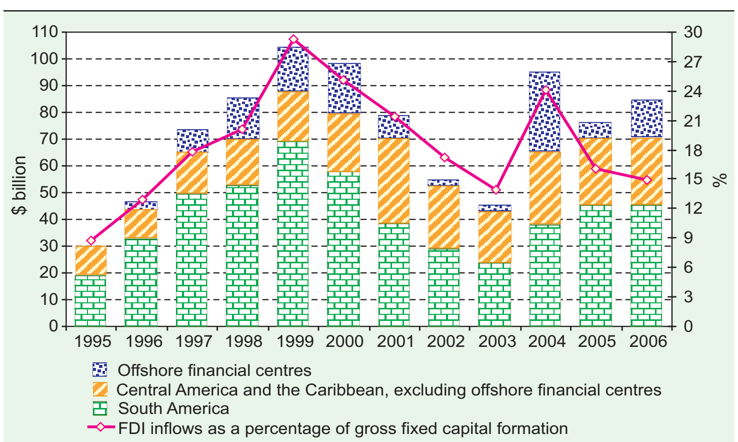
Figure II.16. Latin America and the Caribbean: top 10 recipients of FDI inflows,[a] 2005-2006
(Billions of dollars)



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

[a] Ranked by magnitude of FDI inflows in 2006.

Figure II.17. Latin America and the Caribbean: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

Table II.10. Latin America and the Caribbean[a]: distribution of cross-border M&As by sector/ industry, 2005-2006
(Millions of dollars)

Sector / industry	Sales 2005	Sales 2006	Purchases 2005	Purchases 2006
Total industry	22 532	30 824	10 179	31 350
Primary	814	8 201	881	17 679
Mining, quarrying and petroleum	814	8 201	881	17 679
Secondary	10 793	5 152	5 492	5 605
Food, beverages and tobacco	5 710	2 157	127	1 436
Metals and metal products	3 129	480	3 306	3 327
Services	10 926	17 471	3 806	8 067
Electricity, gas and water distribution	125	3 917	101	1 618
Transport, storage and communications	4 164	4 803	2 532	4 499
Finance	1 077	5 125	1 107	1 437

Source: UNCTAD, cross-border M&A database.
[a] Excludes offshore financial centres such as Belize, Panama, and the Caribbean countries other than Cuba, Dominican Republic, Haiti, Jamaica and Trinidad and Tobago.

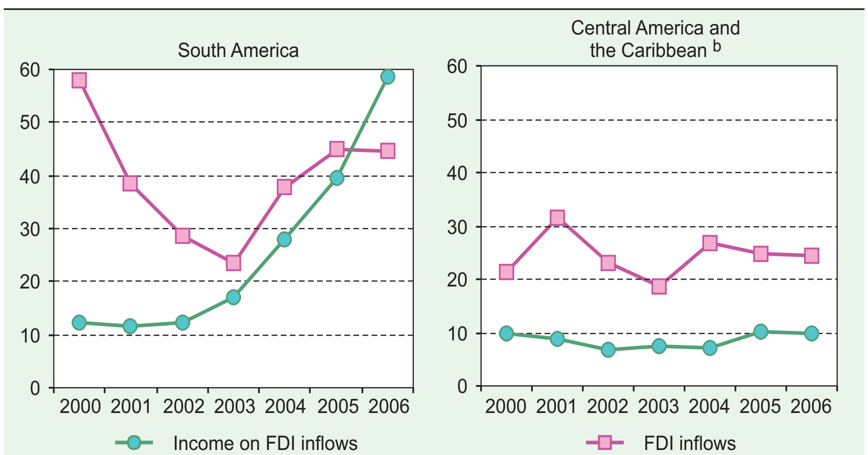
programme (see section c below). In contrast, the large decline in FDI inflows to Venezuela, from $2.6 billion in 2005 to -$540 million in 2006, was due to negative inflows to the oil industry – mostly attributable to financial transactions between foreign oil TNCs and the State-owned oil company PDVSA, while FDI to non-oil activities remained stable.

In Central America and the Caribbean (excluding offshore financial centres) overall FDI inflows were unchanged. While Mexico saw a slight decline (nevertheless still accounting for 77% of all FDI into this subregion) in 2006, other countries compensated for this with increases. In Costa Rica, for example, inward FDI increased by 71%, partly due to a large sale in the financial sector and partly to rising FDI in tourism. In the Dominican Republic, flows increased especially in telecommunications.[92] Other countries of the subregion received less than $1 billion in FDI inflows (table II.11).

(ii) Outward FDI soared

FDI outflows from Latin America and the Caribbean, excluding offshore financial centres, surged by 125% to $43 billion (figure II.19).[93] The primary sector was the main target of the outward FDI, followed by resource-based manufacturing and telecommunications. Brazil was the region's principal source country, with $28 billion in FDI outflows (figure II.20), the country's highest level ever and, for the first time its outflows were higher than its inflows. The $17 billion purchase of Inco (a Canadian nickel producer) by the country's mining company, CVRD, was responsible for a significant share of the increase (see also chapter IV). It was the largest acquisition ever undertaken by a Latin American company, and reflects CVRD's strategy of diversification away from Brazil and iron ore. In addition, a series of other acquisitions and investments by Brazilian companies, such as Itaú (banking), Petrobras (oil and gas), Votorantim (cement, pulp and paper, steel and mining), Gerdau (steel), Odebrecht (construction services, petrochemicals) Camargo Corrêa (cement), Weg (motors and generators) and Marcopolo (buses), also contributed to the country's outward FDI (ECLAC, 2007). It suggests an increasing tendency for large Brazilian companies to pursue a strategy of internationalization through FDI (box II.6). Brazilian FDI has traditionally flowed mainly to offshore financial centres, which, in 2005, hosted 57% of Brazilian outward FDI stock (*WIR05*). However, in recent years, its FDI has mainly targeted developed countries other than financial centres: their share in Brazil's total outward FDI stock jumped from 13% in 2001 to 35% in 2005, while that of developing and transition

Figure II.18. FDI inflows and income on FDI inflows in countries in South America and Central America and the Caribbean,[a] 2000-2006
(Billions of dollars)



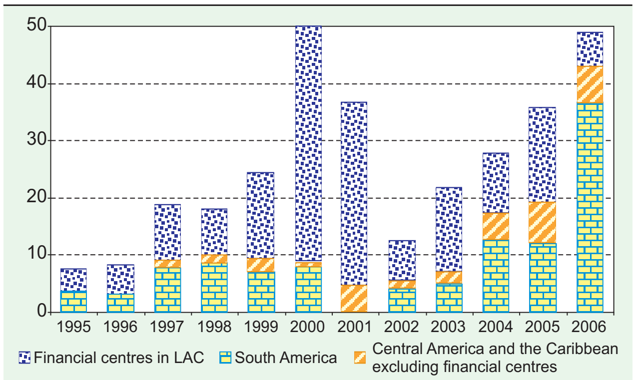
Source: UNCTAD, based on the balance of payments data from the central banks of the respective countries.
[a] The countries covered are those for which income on inward FDI data were available for 2006. In South America they are: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Uruguay and Venezuela. Their share in total FDI inflows to South America in 2006 was 99%. In Central America and the Caribbean they are: Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, and Trinidad and Tobago. Their share in total FDI inflows to Central America and the Caribbean (excluding offshore financial centres) in 2006 was 99%.
[b] Excludes offshore financial centres such as Belize, Panama, and the Caribbean countries other than Cuba, the Dominican Republic, Haiti, Jamaica and Trinidad and Tobago.

Table II.11. Latin America and the Caribbean: country distribution of FDI flows, by range [a], 2006

Range	Inflows	Outflows
Over $10 billion	Mexico and Brazil	Brazil
$5.0 to 9.9 billion	Chile, British Virgin Islands and Colombia	Mexico
$1.0 to 4.9 billion	Argentina, Peru, Cayman Islands, Panama, Ecuador, Costa Rica, Uruguay and Dominican Republic	British Virgin Islands, Chile, Venezuela, Argentina, Cayman Islands, Panama and Colombia
$0.1 to 0.9 billion	Jamaica, Trinidad and Tobago, Bahamas, Honduras, Guatemala, Aruba, Suriname, Nicaragua, Bolivia, Antigua and Barbuda, El Salvador, Saint Kitts and Nevis, Haiti, Paraguay, Grenada, Saint Lucia, Anguilla and Guyana	Peru, Trinidad and Tobago, and Jamaica
Less than $ 0.1 billion	Saint Vincent and the Grenadines, Belize, Netherlands Antilles, Barbados, Turks and Caicos Islands, Dominica, Montserrat, Falkland Islands (Malvinas), Cuba and Venezuela	Costa Rica, Netherlands Antilles, Honduras, Paraguay, Guatemala, Barbados, Bolivia, Nicaragua, Ecuador, Belize, Dominican Republic, Cuba, Aruba, Uruguay and El Salvador

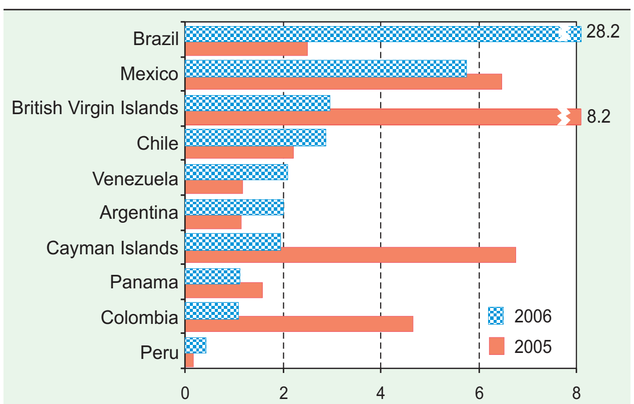
Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Countries are ordered according to their magnitude of FDI.

Figure II.19. Latin America and the Caribbean: FDI outflows, 1995-2006
(Billions of dollars)



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

Figure II.20. Latin America and the Caribbean: top 10 sources of FDI outflows,[a] 2005-2006
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of FDI outflows in 2006.

economies other than financial centres fell from 13% to 8%.[94]

The second largest source of FDI from the region was Mexico with outflows of $5.8 billion, 11% lower than in 2005. Mexican investments abroad were concentrated in telecommunications, but they were also undertaken in other industries such as banking, cement, and food and beverage, and were mainly directed to other Latin American and Caribbean countries. Chile, Venezuela and Argentina were also important and dynamic investors, with outflows increasing by 30%, 77% and 74%, respectively, and surpassing $2 billion each in 2006 (figure II.20). The main target industries for Chile were mining and retailing, for Venezuela, it was petroleum (ECLAC, 2007), and for Argentina, petroleum and steel pipes and tubes.

b. Sectoral trends

In 2006, the manufacturing sector continued to receive the largest share of FDI inflows in Latin America and the Caribbean (excluding offshore financial centres), almost the same as in 2005 at 41%. The share of the services sector increased slightly, from 35% to 37%, while that of the primary sector fell marginally, from 23% to 21%. FDI flows to the services sector increased by an estimated 8%, and those to the primary sector fell by 7% (figure II.21).

(i) Primary sector: modest decline in inflows but foreign investors' interest remains strong

The decline in FDI to the region's primary sector in 2006 was mainly the consequence of agreements between Venezuela's State-owned oil company PDVSA, and foreign TNCs that resulted in significant negative FDI inflows being recorded in that country's oil and gas sector, as noted above. Nevertheless, foreign investors remain interested in the country's vast oil and gas potential, in spite of regulatory changes designed to maximize fiscal revenue and increase State control of the industry (*WIR06,* and section c below). The Government signed new contracts with Chevron (United States), Statoil (Norway), Total (France) and BP (United Kingdom), while ConocoPhilips, ExxonMobil (both United States) and PetroCanada (Canada) opted to end their operations in the country. Many other TNCs are also interested in entering Venezuela, especially the very promising Orinoco Belt. Although large, privately owned foreign companies are still important partners for PDVSA, it is showing an increasing preference for working with other

Box II.6. Brazilian enterprises expanded abroad and consolidated at home

Investments abroad by Brazilian companies soared to a record $28 billion in 2006, exceeding the amount of inward FDI ($19 billion) for the first time. A large part of the outward FDI was attributed to the $17 billion acquisition of Inco (Canada) by CVRD, which has been seeking to expand its non-ferrous metal division and raise its international profile. With this acquisition, CVRD may have become the world's top metal mining company in 2006 in terms of production value (see chapter IV). The company is set to continue its diversification and expansion strategy with an agreement to purchase 100% of the coal mining company AMCI (Australia) for $661 million. The steel company Companhia Siderúrgica Nacional (CSN) had similar ambitions in its attempt to acquire Corus (United Kingdom/Netherlands), but it lost the bid to rival Tata Steel (India), which won for $11 billion. The steel maker Gerdau has also been actively acquiring foreign assets, but at a more modest level: it acquired enterprises in Argentina and Colombia at the end of 2005, and in Peru, the United States and Spain in 2006, while in 2007, it agreed to buy the Mexican steel mill Siderúrgica Tultitlán (Sidertul).

Brazilian companies have begun to invest abroad following years of record exports. In some cases, Brazilian suppliers sought to move closer to their customers, as in the automotive industry: Sabó now has plants in Europe, and Marcopolo (specialized in bus manufacturing) is producing in China. The strong currency, the real, has favoured such moves. Sluggish economic growth at home has been another motivating factor behind some groups' decisions to expand abroad.

Outward investments by Brazilian firms are to some extent part of an expansion and consolidation process that is taking place at home as well as abroad. Brazilian businesses are seeking to consolidate some industries, such as steel and mining, by buying foreign competitors so as not to lose market shares or become a takeover target themselves. Within Brazil itself, domestic buyers were involved in 58% of the 560 M&A deals in 2006 (including both domestic and cross-border), which reached record highs both in volume and value terms. There has been increased consolidation among Brazilian companies themselves, as well as through a large number of Brazilian companies buying foreign-owned assets in Brazil. Examples of the latter included the $2.2 billion purchase of the Brazilian affiliate of BankBoston (United States) by Itaú (Brazil), and Bradesco's (Brazil) purchase of American Express's (United States) assets in Brazil. Some foreign companies that were involved in utilities industries sold their assets to local investors. For example, in the electricity industry, EDF (France) and four United States companies (Alliant Energy, El Paso, Public Service Enterprise Corporation Global and AES) divested their assets to local investors in 2006, and CMS Energy (United States) announced in 2007 that it would do the same.

Source: "Brazil outward bound", *Business Latin America*, 12 February 2007, 12 March 2007 and 24 April 2007 (London, EIU); Gerdau press release, 28 June 2006 and 5 May 2006 (http://www.gerdauaza.com/ing/pressroom/index.asp); and American Express press release, 20 March 2006 (http://home3.americanexpress.com/corp/pc/2006/bradesco_brazil.asp).

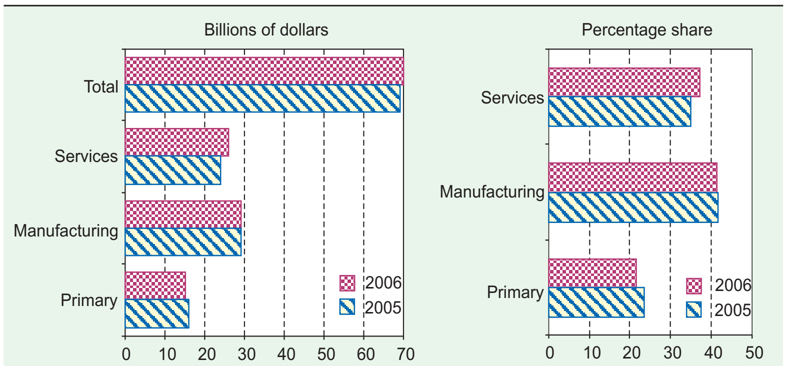
State-owned oil companies. For example, Petrobras is now its preferred partner in efforts to develop extra-heavy oil reserves in the Orinoco Oil Belt and for participating in offshore drilling to produce gas for liquefaction and export. Venezuela's petroleum industry is also attracting investments from China, the Islamic Republic of Iran and the Russian Federation.[95]

In Bolivia, most companies froze new investments after a Government decree in May 2006 that changed the regulations pertaining to the oil and gas industry (*WIR06*). However, after contracts were adapted to the new legislation at the end of 2006 (section c below), enterprises resumed investments. Indeed, in January 2007, eight oil companies, including Brazil's State-owned Petrobras, Repsol YPF (Spain), Total (France), BP and BG (both United Kingdom) bid on a project to export Bolivian natural gas to Argentina.[96] In addition, Gazprom (Russian Federation) is negotiating with the Bolivian State-oil company YPFB for a possible joint venture for gas exploration and production.

In Peru, there has been steady investment in the oil and gas industry. Petroperu, the State oil company, has signed a record 31 oil and gas exploration contracts over the past two years. Peru also intends to expand value-added activities related to its gas reserves by involving TNCs in the development of a $2.8 billion petrochemical complex to produce fertilizers and polyethylene.[97] In Colombia, foreign oil companies are increasingly interested in investing in the oil industry due to new investment incentives, including low royalty rates and the possibility of 100% ownership in some cases. The Government is also seeking to privatize 20% of State-owned Ecopetrol. FDI inflows to the oil industry increased by 57% in 2006, reaching a total of $1.8 billion.[98]

Foreign investment in mining in Latin America and the Caribbean remained buoyant in 2006. In Chile and Colombia, the high levels of FDI in 2005 were maintained in 2006: $1.25 billion and $2 billion respectively, while in Peru, investments amounted to $1.6 billion (Proinversión,

Figure II.21. Latin America and the Caribbean:[a] FDI inflows by sector, 2005-2006



Source: UNCTAD, based on official data from Brazil, Colombia, Costa Rica, Ecuador, Mexico and Venezuela (for the petroleum industry only), 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.

2007), up from $1 billion in 2005 (*WIR06*), and the Government anticipates continued rapid growth in mining FDI, estimated to total nearly $10 billion over the next five years. In Bolivia, despite uncertainties created by revisions to the country's mining tax regime, several foreign mining companies have initiated projects that are due to start production in 2007. Finally, Guyana and Suriname are attracting FDI into the bauxite industry. [99]

(ii) Manufacturing continued to attract the largest inflows

FDI flows to the manufacturing sector in Latin America and the Caribbean are estimated to have remained the same as in 2005, despite a significant decline in cross-border M&As, which suggests an increase in greenfield FDI. High commodity prices and rising world demand encouraged FDI in resources-based manufacturing. On the other hand, the increased FDI in the automotive industry was fuelled by strong domestic demand in, and rising exports from Argentina, and by exports from Mexico. Finally, the *maquila* apparel industry in the Central American and Caribbean countries continues to face increasing competition for FDI from Asian countries, especially since the phasing out of the Multi-Fibre Arrangement (MFA).

In resource-based manufacturing, soaring oil prices raised the demand for ethanol, driving an investment rush by both domestic and foreign investors in sugar production and refining in Latin America. In Brazil, where there has been domestic investment in this industry for a long time, foreign interest rose only after oil price hikes. Sugar production and refining is prospering and attracting FDI also in countries that have signed FTAs with the United States. Other industries that have registered increases in FDI include smelting, refining, metallurgy and petrochemicals in countries such as Bolivia, Brazil, Colombia and Trinidad and Tobago. For example in Brazil, a €3 billion crude steel production facility is being set up by CSA (Brazil-Germany).[100] Finally, in the pulp and paper industry in which FDI has become more prominent since the early 2000s (Barbosa and Mikkilä, 2006), inflows in Brazil rose to $1.5 billion in 2006 mainly due to a $1.2 billion pulp mill project by International Paper (United States); while in Uruguay FDI inflows were boosted by the World Bank's approval of a loan and political risk insurance for a pulp and paper plant being built by Botnia (Finland). The region's advantages in this industry include an abundance of water and land for plantations of fast growing trees and cheaper labour costs. In addition, in Brazil, there is a history of investments in research in genetics, forestry and biotechnology, which has led to improvements in the quality of trees and forest management (Santos Rocha and Togeiro de Almeida, 2007).

In other manufacturing, the automotive industry is an important FDI recipient in Argentina, Brazil and Mexico, where the world's largest automobile and auto parts manufacturers have production facilities. In Mexico, motor vehicle exports rose by 30% in 2006, with 1.5 million units exported (AMIA, 2006), as a result of increased investments by the top five automakers (all foreign) in the country: General Motors, Ford Motor, DaimlerChrysler, Nissan and Volkswagen. Among the factors contributing to Mexico's attractiveness for FDI in the automotive industry is its access to the NAFTA market, and more recently to Europe under the Mexico-EU FTA (effective in 2000) (which also reduces its excessive reliance on a single market).[101]

In Argentina, where output expansion in the automotive industry was boosted by rapid growth in both the domestic and export markets, investments in car terminals are estimated to have amounted to $800 million in 2006.[102] In contrast, in Brazil, FDI flows to the automobile sector fell by 24% in 2006,[103] because of the appreciation of the exchange rate. Nevertheless, significant investment plans – mainly focused on the domestic market – have been announced by companies such as Fiat (Italy), General Motors (United States), Ford (United States), and Volkswagen (Germany), which dominate the domestic market with a combined share of 75%.[104]

Finally, the *maquila* apparel industry an important target of investors, especially from the United States, suffered a significant decline in exports to the United States (practically the only market): Mexican *maquila* apparel exports fell by 13% and those of members of the Central American Free Trade Area and the Dominican Republic (DR-CAFTA) fell by 7%. As a consequence, the share of Mexico and Central American and Caribbean countries in total apparel exports to the United States fell significantly, while those of their Asian competitors rose.[105] Haiti and Nicaragua are the only countries in the region that registered a significant increase in apparel exports in 2006 (11% and 23% respectively) (Asociación Hondureña de Maquiladoras, 2006).

(iii) Modest increase of FDI in services

FDI in the services sector (excluding offshore financial centres) increased by an estimated 8% in 2006. A number of foreign companies expanded their existing activities, or acquired new assets, or established new operations in the region, which more than compensated for withdrawals by other firms (*WIR05* and *WIR06*). For instance, in the telecommunications industry the Mexican companies, América Móvil and Telmex, and Telefónica (Spain), continued to expand in the region and also to consolidate their telecommunications services and media operations by acquiring cable TV operators and broadband Internet services.[106] On the other hand, firms such as Verizon (United States) and Telecom Italia continued their strategy of divestments.[107] Similarly in the financial services industry, Bank of America sold its BankBoston units in Brazil, Chile and Uruguay to the Brazilian bank Itaú (*WIR06*), while UBS (Switzerland) acquired the Brazilian Banco Pactual. In retail, large TNCs, such as Wal-Mart, Carrefour and Casino, have been expanding their investments in Brazil, Colombia, Mexico and Central America (ECLAC, 2007). Finally, in the electricity industry there has been a wave of divestments by foreign companies in Brazil that have sold their assets to domestic investors (box II.6).

c. Policy developments

As in 2005, some countries in Latin America adopted a number of measures less favourable to foreign investors, reversing to some extent the trend that had been dominant from the early 1990s until 2004. These changes concerned mainly the extractive industries and led to the revision of contracts and/or tax regimes with a view to securing for the State a greater share in the windfall profits resulting from soaring commodity prices, and/or its greater control over the industry (chapter VI). The changes also related to some other industries, particularly in Bolivia and Venezuela.

In Venezuela, having taken a majority control in 2006 of 32 marginal oil fields that were managed by foreign oil companies, in 2007 the Government adopted a decree that gave PDVSA a majority equity share and operational control of four joint ventures in the oil-rich Orinoco River basin. Four TNCs involved in the ventures agreed to sign the new agreements that granted PDVSA an average stake of 78%, up from the original 39%, while two refused. The Government of Venezuela assumed State control of other industries, such as telecommunications, electricity and non-fuel mining. In public utilities, after creating a new State-controlled power company in late 2006 to boost electricity generation and halt frequent power supply cuts, the Government declared the energy and telecommunications industries to be strategic and therefore subject to nationalization in 2007. As a result, it negotiated a deal with Verizon, AES and CMS (all United States TNCs) whereby the three agreed to divest their assets to the Government, which now controls the country's largest telecom company, CANTV, and the electricity company, EDC. In non-fuel mining, in 2006 Venezuela's national assembly approved a bill to reform the mining law, and launched a series of public meetings to discuss the reform project with interested parties.

In Bolivia, all foreign oil TNCs agreed to convert their production-sharing contracts into operating contracts, and to turn control over sales to YPFB, Bolivia's State-run oil company, as stipulated in the decree for the nationalization of oil and gas resources of May 2006. In addition, the Government reached a deal in 2007 with Petrobras (Brazil) to renationalize the country's only two oil refineries acquired by Petrobras in 1999 as part of a broad privatization programme. The Government is also moving to take over Empresa Nacional de Telecomunicaciones (Entel), now controlled by Telecom Italia, which was privatized in 1996. Moreover, according to the Minister of Mining, reform of the mining sector's tax regime to secure a higher tax take for the Government is a priority for 2007.[108]

In Peru, where thriving mining activities have been causing social conflicts, the Government created a high-level commission to address this issue. At the same time, it reached a deal with mining companies whereby they agreed to make "voluntary contributions" to avoid tax increases. Under this agreement, the companies will contribute $772 million over the next five years towards fighting poverty, malnutrition and social exclusion. The payment is intended to appease demands by various civil society groups for increased taxes on mining companies.[109]

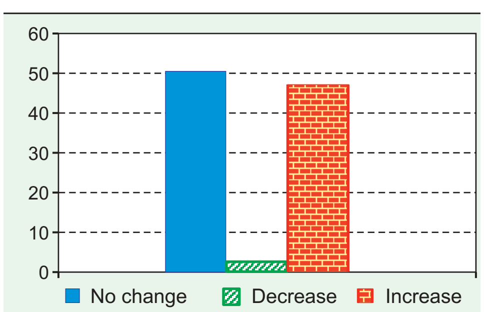
In Argentina, where foreign companies largely control oil and gas production and exports, the Government increased taxes on natural gas exports from 20% to 45% to offset higher costs of imported gas from Bolivia and to avoid domestic price increases. Moreover, in the mineral-rich province of Mendoza, lawmakers voted to block all mining activity if mining companies failed to come up with proposals for a plan to mitigate environmental costs. In public utilities, in December 2006 Argentina's Congress approved an extension for one more year of the Economic Emergency Law, which allows the executive branch to maintain a price freeze on privatized public services and renegotiate contracts with their owners. In January 2007, the Government authorized power distributors Edenor (Argentina) and Edesur (Spain) to increase tariffs by close to 15% for industrial and business clients.[110]

In contrast to some of the above-mentioned policy changes, in Colombia the Government decided to revitalize the privatization programme of the 1990s and launched a series of sales of State assets in financial services and telecommunications. Privatizations of the largest gas distribution company, Ecogas, local electricity distributors, and part of the largest transmission company, are in the pipeline for 2007. The country's Congress also approved the privatization of 20% of the State-owned oil company Ecopetrol, and approved the reduction of corporate and personal income tax rates to 34% in 2007 and 33% in 2008 from the current 38.5%.[111]

In other Latin American and Caribbean countries, various other changes in FDI-related policy were introduced. Brazil, for instance, ended the monopoly on reinsurance by the State-owned Instituto de Resseguros do Brasil in December 2006. Foreign investment will be allowed, though it will be restricted to 40% of Brazil's market during the first three years of the market opening.[112]

Latin American and Caribbean countries continued to sign trade agreements that are likely to affect FDI flows to and from their economies. Chile signed FTAs with China in 2006 [113] and with Japan in 2007. In addition, the Andean Community of Nations has agreed to make Chile an associate member of its trading bloc; the country quit the group 30 years ago. Moreover, the DR-CAFTA agreement became effective during 2006 and 2007 in all signatory countries (Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua), except Costa Rica.

Figure II.22. FDI prospects in Latin America and the Caribbean, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)



Source: UNCTAD, 2007b.

d. Prospects: moderate growth of inflows, reduced outflows

FDI inflows into Latin America and the Caribbean, excluding the offshore financial centres, are expected to increase moderately in 2007. Commodity prices (see chapter III) and regional economic growth should remain strong in 2007,[114] boosting TNCs' profits and FDI. This forecast is confirmed by the results of UNCTAD's *World Investment Prospects Survey* in the region, with 47% of foreign companies indicating plans to increase their investments in the period 2007-2009, 2% to decrease them, and 50% to maintain them at the same level (figure II.22).

However, as cross-border M&As involving the acquisition of assets owned by nationals are not expected to recover significantly, and the withdrawal of TNCs from service activities is likely to continue, the growth of FDI inflows is expected to be driven mainly by greenfield investments, and could therefore be rather moderate. Preliminary cross-border M&A data for the first six months of 2007 show almost the same level as in the corresponding period of 2006. Acquisitions by foreign companies of assets owned by nationals amounted to $9.5 billion – half the total amount of 2006. Moreover, a number of foreign companies sold their assets to local investors during the first months of 2007, or announced their intention to do so,[115] confirming the likelihood of a slowdown in FDI growth.

FDI outflows from Latin America and the Caribbean, excluding offshore financial centres, are expected to decline in 2007 following strong growth in 2006. Preliminary data from Brazil support this forecast: they indicate negative outflows of FDI (-$3.5 billion) during the first five months (because of the high amount of loan payments from Brazilian affiliates to their parent company in Brazil).[116] But a sharp increase in FDI outflows from Mexico should partly compensate for the reduced outflows from Brazil.

B. South-East Europe and the Commonwealth of Independent States[117]

1. Geographical trends

Inward FDI grew significantly in both South-East Europe and the Commonwealth of Independent States (CIS) in 2006. In South-East Europe, most of the FDI inflows were driven by the privatization of State-owned enterprises and by large projects benefiting from a combination of low production costs in the region and the prospective entry of Bulgaria and Romania into the EU. In the CIS, all resource-based economies experienced strong inward-FDI growth. FDI flows to the Russian Federation grew markedly despite an apparent tightening of national legislation on extraction contracts and on foreigners' access to resources. One reason may be that these legal changes in effect codified and clarified de facto restrictions on foreign investors' involvement in natural resources instead of introducing new constraints. Developed countries, mainly EU members, continued to account for the largest share of flows to the region in the form of both greenfield projects and cross-border M&As. Outward FDI in 2006 also increased, notably from the Russian Federation. There are indications that FDI will grow further in 2007, especially in the large countries and in the two new EU members.

a. *Inward FDI surged*

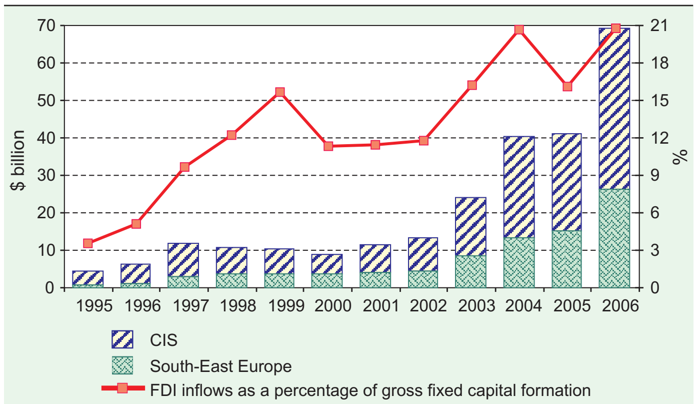
In 2006, FDI flows to South-East Europe and the CIS grew by 68%, to $69 billion, marking the sixth consecutive year of growth and a significant rise over the two previous years (figure II.23). As a result, the share of inward FDI in gross fixed capital formation rose from 16% in 2005 to 21% in 2006.

As in previous years, inflows remained unevenly distributed, with five countries (the Russian Federation, Romania, Kazakhstan, Ukraine and Bulgaria in that order) accounting for 82% of the total. Inflows to the region's largest economy, the Russian Federation, more than doubled (figure II.24), reaching a record $29 billion.

Flows to Romania and Bulgaria also grew significantly in 2006, in anticipation of their joining the EU on 1 January 2007 (box II.7). Romania was the second largest FDI recipient, with most of the $11.4 billion worth of flows linked to privatization.[118] There was a substantial increase in inflows to Kazakhstan, which reached an unprecedented level of more than $6 billion (figure II.24 and annex table B.1), mainly due to oil and gas projects, making it the third largest recipient in the region. In contrast, inflows into Ukraine fell in 2006, possibly due to the reduction in privatization-related FDI, combined with the abolition of incentives in special economic zones. In 12 countries of the region, FDI flows remained below $1 billion, but in certain economies such as Montenegro, they are still considerable in relation to the size of economy. FDI inflows rose in 17 countries in South-East Europe and the CIS in 2006, compared to nine in 2005 (annex table B.1).

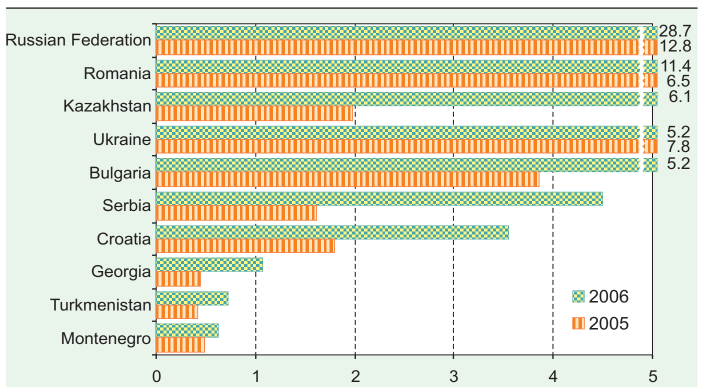
Developed countries were the main investors in the region's greenfield FDI projects. EU countries accounted for 70% of such projects, followed by the United States with 9%. The share of the Russian Federation as a source of greenfield FDI projects remained low (4%).

Figure II.23. South-East Europe and CIS: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

Figure II.24. South-East Europe and CIS: top 10 recipients of FDI inflows, 2005-2006[a]
(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 2006 FDI inflows.

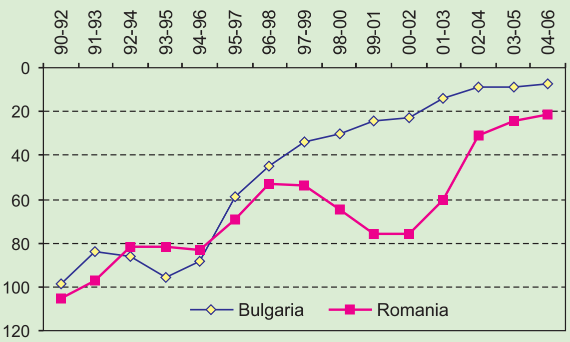
Box II.7. The accession of Bulgaria and Romania to the EU: impact on FDI

In contrast with FDI flows to the eight Eastern European countries that joined the EU on 1 May 2004, inflows to Bulgaria and Romania remained small for most of 1990s due to an inadequate business infrastructure, economic instability, slow privatization and regional conflicts. Only in the beginning of the 2000s[a] did they begin to receive sizeable FDI, partly driven by privatizations, as well as important greenfield investments. In 2006, the FDI stock in Bulgaria and Romania together reached $62 billion, representing a 18-fold increase over the past decade.

After several years of negotiations, the two countries became members of the EU in January 2007. The pre-accession process gradually transformed the business environment of the two new member States and had a significant impact on FDI. Consequently Bulgaria's rank in the UNCTAD FDI Performance Index moved up to 7th place in 2004-2006 from 92nd in 1990-1992, while Romania's ranking improved from 101st to 21st (box figure II.7.1). Competitive labour costs remain an important factor for efficiency-seeking FDI, but higher value-added industries are also attracting FDI.

EU accession will help anchor the ongoing reforms and support the convergence of the economies of Bulgaria and Romania with those of the rest of the EU. Apart from adopting the EU law (the acquis communautaire), these countries are expected to meet the "benchmarks" established by the European Commission in areas such as judicial independence, fight against crime and corruption, and mandatory structural reform to increase transparency and accountability in public administration. These steps could further increase competitiveness in these countries.

Box figure II.7.1. Inward FDI Performance Index ranking, Bulgaria, Romania, 1990-2006[a]



Source: UNCTAD.

[a] For the calculation of the Inward FDI Performance Index, see notes to table I.7, chapter I. Ranking out of 141 countries.

Source: UNCTAD.

[a] Romania's FDI flows reached $2 billion in 1998 due to large privatizations that year (*WIR99*: 70), but this was only a temporary surge.

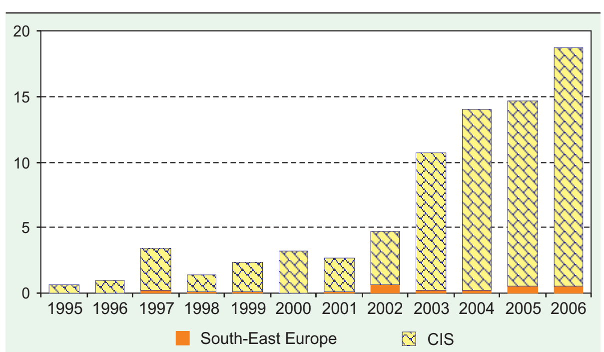
In cross-border M&As, the acquisition of private companies dominated in the CIS countries, whereas in South-East Europe most of the M&As involved privatization deals. With the acquisition of Banca Comerciala Romana (Romania) by Erste Bank (Austria), Austria once again became the leading source of cross-border M&A-based investment in the region, followed by the United States and Norway. FDI from developing countries and from sources within the region has also recently emerged (table II.12 and *WIR06*). The share of developing-country TNCs as buyers in cross-border M&As of enterprises in South-East Europe and CIS increased to 16% in 2006, from a mere 1% on 2005. China was the leading buyer from developing countries, while the Russian Federation accounted for 5% of total cross-border M&As in the region.

b. Outward FDI growth was sustained

FDI outflows increased for a fifth consecutive year, amounting to $18.7 billion (figure II.25). The Russian Federation alone accounted for $18 billion, representing more than 96% of the total and a significant increase (41%) from the FDI outflows in 2005. Some large resource-based Russian TNCs such as Norisk Nickel and the Evraz Group continue to invest abroad. Similarly, Rusal and Sual merged with part of Glencore International (Switzerland) to create the world's largest aluminium and alumina producer (box II.8 and chapter IV).[119]

Russian banks also increased their presence in the region, extending for instance into Kazakhstan and Ukraine. FDI outflows from other countries in

Figure II.25. South-East Europe and CIS: FDI outflows, 1995-2006
(Billions of dollars)



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

the region remained modest in 2006 – less than $1 billion.

In greenfield operations, half the projects by investors from South-East Europe and the CIS were undertaken within the region, and were concentrated mainly in the development of extraction activities, such as mining, metals and oil fields. For example, Petrom Romania (now an affiliate of Austria's OMV) invested $190 million to develop the Komsomolkskoe oil field in Kazakhstan. In terms of value, cross-border M&A purchases by TNCs from the region decreased in 2006 compared to 2005, but within the region they increased by 59% (table II.12).

2. Sectoral trends: FDI in services was buoyant

The data on cross-border M&As in 2006 indicates that the primary and services sectors of South-East Europe and the CIS received higher inflows while flows into manufacturing declined.

Table II.12. South-East Europe and CIS: Cross-border M&As, by home/host region, 2005-2006
(Millions of dollars)

	Sales		Purchases	
Home/host region	2005	2006	2005	2006
World	17 318	25 130	6 812	5 034
Developed countries	16 224	19 619	3 801	2 793
Europe	14 075	16 305	3 340	2 445
European Union-25	14 075	13 969	3 340	2 445
Austria	3 239	5 632	-	-
Czech Republic	635	278	284	-
France	505	1 951	-	-
Germany	569	1 477	15	10
Greece	362	821	-	143
Hungary	497	1 490	-	-
Italy	731	452	653	700
Netherlands	6 189	409	-	-
Poland	51	60	383	-
United Kingdom	286	539	2 005	1 488
Other developed Europe	-	2 336	-	-
Norway	-	1 956	-	-
United States	1 948	3 038	-	348
Japan	14	-	-	-
Developing economies	145	4 006	2 062	736
Africa	22	81	469	675
South Africa	-	81	469	675
Latin America and the Caribbean	102	28	-	-
Asia	21	3 897	1 593	61
Turkey	-	297	1 593	22
China	-	3 500	-	-
India	20	100	-	-
Transition economies	949	1 505	949	1 505
South-East Europe	32	149	91	149
Bulgaria	22	78	20	78
CIS	916	1 356	857	1 356
Russian Federation	910	1 249	237	264

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

Primary sector. The primary sector continued to attract investors, despite new restrictions, especially in oil and gas extraction, in some members of the CIS, and uncertainty over access to and the use of oil and gas transportation (box II.9). However the recent wave of domestic M&As in countries of the region may deter further FDI, especially in extractive industries (box II.8). According to cross-border M&A sales data for 2006, the share of this sector in total sales increased to 17%, from 12% in 2005 (table II.13). Particularly notable was the purchase of OAO Udmurneft by Sinopec (China) (for $3.5 billion).

Manufacturing. According to cross-border M&A data, FDI inflows to the manufacturing sector were lower than in 2005 (table II.13). However, within manufacturing, there was a significant increase of flows to the chemical industry due to large cross-border acquisitions in the pharmaceutical industry in South-East Europe (Croatia, Serbia and Romania). Projects in manufacturing represented 55% of all greenfield investments in the region in 2006.

Services sector. FDI in services was particularly buoyant, as reflected in cross-border M&A sales in services which almost doubled in value from 2005 (table II.13) due to increased cross-border M&As in the banking industry. For example Russia Raiffeisen International (Austria) signed an agreement to buy 100% of Impexbank (Russian Federation) for up to $550 million; OTP Bank (Hungary) acquired Investsberbank (Russian Federation) for $477 million.[120] Additionally, large investments were made in energy generation: for example, the energy giant AES (United States) started the rehabilitation of the Maritsa East 1 complex in Bulgaria, with an investment of $1.4 billion. And in telecommunications, Norwegian Telenor acquired Mobi 63 (Serbia) for $1.5 billion.

The number of greenfield projects in services rose by 28% from that of 2005, with construction attracting the highest share. Efficiency-seeking investment in industries such as information technology and business services was particularly significant because of the region's skilled labour force. FDI inflows also continue to be important in high value-added activities such as research and development.

As far as the sectoral distribution of outward FDI is concerned, data on cross-border M&As purchases show that petroleum extraction as well as financial services remained the most important targets for the region's TNCs.

Box II.8. The Rusal/Sual/Glencore merger creates the largest integrated aluminium TNC in the world

In the mid-2000s, cross-border M&As in mining revived, particularly in the aluminium industry. Three main trends are emerging in this current wave (Humphreys, 2006): first, it is happening at the peak of the production and price cycle; second, the main driver for the cash-rich companies is their long-term strategy to meet rapidly increasing world demand, especially in East and South-East Asia; third, companies from emerging markets are increasingly involved in M&As. An example is the merger of Rusal, the Russian Federation's largest aluminium company, with its domestic upstream competitor Sual and with Switzerland-based Glencore's aluminium business in 2007. This follows the merger of BHP Billiton/WMC Resources Ltd. in 2005 and that of Xstrata/Falconbridge in 2006. The Rusal merger, concluded on 27 March 2007,[a] has created a world leader in aluminium production (by tonnage), with an estimated share of 12.5% in global aluminium sales and 16% of global alumina production, and locations in 17 countries.

One of the main questions concerning the Rusal/Sual/Glencore merger is whether it has been driven by industrial and commercial logic, or whether national interests have also played a part, as in the case of the oil and gas industry in the Russian Federation.

While cross-border M&As in developed countries have been largely horizontal, in emerging markets, especially in the former centrally planned economies, more vertical or "integrated" M&As are taking place. This is a replication of the past experience of huge State-owned enterprises having almost complete control over the supply chain. Similarly, the Rusal/Sual/Glencore merger aims at restoring control over the entire value chain, while also entering new markets. Hence the merger has been both vertical and horizontal: Rusal has surplus bauxite in its supply chain but is short of alumina, while Sual and Glencore have excess refining capacity, and will benefit from Rusal's bauxite surplus.

The merger has wide-ranging implications for the geography of outward FDI from the Russian Federation. Even though both Russian companies (box table II.8.1) had extended their global reach for accessing natural resources through overseas M&As, they were still largely concentrated in the Russian Federation. With the integration of Glencore's assets, their foreign reach will have increased significantly. Moreover, the merger will have given them control of almost the entire Russian aluminium market, rendering competition from foreign companies virtually impossible.

Box table II.8.1. Main assets of Rusal, Sual and Glencore, 2006

Rusal	Sual	Glencore
In the Russian Federation	**In the Russian Federation**	Alumina Partners of Jamaica (Jamaica)
Achinsk alumina refinery	Bogoslovsk aluminium plant	Aughinish Alumina Ltd.(Ireland)
Boksitogorsk alumina refinery	Irkutsk aluminium smelter	EurAllumina Spa (Italy)
JSC Bratsk aluminium plant	Kandalaksha aluminium smelter	Kubikenborg Aluminium Sundsvall AB (Sweden)
Krasnoyarsk aluminium smelter	Nadvoitsy aluminium smelter	West Indies Alumina Co. (Jamaica)
Novokuzneck aluminium smelter	North Ural bauxite mine	
Sayanal	Pikalevo alumina refinery	
Sayanogorks aluminium smelter	Sual-PM Ltd.	
	Ural Silicon	
In other countries	Urals aluminium smelter	
Armenia foil mill (Armenia)	Urals Foil	
Bauxite Co. of Guyana Inc. (Guyana)	Volgograd aluminium smelter	
Cathode plant (China)	Volkhov aluminium smelter	
Compagnie de Bauxite de Kindia (Guinea)		
Friguia alumina refinery (Guinea)	**In other countries**	
Nikolaev alumina refinery (Ukraine)	Zaporozhye aluminium combine (Ukraine)	
Queensland Alumina ltd. (Australia) 20%		

Source: "Oleg Deripaska answers Alcoa; Now, the real questions begin", *American Metal Market*, 16 October 2006:13.

Source: UNCTAD.

[a] "RUSAL, SUAL and Glencore deal completed" , Press Release of United Company RUSAL, 27 March 2007.

3. Policy developments

Countries of South-East Europe and the CIS continued to adopt policies aimed at attracting FDI. However different groups of countries have followed different policy priorities.

In some natural-resource-based economies of the CIS, such as the Russian Federation, Kazakhstan and Uzbekistan, the State continues to increase its control of strategic industries. In the Russian Federation, for instance, the Government is pursuing a two-pronged strategy. The first aims to prevent or limit the direct control of resources by foreign investors by producing a list of strategic industries[121] that cannot be privatized, or by blocking 25% of the shares or 50.1% majority shares in those industries for the State or other national investors. Second, it has adopted some indirect measures, such as stricter environmental standards, which are putting pressure on foreign companies to sell part of their stakes to local firms, as in the case of the Sakhalin-2 project.[122] In Kazakhstan, the

Box II.9. Who controls the pipelines?

For both producers and consumers of oil and gas, the question of who controls access to, and the use of, transportation infrastructure is of strategic importance. This is particularly true of pipelines, which offer the cheapest, safest and most efficient way of transporting large volumes of oil and gas. Indeed, in the current era of energy security, a concern of many countries, pipelines are considered an integral and perhaps the most vital part of the oil and gas value chain (Liuhto, 2007).[a] This is also a key factor in determining FDI decisions in extraction, because private investment may be impossible if access to pipelines is denied or is too expensive. In the CIS, the Russian Federation occupies the largest land area in the world, while other major oil and gas producers, such as Azerbaijan, Kazakhstan and Turkmenistan are landlocked. For the other resource-based countries in the CIS the disadvantages of landlockedness are further exacerbated by the fact that all pipelines pass through the Russian Federation, making them overly dependent on a single export route.

Since ownership of pipelines gives leverage, or even control, over extracting and producing companies, the pipelines have remained in States' control in all members of the CIS even during the much-contested privatization of the early 1990s. Indeed, in all countries of the region the transport facilities are controlled by majority State-owned companies such as Gazprom and Transneft in the Russian Federation, Beltransgas in Belarus and Naftogas in Ukraine. Recently, both the Russian giants mentioned above have increased their ownership of the transport routes of other countries in exchange for lower export prices that they charge for oil and gas. For example Gazprom[b] has full control over the gas pipelines running through the Republic of Moldova and Armenia, as well as majority shares in the pipelines in the Baltic States, Belarus, Serbia and other countries.

Discriminatory access to transit pipelines is one of the main reasons for distortions and inefficiencies in the energy sector in the CIS, hindering both intraregional and extraregional trade.[c]

Strategically, ownership has implications for access of third parties to the pipelines. New national borders after the break-up of the Soviet Union created additional difficulties for both importing and exporting countries, as the fragmentation of ownership increased the number of governments that extract rents from their own respective segments of the pipelines. Access to regional and European markets fell largely under the control of neighbouring countries, whose national governments took advantage of monopolistic positions to extract rents by limiting pipeline access (Mathieu and Shiells, 2002). Turkmenistan and Uzbekistan, for instance, are large producers and exporters of natural gas, but they find it difficult to export due to restrictions on their access to the Russian Federation transit pipelines.

The episodes of gas and oil supply interruption in Belarus in early 2007, and gas supply interruption in early 2006 in Ukraine also showed that final customers in the EU are susceptible to uncertainties in the energy market. Producers and consumers who have to pay monopoly rents for access to pipelines are therefore seeking to improve their energy security by diversifying the transportation routes. The construction of alternative pipelines such as the Baku-Tbilisi-Ceyhan oil pipeline linking the Azeri-Chirag-Guneshli oil field in the Caspian Sea to the Mediterranean Sea as well as the Nord Stream gas pipeline linking the Russian Federation with Germany under the Baltic Sea are thus long-term strategic investments, irrespective of their immediate costs.

Source: UNCTAD.

[a] Liuhto (2007) argues that hydrocarbon pipelines are strategically even more important for the Russian Government than the hydrocarbon reserves.

[b] Gazprom owns and operates the Unified Gas Supply System, which is the largest gas transportation, storage and processing system in the world.

[c] See Mathieu and Shiells (2002) for a discussion of the energy sector in the CIS.

Government decreed a pre-emptive right to block the sale of energy assets on its territory[123] while in Uzbekistan, the mining company Newmont (United States) had its 50% share in the gold-extraction joint venture Zarafshan-Newmont expropriated in a dispute over taxes.[124]

At the same time, the business climate for foreign investors has improved in non-strategic industries. In 2006, in the context of their bid for WTO membership, some countries harmonized their legislation with WTO norms and standards. In Ukraine, for instance, foreign banks were allowed to establish their branches in the country, and foreigners were allowed to provide legal services. In the Russian Federation, in addition to some improvements in legislation related to intellectual property rights, foreign investors have obtained similar rights as those of domestic investors to buy Russian banking assets (although the Russian banks have to obtain permission from the central bank when selling more than 10% of their assets, compared to 20% previously). In Kazakhstan, a new law to attract investments in the securities market was approved, while in Kyrgyzstan a 10% flat tax rate replaced an earlier corporate tax of 20%.

In South-East European countries, policies are in line with their accession (or aspirations for accession) to the EU as well as with their interest

Table II.13 South-East Europe and CIS: cross-border M&As, by sector/industry, 2005-2006
(Million of dollars)

	Sales		Purchases	
Sector/industry	2005	2006	2005	2006
Total industry	17 318	25 130	6 812	5 034
Primary	2 088	4 374	2 022	1 799
Mining, quarrying and petroleum	2 088	4 360	2 022	1 784
Mining and quarrying	57	543	-	22
Petroleum	2 031	3 817	2 022	1 762
Secondary	6 747	4 570	2 553	1 265
Food, beverages and tobacco	1 112	739	217	201
Textiles, clothing and leather	1	81	-	-
Chemicals and chemical products	232	3 491	484	4
Metals and metal products	5 323	166	1 851	917
Machinery	12	4	-	-
Electrical and electronic equipment	-	25	-	143
Motor vehicles and other transport equipment	65	15	-	-
Services	8 483	16 185	2 237	1 971
Electricity, gas, and water distribution	1 488	950	52	31
Construction firms	-	49	-	-
Trade	108	298	-	5
Hotels and restaurants	128	35	-	30
Transport, storage and communications	3 155	3 150	327	860
Telecommunications	3 105	2 870	327	860
Finance	2 677	10 961	1 858	1 045
Business activities	153	492	-	-

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

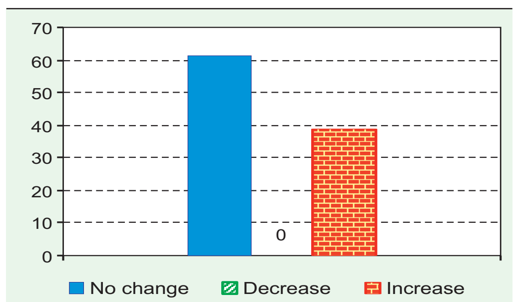
in accelerating the privatization of State assets especially in the telecom and energy industries.[125] As part of the accession process, Bulgaria and Romania, for instance, have to undertake reforms related to judicial independence, accountability, fighting corruption, and tackling of organized crime (box II.7). Such efforts should further improve the climate for all investments, including FDI. In Albania, Croatia and Serbia also measures favourable to foreign investors were adopted.[126]

4. Prospects: brighter for larger economies and new EU members

FDI in South-East Europe and CIS is expected to be particularly buoyant in the larger economies such as the Russian Federation and Ukraine, as well as in the new EU members: Bulgaria and Romania. Even though FDI prospects for Kazakhstan and the Russian Federation could be affected by the tighter grip of their Governments on strategic industries, foreign investors are eager to access these countries' natural resources, even under stricter conditions.[127] FDI in the Russian Federation is also likely to grow in other activities such as the retail trade (e.g. Ikea of Sweden), the automotive industry (Ford, General Motors, and Toyota) and banking (Citibank). With strong real income growth, a booming consumer market, and GDP growth averaging 7% in the last five years (IMF, 2007a), the country will continue to attract market-seeking FDI. The Government's privatization plan for 2007 includes 1,500 companies and more than 300 real estate properties with total proceeds exceeding $1.5 billion (IIF, 2007). The business environment in the Russian Federation improved in 2006 (World Bank, 2006). The values of cross-border M&A sales and purchases in the first half of 2007 in the Russian Federation were already larger than those for the whole year in 2006.

According to UNCTAD's *World Investment Prospects Survey*, South-East Europe and the CIS[128] was the only region where no TNC participating in the survey expected a decrease in FDI inflows in 2007-2008, while 39% anticipated an increase and 61% expected no change (figure II.26). About 21% of the responding TNCs expected an increase in FDI inflows to the Russian Federation, making it the fourth among the most preferred FDI destinations in the world. This was confirmed as well by other corporate surveys. In an annual survey of Japanese manufacturing TNCs (JBIC, 2007), for instance, the largest number of respondents stated an intention to strengthen or expand their activities in the Russian Federation.

Figure II.26. FDI prospects in South-East Europe and CIS, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)



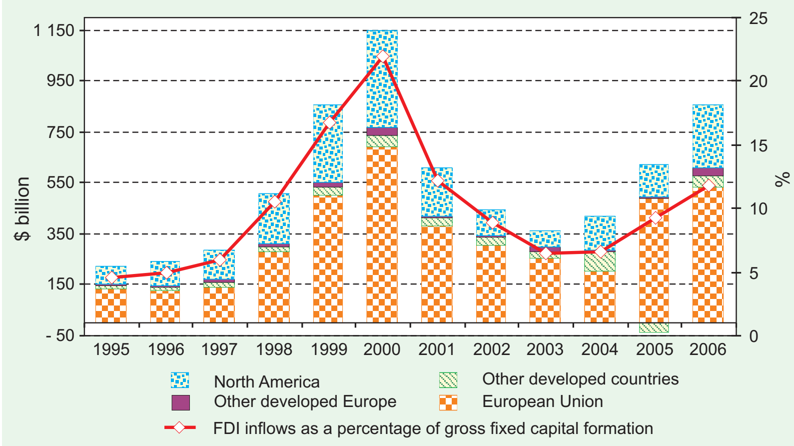
Source: UNCTAD, 2007b.

C. Developed countries

FDI inflows to developed countries surged to $857 billion, more than twice that in 2004. As in 2005, FDI was driven mainly by cross-border M&As, spurred by favourable financing conditions, high corporate profits, sustained economic growth and rising stock market prices. In contrast to the upward phase of the previous FDI cycle at the end of the last decade, the current expansion was widespread across all the developed regions and economic sectors. Increasing market integration promoted higher cross-border investments in manufacturing, energy, telecommunications and transportation. Private equity and hedge funds played an important role.

While the United States recovered its position as the largest single FDI host country in 2006, the 25 countries of the EU together accounted for about 41% of total FDI inflows. Flows to most countries in Europe remained stable or rose as compared to those in 2005. Japan's FDI inflows were negative for the first time since 1989. FDI outflows from developed countries rose by 45%, to $1,023 billion, marking their fifth consecutive year of growth. The largest share of such flows was directed towards other developed countries. Trends in cross-border M&As as well as UNCTAD's *World Investment Prospects Survey* suggest that FDI into developed countries will reach a new high in 2007.

Figure II.27. Developed countries: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

1. Geographical trends

a. Inward FDI grew in all regions and all sectors

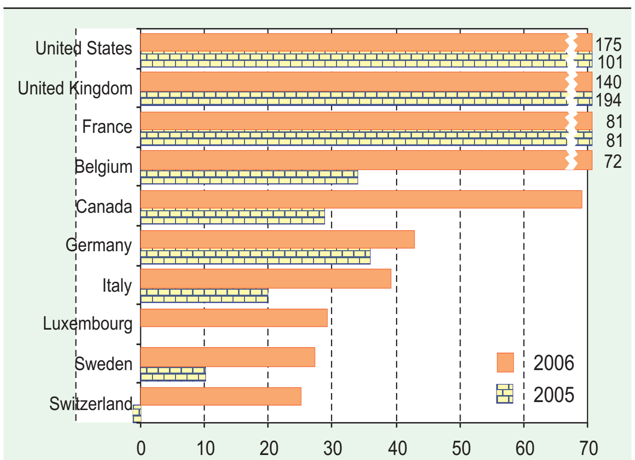
FDI inflows to developed countries rose for the third consecutive year, by 45% in 2006, to reach $857 billion (figure II.27). Inflows rose in 24 out of the 36 developed countries (annex table B.1), and their share in world FDI inflows increased from 62% to about 66%.

FDI inflows into *North America* rose by 88%, to $244 billion (figure II.27). With its economy growing at more than 3% in 2006, fuelled by buoyant consumer demand and high corporate profits, FDI inflows to the *United States* rebounded to $175 billion (figure II.28). Reinvested earnings, boosted by the continued high profitability of foreign affiliates in the country, grew by 65% to an all-time high of $65 billion. There was an unprecedented surge of investments in the chemical industry, which attracted $26 billion, accounting for 15% of total inflows. This growth was linked to some large cross-border M&As in the pharmaceutical industry and a weaker dollar.[129] Flows to finance and banking grew almost fivefold compared to 2005, reaching $31 billion, while those to the wholesale trade rose by 34% to $21 billion. Germany was the top source country of FDI in the United States, followed by France, Japan and the Netherlands in that order (United States, Bureau of Economic Analysis, 2007).

After a sharp rise in 2005, FDI inflows into *Canada* doubled to $69 billion in 2006, mainly due to a wave of cross-border M&As in the mining industry, notably the acquisitions of Inco by CVRD (Brazil) and of Falconbridge by Xstrata (Switzerland), each valued at more than $17 billion (annex table A.I.3, chapter IV). FDI in the buoyant mineral industry, among other activities, was stimulated by the country's strong economic growth, tax cuts in recent years and a very competitive business environment (box II.10).

FDI flows into the 25 EU countries rose by 9% in 2006, to a total of $531 billion. Much of the growth was again driven by cross-border corporate

Figure II.28. Developed countries: top 10 recipients of FDI inflows, 2005-2006[a]
(Billions of dollars)



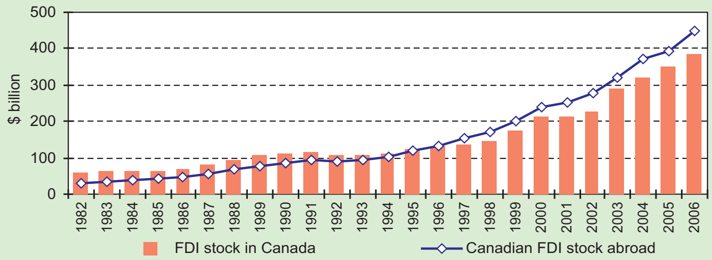
Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Ranked by the magnitude of FDI inflows in 2006.

Box II.10. Canada: using inward and outward FDI to internationalize

Canada is among the most attractive business locations in the world. The country was ranked first by the World Bank among its surveyed countries for ease of starting a business (World Bank, 2006). Moreover, in UNCTAD's Inward FDI Potential Index, it has been among the top five countries since 1990. At the end of 2006, the inward FDI stock of Canada amounted to $385 billion (box figure II.10.1) – a fourfold increase from its 1990 level.[a] Foreign affiliates accounted for around 45% of the country's exports and 30% of total business revenues in 2005.[b]

Box figure II.10.1. Canadian inward and outward FDI stocks, 1982-2006



Source. UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

The internationalization of the Canadian economy also continues through outward FDI. Canada ranks among the top 25 outward investor economies in UNCTAD's Outward FDI Performance Index. In contrast to FDI inflows, which have fluctuated heavily in recent years, annual outflows have been relatively stable: their stock has increased more than fivefold since 1990, to $449 billion in 2006 (box figure II.10.1).

The Canada-US Free Trade Agreement of 1988 and the North American Free Trade Agreement (NAFTA) of 1992 have encouraged Canadian FDI into the United States (MacDermott, 2007; Beaulieu et al., 2006), the prime target country for Canadian TNCs. During the period 2000-2006, 51% of Canadian outward FDI went to that country, compared to 19% to the EU. The leading investors abroad were firms in the finance and insurance industry, which accounted for 46% of total outflows, while those in the energy and metallic minerals industry accounted for 20%. In 2006, Canadian TNCs undertook several large acquisitions in the United States; for example, Goldcorp Inc. acquired Glamis Gold, a United States mining company, for $8.7 billion, and Brookfield, a Toronto-based real estate firm, together with Blackstone, the United States private equity group, bought Trizec Properties, a real estate investment trust company, for $2.9 billion (annex table A.I.3).

Further stimulus to outward FDI has come from the Government. Its international commercial policy recently has been paying more attention to outward FDI, a departure from its previous focus on trade and inward FDI (Beaulieu et al., 2006). In 2005, the Government acknowledged that the Canadian economy also benefits from outward investment as this contributes to competitiveness and increased R&D, and leads to technology transfers and spillovers to the Canadian economy.[c]

Source: UNCTAD.

[a] Compared to its potential, Canada had a lower Inward FDI Performance Index, ranking only 71st, but even this rank is much better than that of other developed countries such as the United States and the United Kingdom.

[b] Source: "Canada's international policy statement–a role of pride and influence in the world commerce", at: http://www.itcan-cican.gc.ca/ips/pdf/IPS-commerce-en.pdf.

[c] Ibid.

restructuring. In fact, 8 of the world's 10 largest cross-border M&As in 2006 took place within the EU. Intra-EU FDI in 2006 was responsible for an appreciable proportion of the inflows into EU member countries.

In the *EU-15*, inward FDI rose by 10%, to reach $492 billion in 2006. Lower flows to the United Kingdom, the Netherlands and Spain were more than offset by the increase in flows to Belgium, Germany, Italy and Luxembourg. FDI inflows into the *United Kingdom* fell by 28%, to $140 billion, largely reflecting a significant decrease in equity inflows (by 34%) and repayment of intra-company debt by foreign affiliates to their parent firms. Nevertheless, the country remained the largest FDI recipient in Europe in 2006, and the second largest worldwide. Several high-value cross-border acquisitions of United Kingdom firms took place, mainly in the telecommunications, transportation and chemical industries.[130] Inflows to *Sweden* amounted to $27 billion, the second largest amount since 1999, due to a significant increase in intra-company loans and equity inflows.

Inward FDI flows to the 12 countries forming the *European Monetary Union* (EMU) grew significantly in 2006, rising by 37% to $318 billion. Inflows to *Belgium* more than doubled to $72 billion, raising its total FDI stock to $603 billion, which was more than the country's GDP at the end of 2006. The continued presence in Belgium of TNC "coordination centres",[131] as well as new tax incentives that entered into force in January

2006, may have contributed to that increase. *France* recorded a small increase in inflows to $81 billion – representing a quarter of total inflows to the 12 EMU countries in 2006.

Inflows to *Germany* increased by 20%, to reach $43 billion in 2006, the bulk of which came from France, Denmark and the United States in that order. Among industries, banking and insurance received the largest share (32%) (Deutsche Bundesbank, 2007). *Italy's* inward FDI flows, still low compared to other European countries, doubled to $39 billion, due to large cross-border M&As in the banking sector. Inflows to *Luxembourg* rose substantially mainly due to the purchase of Arcelor by Mittal (Netherlands/United Kingdom) for $32 billion – the largest acquisition in 2006 (annex table A.I.3). After two consecutive years of negative inflows, as a result of repayment of loans by foreign affiliates to their parent firms, inward FDI flows to *Ireland* increased to $13 billion in 2006.

A few EMU-12 countries, namely Austria, Spain and the Netherlands, saw a decrease in FDI inflows in 2006. Inflows to *Spain* fell to $20 billion, the lowest level since 1999, largely reflecting decreased FDI in manufacturing, mainly due to competition from Eastern European and Asian countries. In the *Netherlands* inflows amounted to $4.4 billion in 2006, down from $41 billion in 2005, mostly due to the repayment of unusually high intra-company loans in 2005 by some United States and European affiliates.

FDI inflows to the *10 new EU member countries* (i.e. excluding the most recent accession countries of Bulgaria and Romania) retained their upward trend, totalling $39 billion, resulting mainly from a continued rise in reinvested earnings. *Poland* was the top recipient of that group, with record flows of $14 billion, as a result of increased investments not only from European investors, but also from Japanese companies such as Sharp, Bridgestone, Toyota and Toshiba. Germany and Italy (in that order) continued to be the leading sources of FDI to these countries.[132]

Among non-EU countries in Europe, *Switzerland* saw a recovery of FDI inflows in 2006, amounting to $25 billion, largely driven by record reinvested earnings of $14 billion. Its biotechnology and finance industries attracted the most foreign investments (Ernst and Young, 2006).[133]

In 2006, FDI inflows to *Japan* turned negative, falling to -$6.5 billion, following an already low inflow of $2.8 billion in 2005. Reinvested earnings of $2.3 billion could not compensate for the large negative equity inflows of $8.6 billion. Large disinvestments by Japanese affiliates of Vodafone and GM through their financial affiliates in the Netherlands, Canada and Hong Kong (China), in that order, were responsible for that decrease. In 2006, Japan's economic expansion was still hampered by deflationary pressures and low productivity growth in non-tradable goods and services (Moody's, 2007). The decline in FDI inflows made it impossible to achieve the ambitious target to double Japan's inward FDI stock by the end of 2006 (*WIR06*: 85). In *Australia,* after the large disinvestment of $35 billion in 2005, mainly due to the reincorporation of News Corp. (*WIR06*), inflows rose to $24 billion.

In 2006, cross-border M&As of developed-country firms increased by 20%, to $728 billion, the second largest annual increase so far, driven partly by private equity funds (chapter I). The rebound, in both number and value of deals, similar to that in 2005, was driven by economic expansion in the United States and the euro area, strong corporate profits, improved capacity utilization and rising stock markets in developed countries. Nearly 90% of M&As in developed countries were concluded by firms from other developed countries. Some developing-country TNCs were also involved in several mega M&A deals in developed countries in 2006 (annex table A.I.3). Altogether, developing-country firms invested up to $65 billion in acquisitions in developed countries – a 50% increase from the previous year.

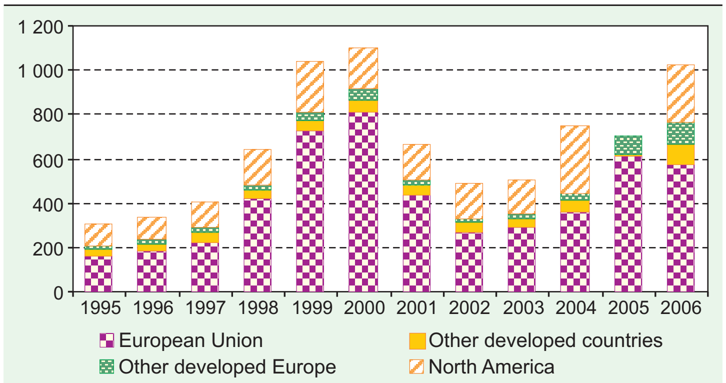
Like cross-border M&As, greenfield projects increased in all major subgroups/economies of developed countries to a total of 5,197 recorded projects in 2006 compared to 4,662 in 2005 (annex table A.I.1). While the EU had the largest combined number (3,844) as well as share (74%) of such projects in developed countries, the United States continued to be the single country with the largest number of projects – 723 in all. The number of greenfield projects in developed countries by firms from developing countries grew by 15% in 2006 to 405 projects.

b. Outward FDI increased sharply

Outflows from developed countries amounted to $1,023 billion, a growth of 45% (figure II.29). Developed countries continued to maintain their position as net outward investors, with outflows exceeding inflows by $165 billion. While there was a rebound of FDI outflows from the United States, more than half of total outflows from developed countries in 2006 were from the EU. Outflows from the 10 new EU members, although significantly higher than in 2005, continued to be modest compared to inflows ($12 billion, or 31% of FDI inflows).

A major reason for the upswing in FDI outflows was a rebound in outward FDI from the *United States,* the largest outward investor in 2006

Figure II.29. Developed countries: FDI outflows, 1995-2006
(Billions of dollars)



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

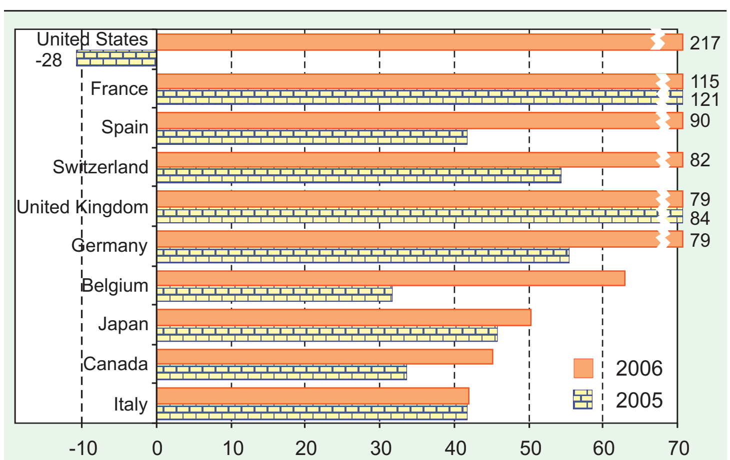
(figure II.30). After the negative outflows of FDI registered in 2005 due to the repatriation of profits induced by the one-off tax incentives provided by the American Jobs Creation Act (*WIR06*: 89), FDI flows from the United States jumped to $217 billion in 2006, while its FDI stock abroad rose to $2.4 trillion. Reinvested earnings ($201 billion) were the main FDI component in that increase. The EU was the region with the highest level of investments ($112 billion) by United States companies, followed by Asia and Latin America in that order. Manufacturing and financial firms were the major investors, accounting for $60 billion and $25 billion respectively (United States Bureau of Economic Analysis, 2007).

In 2006, FDI outflows from the *EU* countries fell slightly, to $572 million. Nevertheless, seven EU countries ranked among the top 10 developed source countries (figure II.30, table II.14). With outflows of $115 billion, slightly lower than those in 2005, *France* was the second largest source of FDI worldwide for the second year in a row. Companies in *Spain*, profiting from special incentives (*WIR06*: 89) and high growth in various sectors in their home economy (especially property, construction and banking), continued their rapid rate of outward expansion, resulting in record outflows of $90 billion. Of the three largest cross-border M&As in 2006, two originated from Spain (annex table A.I.3). Large overseas acquisitions by German companies, mainly in the United Kingdom and the United States, led to an increase of 43% in *Germany's* FDI outflows in 2006.

Other major sources of FDI from Europe were the Netherlands, Switzerland and the United Kingdom. FDI from *Switzerland* nearly doubled to $82 billion, also a new record. It took the form primarily of acquisitions in the United States and Canada, and mainly in finance and holding companies but also in the mining and chemical industries (Swiss National Bank, 2007). Outflows from the *United Kingdom* fell by 5% to $79 billion; nevertheless, its position as the world's second largest source country of FDI in terms of stock remained intact. Large United Kingdom companies in telecommunications and finance invested in developing countries, as illustrated by the acquisitions by the Vodafone group of firms in Turkey and South Africa and by HSBC of a bank in Panama.[134] FDI from *the Netherlands* amounted to $23 billion as a result of the acquisition of Arcelor (Luxembourg) by Mittal Steel (registered in the Netherlands).

In contrast to its declining inflows, *Japan's* FDI outflows increased further in 2006, by 10%, to reach a record $50 billion, the second highest since 1990. The depreciation of the yen did not deter outward FDI, while high corporate profitability of Japanese foreign affiliates enhanced reinvested earnings abroad to $16 billion, the largest ever. While the largest share of Japan's outward FDI flows went to Western Europe (36%), the second largest recipient was Asia (with 35%), overtaking North America (19%). The United States, however, was the single largest country recipient of Japanese FDI with $9 billion in investments, slightly lower than the $12 billion recorded in 2005, followed by the Netherlands, the United Kingdom[135] and China. Finally, outflows from *Israel* reached a record $14

Figure II.30. Developed countries: top 10 sources of FDI outflows, 2005-2006[a]
(Billions of dollars)



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

Table II.14. Developed countries: country distribution of FDI flows, by range,[a] 2006

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

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

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

Table II.15. Developed countries: cross-border M&As, by sector/industry, 2005-2006
(Million of dollars)

	Sales		Purchases	
Sector/industry	2005	2006	2005	2006
Total industry	604 882	727 955	627 064	752 482
Primary	110 474	65 119	98 035	56 850
Mining, quarrying and petroleum	108 769	63 036	97 838	54 102
Mining and quarrying	11 035	50 492	4 858	36 903
Petroleum	97 735	12 544	92 980	17 199
Secondary	171 020	247 233	125 684	197 125
Food, beverages and tobacco	31 706	16 823	17 516	15 474
Textiles, clothing and leather	2 031	1 721	4 638	694
Woods and wood products	3 862	4 841	3 340	4 181
Printing, publishing and allied services	9 778	24 922	7 460	9 223
Oil, gas and petroleum refining	1 882	2 548	757	446
Chemicals and chemical products	53 017	54 162	36 574	36 642
Rubber and miscellaneous plastic products	2 421	7 244	1 336	5 715
Stone, clay, glass and concrete products	4 521	8 557	10 024	7 916
Metals and metal products	20 184	46 606	12 943	42 505
Machinery	4 235	16 520	5 117	21 422
Electrical and electronic equipment	12 687	37 750	10 195	33 760
Measuring, medical, photo equipment & clocks	13 438	8 748	6 424	10 193
Motor vehicles and other transport equipment	9 744	15 449	8 859	8 381
Services	323 388	415 602	403 309	498 507
Electricity, gas and water distribution	35 596	17 630	25 364	9 890
Construction firms	6 124	10 956	2 802	6 592
Trade	24 908	20 267	14 377	13 878
Hotels and restaurants	5 507	26 943	1 814	13 001
Transport, storage and communications	73 900	102 812	49 646	67 022
Telecommunications	47 141	58 151	29 896	59 325
Finance	63 927	92 055	253 322	333 967
Business activities	85 374	101 831	46 321	38 141
Health and social services	5 312	13 425	1 621	1 059
Community, social & personal service activities	21 050	25 439	6 734	10 061

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

billion because of large M&As such as the above-mentioned acquisition by Teva Pharma Inds Ltd of Ivax Corp (United States) (annex table A.I.3).

The countries among the *10 new EU members* with more than $1 billion in outward FDI were Poland, Hungary, the Czech Republic and Estonia.

2. Sectoral trends: services continued to dominate

Judging from information on cross-border M&As by sector in 2006, services continued to dominate FDI flows between developed countries. Manufacturing gained in importance in terms of both target and acquiring firms, while the importance of the primary sector declined compared to 2005 (table II.15).

In the *primary sector,* although the exceptionally large cross-border M&As in 2005 (such as the acquisition of Royal Dutch Petroleum by Shell Transport &Trading Co. cited in *WIR06*: 273) were not repeated in 2006, the volume of sales and purchases remained high. Cross-border M&As in mining alone, which accounts for the bulk of M&As in the primary sector, increased almost fivefold in terms of sales and more than sevenfold in terms of purchases (table II.15). High commodity prices as well as consolidation of the mining and quarrying industries (Part Two) were the main drivers of this trend. Nevertheless, because of the larger increase in the value of cross-border M&As in manufacturing and services, the share of the primary sector in total cross-border M&As declined.

Cross-border M&As in the *manufacturing sector* of developed countries rose by 45% in terms of sales and by 57% in terms of purchases, led by a significant increase in the metals and metal product, printing and publishing and electrical and electronic equipment industries. While M&As in chemicals and chemical products remained the same as in 2005, the main target in the manufacturing sector and the largest cross-border M&A deal in 2006 was the acquisition of Arcelor by Mittal (annex table A.I.3), which made the metal industry the largest recipient.

Services continued to be the main target and acquiring sector for cross-border M&As in developed countries. M&A activity was particularly intense in financial services, mainly due to ongoing financial deregulation and restructuring. M&As also increased significantly in telecommunications[136] and tourism. In 2006, there was a significant increase in FDI in R&D activities, especially in the pharmaceutical and automotive industries (United Kingdom Department of Trade and Industry, 2006).[137] Apart from being a hub for some manufacturing activities, mainly the automotive industry (*WIR06*: 91), the group of 10 new EU-member countries is becoming attractive also for certain high value-added activities such as R&D.[138]

3. Policy developments

In 2006, many developed countries adopted policies that could directly or indirectly increase their attractiveness for FDI: of the 37 changes in their regulatory frameworks affecting FDI, 30 aimed at facilitating more FDI.[139] These policies included privatization and liberalization efforts, tax cuts and other monetary incentives, as well as promotion and marketing activities.

Privatization and liberalization. Most of the 10 new EU member States (that joined the EU in 2004) continued the process of privatization and opening up of their domestic economies to foreign investors in 2006, although at a slower pace. The Governments of Latvia and Malta, for instance, sold some State-owned assets. On the other hand, the new Government of Slovakia halted further privatizations of State-owned companies. In other EU countries, such as Austria, Portugal, France and Ireland, several large-scale privatizations were announced or completed.[140]

Further liberalization and opening up of some protected industries also took place. For example, the European Parliament approved the EU Directive on Services in the Internal Market in December 2006 (*WIR06*: 93), which is expected to stimulate FDI in this sector. In Australia, a new law was passed that allows more foreign investments and mergers in media: the earlier quantitative restrictions for FDI were eliminated, although investments in the industry would still require government approval. In Italy, the Minister for Economic Development announced a decree to start a programme of liberalization and increase competition in heavily protected services such as professional services, pharmacies, banks and taxis. In Greece, the Government opened its tourism industry to large-scale foreign investment. Japan relaxed its competition policy to facilitate the establishment of large-scale retailing operations.

Tax policy and other incentives. In 2006, several developed countries reformed their tax systems or cut their corporate tax rates to stimulate investment and attract foreign investors. In Austria, for example, new legislation abolished the Austrian non-resident capital gains tax for most foreign investors. The Czech Republic, Estonia, Greece and the Netherlands, introduced further cuts in their corporate tax rates. In Japan, foreign companies have been allowed to acquire Japanese firms through the exchange of shares since May 2007, which is expected to encourage cross-border M&As.[141] In Hungary, even though an additional business tax – called a solidarity tax – was introduced, the withholding tax for dividends paid to foreign corporations was abolished. And in Luxembourg, the dividend withholding tax rate was reduced from 20% to 15% and the income tax in Luxembourg City, where most of the holding and finance companies are located, was also reduced.

However, protectionist sentiment and various kinds of institutional barriers against foreign investment persist, and some are even on the rise again in several developed countries. In Austria, for example, the establishment of a private fund to protect Austrian companies from foreign takeovers is under discussion.[142] A report of the European Commission has concluded that the Community's corporate takeover rules of 2004 have failed to alleviate hostile takeovers (European Commission, 2006). At the same time, efforts are under way to reduce barriers to FDI. For example the European Commission tried to advise Spain to drop restrictions on the bid by the German energy group E.ON for Spanish power company Endesa (though eventually the German bid was withdrawn). In another case, the EU Advocate General in February 2007 backed the EU Commission's 2005 decision to take Germany to the European Court of Justice by claiming that the "Volkswagen Law" contravened EU rules on the free movement of capital (European Court of Justice, 2007).[143]

In the United States, although the continuing commitment to open up to investment and trade has been expressed on several occasions,[144] steps were taken to ensure that foreign investments do not jeopardize national security. Indeed, the Committee on Foreign Direct Investment in the United States (CFIUS) was reorganized for this purpose, and the time period for approval of foreign acquisitions will be extended, especially if the foreign investor is an enterprise that is partly or wholly-owned by a foreign government (*WIR06*).

4. Prospects: optimism for further growth in FDI

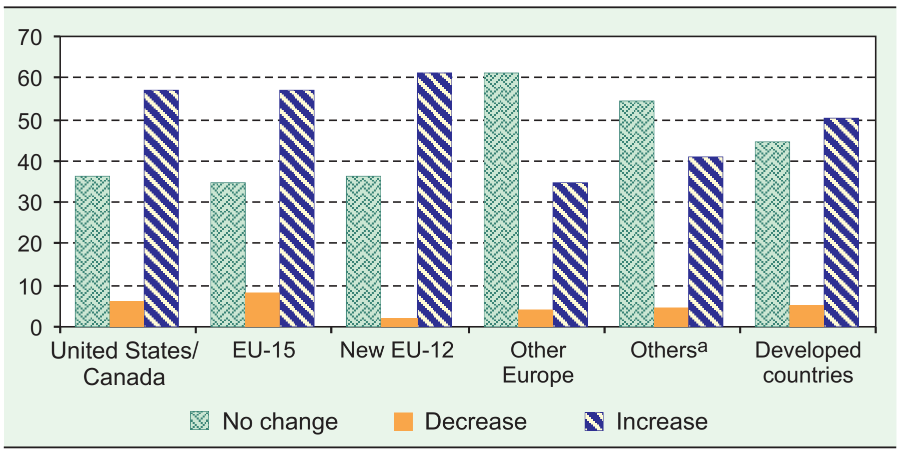
The medium-term prospects point to continued high levels of FDI flows to most developed countries, as many of the factors pushing

FDI flows upwards are expected to prevail for some time. Economic growth in developed countries seems set to remain robust in 2007 and 2008 (IMF, 2007a) and should continue to support corporate profits and upward movement of equity prices, stimulating further cross-border investments in those countries. While the pace of economic expansion in the United States has eased, it remains solid in the euro area and Japan. The OECD's leading indicators of economic performance in the first half of 2007 point to an upward trend in all the regions, with significant economic growth especially in South-East Asia (OECD, 2007). Increased FDI outflows can therefore be expected, especially to the developing countries. The EU's Directive on Services and the relaxation of some of the requirements of the United States' Sarbanes-Oxley Act[145] are expected to have a positive influence on FDI activity in 2007. The significant increase in cross-border M&As in developed countries (66% in value) in the first half of 2007, compared to the same period in 2006, is another indicator of higher FDI flows in 2007.

UNCTAD's *World Investment Prospects Survey* also indicates bright prospects for further growth in FDI flows in developed countries, with half of the TNCs surveyed anticipating an increase in FDI inflows into developed countries, and 44% expecting flows to remain the same (figure II.31). Growth of FDI inflows is likely to be the strongest in the United States, the United Kingdom, Poland and Germany (table I.14). Among developed countries as a whole, TNCs expressed greater optimism for FDI inflows to the new EU-12 members,[146] North America and the EU-15, in that order; while in other European and other developed countries (Japan, Australia and New Zealand) 41% of respondents expected FDI inflows to remain stable for the next three years. A number of other corporate surveys reflect optimism regarding business and FDI prospects.[147]

However several risks remain. Economic developments crucially depend on future oil prices and the unwinding of global current-account imbalances. The United States' deficits, asset price inflation, and a resulting increase in interest rates, present risks for the world economy. Although the considerable turbulence experienced by financial markets in early 2007 has calmed down, it is a reminder to investors and policymakers of potential financial market risks. The large increase in private equity buyouts in several countries and the accompanying transfer of risks to hedge funds has also increased the vulnerability of financial markets to various shocks (IMF, 2007a; and chapter I).

Figure II.31. FDI prospects in developed countries, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)



Source: UNCTAD, 2007b.
[a] Australia, Japan and New Zealand.

Notes

1 At times this share has been higher, reaching more than 70% at the beginning of the decade.

2 Data on greenfield projects in this Chapter come from OCO Consulting, LOCOmonitor database (www.locomonitor.com).

3 Data on international reserves from the IMF's *International Financial Statistics*.

4 Based on 29 countries; *source*: IMF, *Balance of Payments Statistics*.

5 In addition to major oil producers such as Nigeria, Algeria, the Libyan Arab Jamahiriya, Angola and Sudan, mineral-producing countries such as Kenya, Mauritius, Lesotho, Swaziland, the United Republic of Tanzania, Uganda, and Zambia that had started to receive FDI in manufacturing, especially textile processing and export-oriented activities, also received larger inflows into resource exploration activities.

6 Zambia is the world's fourth largest copper producer, with most of the production undertaken by TNCs (chapter IV). See also "Zambian producers suffer as copper bonanza sends exchange rate soaring", *Financial Times*, 26 September 2006.

7 Under this Act, the United States Government has been offering trade preferences since 2000 to promote trade and investment in Africa. The expiration of this Act has been extended until 2015.

8 In 2005-2006, Lesotho witnessed an 8.3% contraction in manufacturing, which was strongly influenced by the removal of quotas after the expiry of the Multi Fibre Arrangement (MFA) on exports from low-cost Asian producers and the continued strength of the South African rand (Lesotho's mloti is pegged to the rand). *Source*: "Lesotho economy: Manufacturing sector performance to improve", *EIU Viewswire*, 28 June 2006. For Swaziland, see for instance, *Africa Renewal* (previously *Africa Recovery*), vol., 20, No. 1, April 2006: 18.

9 For example, France's Crédit Agricole acquired Egyptian American Bank (later renamed the new bank Crédit Agricole-Egypt) (*Source*: "Credit Agricole Egypt's Adrien Phares on his bank's acquisition of EAB", *Business Today*, 16 August 2006). In Nigeria, CNOOC (China) acquired NNPC OML-130 for $3 billion, and in Sudan, inflows surged partly as a result of the sale of MobiTel to MTC Kuwait for $1.33 billion.

10 This subregion comprises Algeria, Egypt, the Libyan Arab Jamahiriya, Morocco, Sudan and Tunisia.

11 The North African countries received FDI in the manufacturing sector from TNCs engaged in the production of cosmetics, water storage tanks, auto valves, irrigation pumps, minibus assembly lines, utility vehicles and pick-up trucks, paints, pharmaceuticals and chemical production. *Source*: PricewaterhouseCoopers (www.pwc.com).

12 *Source:* Central Bank of Egypt. For instance, pharmaceutical giant AstraZeneca invested in a plant to manufacture medicines (for cardiovascular disease, psychiatric disorders and cancer) in Egypt in 2006 ("AstraZeneca opens first manufacturing plant in the Middle East", in-Pharma Technologist.com (www.in-pharmatechnologist.com).

13 Tunisia sold 35% of Tunisie Telecom (TT) to a consortium comprising Dubai Technology and Media Free Zone, and Dubai Investment Group for $2.3 billion.

14 The subregion comprises Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Saint Helena, Senegal, Sierra Leone and Togo.

15 *Source*: "Ernie Els to design course in Cape Verde Islands", *Golf Today Travel,* 12 September 2006 (http://www.golftoday.co.uk/travel/press_releases/els_cape_verde.html).

16 The subregion comprises: Burundi, Cameroon, the Central African Republic, Chad, Congo, the Democratic Republic of the Congo, Equatorial Guinea, Gabon, Rwanda and Sao Tome and Principe.

17 Pecten is part of the Shell Group ("Pecten Cameroon Company", *MBendi*, 7 October 2006 (www.mbendi.com)).

18 The subregion comprises Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Mauritius, Seychelles, Somalia, Uganda and the United Republic of Tanzania.

19 The subregion comprises Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Zambia and Zimbabwe.

20 *Sources*: "Vodafone raises South Africa stake to 50%", *Computer Business Review Online*, 7 December 2006 (http://www.cbronline.com/article_news.asp?guid=78E3F61D-8188-461D-BD07-458659500C6A); "India's Tata group acquiring 26 PCT stake in SAfrican telecom", *AFX News Limited*, 22 August 2006 (http://www.forbes.com/business/feeds/afx/2006/08/22/afx2963999.html); and "Dubai-led group gets Cape V&A for R7bn", *Business Day*, 9 October 2006. (http://www.businessday.co.za/articles/dailymailer.aspx?ID=BD4A275648).

21 See: www.unctad.org/fdistatistics for longer time series data.

22 *Source*: "South Africa: Scrambling for Africa", *AllAfrica*, 22 November 2006 (http://allafrica.com/stories/200607240385.html); "AngloGold in $58 million Russian mining alliance", *BusinessDay*, 7 April 2006; "SA firm wins new oil rights in Tanzania", *All Africa*, 2 May 2006 (www.allafrica.com); and "AngloGold in $58 million Russian mining alliance", *BusinessDay*, 7 April 2006.

23 Orascom (Egypt) bought a 19.3% stake in Hong Kong-based Hutchison; Telkom acquired part of Portugal Telecom, including its operations in several African countries such as Angola and Morocco; MTN bought into Lebanon's Investcom; Maroc Télécom acquired a majority stake in Burundi's Office national des telecommunications (Onatel); and Naguib Sawiris of Egypt purchased Wind Telecomuncazioni SpA of Italy.

24 Angola eased procedures for the entry of foreigners into the country; Kenya scrapped or simplified various types of operational licences, set up a Business Regulatory Reform Unit to bring standards up to international best practices and introduced a 24-hour service at the port of Mombasa and Mauritania eliminated various restrictions on foreign-exchange operations.

25 See endnote 69 in chapter I.

26 Under AGOA, Africa-based clothing exporters were able to import fabric from the cheapest available suppliers while still enjoying duty-free access to the United States market. When this concession expires in 2007, some of the foreign-owned clothing firms in eligible African countries may well decide to relocate elsewhere. In December 2006, the United States Congress passed AIIA under the AGOA to help avert the diversion of FDI and the loss of thousands of jobs in the region. The new Act supplements and extends the provisions of AGOA to help producers in sub-Saharan Africa better withstand greater competitive pressures from China following the expiry of MFA in 2005.

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

28 FDI to financial service industries (mainly banking) declined from $12 billion in 2005 to $6 in 2006. Data on FDI in financial industries is reported by the Chinese Government based on data collected separately by China's three financial regulatory bodies: the banking, insurance and securities regulatory commissions. According to the China Banking Regulatory Commission, however, its data on foreign investments are not based on the standard balance-of-payments (BOP) definition of FDI (UNCTAD, 2007e).

29 There has been a worsening labour shortage in coastal provinces such as Guangdong. In response, minimum wage levels in several cities in the province have risen significantly in recent years. For example, the minimum wage increased by 17.4% in Shenzhen in 2006.

30 *Source*: Ministry of Commerce, Industry and Energy.

31 ASEAN members are: Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.

32 The project is expected eventually to employ 3,000 workers and double Texas Instruments' production capacity ("Texas Instruments unveils $1 billion Philippines expansion", 3 May 2007, at: www.marketwatch.com).

33 Although wages in Viet Nam have been rising rapidly particularly after the minimum wage level was increased in early 2006, the wage rate is still attractive compared to that in China. The monthly wage rate (including all benefits) of the average worker in Viet Nam was about $90-$110 compared to $160-$190 in southern China in 2006 (JETRO, 2006: 88).

34 The subregion comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

35 This includes, for instance, the investment of $20 billion by Emaar Properties (United Arab Emirates) in real estate development in Islamabad and Karachi (see "Emaar unveils three real estate projects in Pakistan with total investment of AED 8.8 billion", at: http://www.emaar.com).

36 Largest M&As undertaken by Singaporean firms in developed countries include the PSA International-Peninsular & Oriental Steam Navigation (United Kingdom) deal ($6.4 billion) and the Temasek-Standard Chartered (United Kingdom) deal ($4.3 billion), though they are not recorded in 2006 (because payment was not made).

37 For example, see "A new wave of overseas investment has led to concerns of hollowing out", 30 October 2006 (www.Xinhuanet.com).

38 The objective of establishing these zones is to promote the internationalization of Chinese SMEs. The zones are established and run by Chinese enterprises, with financial support from the Chinese Government (*source*: Ministry of Commerce).

39 So far, the Central Foreign Exchange Management Centre, under the State Administration of Foreign Exchange (SAFE), has been the only government agency responsible for managing China's foreign exchanged reserves ($1 trillion by the end of 2006). Following the conventional approach to reserves management, which emphasizes security and liquidity, the agency has only invested in fixed-income securities such as United States Treasury Bonds. As highlighted in *WIR06* (box II.7), the Chinese Government has been considering alternative uses for its foreign currency reserves in view of the relatively low returns and high risks associated with the approach followed hitherto. Following a decision made by the State Council at the Central Financial Work Meeting in January 2007, the Chinese Government is establishing a Government Investment Corporation, which is expected to manage a possible $200 billion fund drawn from the pool of China's foreign currency reserves.

40 In 2005, Tata Steel acquired NatSteel (Singapore) for $486 million. In 2006, Tata Tea purchased a 30% stake in Energy Brands Inc. (United States) for a total acquisition price of $677 million, and Tata Coffee (a subsidiary of Tata Tea) acquired Eight O'Clock Coffee Company (United States) for $220 million.

41 India is now the second largest source of FDI inflows to London, accounting for 16% of total inflows.

42 For example, in terms of sales, Hongfujin Precision Industry (Shenzhen), a subsidiary of Hon Hai Precision Industry, has surpassed Motorola (China) in size, becoming the largest foreign affiliate in China, with about $15.7 billion in sales and $14.5 billion in exports in 2006 (Ministry of Commerce of China). In addition, the affiliates in China of Taiwan Province-based Quanta Computer and Inventec ranked number eight and nine, respectively, in the list of top foreign affiliates in China in 2006.

43 For example, China Huadian Corporation is cooperating with its local partner Perusahaan Listrik Negara on a $2 billion electricity project in Indonesia. Other agreements (worth $4 billion) in electricity and extractive industries were signed in October 2006 at a China-Indonesia energy forum in Shanghai.

44 For example, Royal Dutch Shell announced in July 2006 that it would invest in a $5 billion coal-to-liquids plant in Ningxia Province. Anglo American is considering a coal-mining and processing complex worth about $4 billion ("Anglo American shows China interest", *Financial Times*, 16 November 2006).

45 FDI in high-tech industries such as telecom equipment increased significantly in 2006 (according to data provided by the Ministry of Commerce).

46 *Source:* the Reserve Bank of India.

47 For example, Wal-Mart will cooperate with the local Bharti Enterprises to build hundreds of shops in the next five years ("Wal-Mart will enter the Indian retailing industry", *Financial Times*, 28 November 2006).

48 According to China's Ministry of Commerce (MOFCOM), Carrefour (France) had established 79 branches in China by the end of June 2006, with total sales reaching $15 billion in the first half of 2006 (http://mnc.people.com.cn/GB/54823/4929860.html). In February 2007, Wal-Mart acquired a 35% stake in Bounteous Company Ltd. (Taiwan Province of China), which operates Trust-Mart in mainland China (see "Wal-Mart expands in China through Trust-Mart stake", 27 February 2007, *MarketWatch*, at: www.marketwatch.com).

49 For example, Wal-Mart sold its 16 branches in the Republic of Korea to the local E-Mart in 2006. (Evan Ramstad, "South Korea's E-Mart is no Wal-Mart, which is why locals love it", *Wall Street Journal*, 10 August 2006).

50 For example, TCL had to write off much of its investment recently after it acquired Thomson (France) in 2004.

51 The applications for establishing branches in the United States by Chinese banks, such as Bank of China, China Construction Bank and Bank of Communications, have been denied several times by the United States authorities over the past decade. However, this may change after the Second China-United States Strategic Economic Dialogue in 2007, which reached the conclusion that any such applications should be examined based on the principle of national treatment (Mei Xinyu, "Chinese banks eyes overseas markets", 5 June 2007, at: www.FTChinese.com).

52 A priority objective indicated by both the Ministry of Commerce and the National Development and Reform Commission.

53 The new income tax rate will be 25%, but foreign affiliates can continue to enjoy previous tax rates (15% or 24% depending on location) during a five-year transition period.

54 The Indian National Security Commission has proposed to all economic departments of the Government that FDI from certain countries should be subject to approval and monitoring with regard to national security implications.

55 In 2006, the Ministry of Commerce and the National Development and Reform Commission introduced new rules on foreign takeovers in order to ensure a standard treatment for acquisitions and a screening based on antitrust and "national economic security" concerns. In July 2006, the Government introduced a regulation to restrict FDI in real estate in order to avoid overheating in China's real estate market.

56 Seven industries, including telecommunications, petroleum, defence, electricity, coal mining, civil aviation and ocean shipping, are considered to be of strategic importance, and thus to be controlled by the State.

57 For example, China announced plans to invest about $200 billion in its railway system over the next five years, and Viet Nam is planning a high-speed railway system.

58 First, poor infrastructure prevents the country from attracting efficiency-seeking FDI. Second, while the Government is making efforts to attract FDI projects, they are not necessarily welcomed by local communities.

59 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.

60 Turkey was host to the largest cross-border M&A deal of the year in the region – the purchase of TELSIM Mobil Telekomunikasyon of Turkey by the United Kingdom's Vodafone Group for $4.6 billion (annex table A.I.3). There were an estimated 43 completed cross-border M&A sales in the country, compared with 23 in 2005 (annex table B.5).

61 Some 93 greenfield projects were recorded in Saudi Arabia, with over 10 in the construction sector (OCO Consulting, Locomonitor database, at:www.locomonitor.com).

62 Including the Islamic Republic of Iran, Iraq, Jordan, Lebanon, the Palestinian Territory, the Syrian Arab Republic and Yemen.

63 In principle, cross-border M&As should be part of FDI flows, but due to different methodologies in collecting these two sets

of data, figures do not match. For details on data differences between cross-border M&As and FDI flows, see *WIR00*.

64 *Source*: *Oxford Analytica*, 2 July 2007.

65 For example, ExxonMobil (United States), Royal Dutch Shell (United Kingdom/Netherlands) and Sasol (South Africa) have gas exploration projects in Qatar, and Royal Dutch Shell and Total (France) have them in Saudi Arabia.

66 In petroleum refining, the most significant cross-border acquisition in 2006 took place in Turkey, where OMV (Austria) took a 34% stake in the oil and gas firm Petrol Ofisi AS (Turkey) for $1.1 billion.

67 The motor vehicles and other transport equipment industry accounted for 13% of Turkey's total inward FDI stock in 2004, the second largest recipient industry after transport, storage and communications. This trend is continuing: in 2006, Doktas Docum Sanayi ve Ticaret, an automobile parts and components firm was acquired by Componenta Oyj (Finland) for $110 million.

68 Jordan Investment Board, *Investment Statistics 2006* (http://www.jordaninvestment.com).

69 Islamic finance, or the use and provision of finance in compliance with Islamic norms (based on the Shariah), operates on the principle of distribution of investment profits, rather than paying out and receiving interest for access to finance. Therefore, Islamic finance can take the form of direct investment rather than loan finance.

70 In June 2006, Umniah Mobile Communications, a major player in Jordan's highly competitive cellular market was bought by Batelco (Bahrain) for $415 million ("Batelco acquires Jordan mobile operator for $415 mln*", Khaleej Times*, 25 June 2006), and the Government of Jordan sold off its remaining 41.5% shares of Jordan Telecom to France Télécom for $183 million ("France Telecom acquires a majority interest in Jordan Telecom*"*, *Financial Times*, 30 June 2006).

71 *Source*: UNCTAD, database on national laws and regulations.

72 The Central Bank of Bahrain has also enacted a Trust Law that specifies which investment products can be sold and invested in Bahrain (Bahrain Trust Law, *EIU Viewswire*, October 2006). As of 1 July 2006, licensing categories were defined by the type of regulated activity rather than the type of institution. Offshore banks, including investment banks, will now be covered by a "wholesale banking" licence ("Offshore Banking in Bahrain", *EIU Viewswire*, October 2006). For Saudi Arabia, see "Saudis to construct Euro 5.2 bn financial district in Riyadh", *Financial Times*, 10 May 2006 and for Qatar, see "Qatar Central Bank, 2006", *EIU Viewswire* (www.viewswire.com), 2006.

73 Non-Omani citizens will have the right to own residential property and land in "integrated tourism complexes". *Oman Tourism, EIU Viewswire*, March 2006.

74 The Qatar Government opened its market to foreign investment in the gas sector. There are several large projects under this initiative. For example, the Qatar Liquefied Gas Company Limited (Qatar Gas), a joint-venture company between Qatar Petroleum and ExxonMobil Corporation, has expanded its facilities at the Ras Laffan industrial city natural gas liquefaction plant in Qatar. Started in early 2005, the project investment has been estimated at $12 billion. Royal Dutch Shell is also investing in a Qatar gas plant to turn Qatari gas into super clean fuel, in a project worth up to $18 billion.

75 The law also consolidates existing legislation and introduces new, tighter provisions regarding transfer pricing and tax havens. Turkey Tax Law*, EIU Viewswire*, March 2006.

76 See, for example, "UAE mulls FDI reform", Khaleej Times, 22 December 2006; and "UAE Labour Law*"*, *EIU Viewswire*, June 2006.

77 http://ec.europa.eu/trade/issues/bilateral/, accessed in March 2007.

78 The health-care sector is considered to be the industry with the highest growth potential, especially in the West Asian subregion (PricewaterhouseCoopers, 2007a), which could attract some FDI. In Jordan for instance, Kuwaiti investors are seeking government approval to launch a medical city near Amman at a cost of $3-5 billion.

79 In Kuwait, for example, legislation is expected to be passed in 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 (Salisu and Yagudin, 2007).

80 Oceania comprises American Samoa, Cook Islands, Fiji, French Polynesia, Guam, Kiribati, Marshall Islands, the Federated States of Micronesia, Nauru, New Caledonia, Niue, Norfolk Islands, Northern Mariana Islands, Palau, Papua New Guinea, Samoa, the Solomon Islands, Tokelau, Tonga, Tuvalu, Vanuatu, Wallis and Futuna Islands.

81 Their ranking according to the UNCTAD Inward FDI Performance Index, would be 94 and 136, respectively. However, the index for these economies is calculated separately from that of other economies; only Papua New Guinea is included in the index, which is limited to 141 economies for which the Inward FDI Potential Index is constructed (annex table A.I.6).

82 Following the agreement signed with China Metallurgical Construction Group Corporation in 2005 by the Government of Papua New Guinea, work has commenced at the joint Ramu Nickel-cobalt project in which the Chinese corporation holds 85% of equity.

83 The First Ministerial Meeting of the China-Pacific Island Countries Economic Development & Cooperation Forum took place in Fiji in 2006 with a view to promoting relations between China and the Pacific countries. China is establishing a loan-finance facility or an investment fund to enable qualified Chinese enterprises to invest in various Pacific island countries.

84 For example, in Fiji following a coup in December 2006, an initial decline in the number of tourist arrivals was observed, but the sector is showing signs of rapid recovery (EIU, 2007c). However, it is forecast that the long-run impacts of the coup will result in some 8% contraction in Fiji's real GDP (Narayan and Prasad, 2007). In the short term, FDI is expected to decline, although not nearly as much as the 33% decline in the aftermath of the 2000 coup. The interim Government has set up an inter-agency FDI taskforce to ensure that existing investment projects are implemented, but investors' confidence seems to recover only after a politically stable environment is re-established. In the Solomon Islands, after elections in April 2006, riots led to several business owners fleeing the capital. Tonga also witnessed violence, which led to the destruction of 80% of the capital's business district (EIU, 2007d).

85 Oil Search Ltd. was incorporated in Papua New Guinea in 1929 and is listed on the Australian Stock Exchange, with the Government of Papua New Guinea as the principal shareholder (of about 18%).

86 Bermuda is no longer included in this region, as it is now classified under developed countries.

87 For the Homeland Investment Act, see *WIR06*: 89.

88 Although this ratio must be interpreted with caution because data on FDI and M&As are not quite comparable (see *WIR00*), it is however a good barometer of the relative importance of M&As as a mode of FDI.

89 In 2006, the purchase by TNCs of local assets owned by foreign affiliates surged by 183 % while that of local assets owned by nationals decreased by 22 %. Both transactions are recorded as cross-border M&As (*source*: UNCTAD, cross-border M&As database (www.unctad.org/fdistatistics)).

90 Reinvested earnings are recorded both in the current account of the balance of payments (as being paid to the direct investor as investment income) and in the capital account (as being reinvested in the enterprise as FDI inflows).

91 Data on reinvested earnings in 2006 are available for Argentina, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Uruguay and Venezuela. These countries received 57% of the total inward FDI to South America in 2006.

92 *Source*: Central Bank of Costa Rica and Central Bank of the Dominican Republic.

93 Including offshore financial centres, outflows increased by 37%, to $49 billion.

94 *Source*: Central Bank of Brazil.

95 *Alexander's Gas & Oil Connections*, Vol. 10, No. 18, 28 September 2005*; América Economía.com,* Edición 342, 29 June 2007, and PDVSA (www.pdvsa.com).

96 *Business Latin America*, 22 January 2007 (London: EIU).

[97] *Business Latin America*, 29 January 2007 (London: EIU), *Business Latin America*, 30 October 2006 (London: EIU), and *Mercopress*, 8 March 2007 (www.mercopress.com).

[98] Banco de la República, Subgerencia de Estudios Económicos, at: www.banrep.gov.co/economia/flujos/flujoinv.xls.

[99] *Sources*: for Chile, Comisión Chilena del Cobre (Cochilco) (www.cochilco.cl) (the amount does not include investments in exploration and in routine maintenance); for Colombia, Banco de la República, *Subgerencia de Estudios Económicos*, at: www.banrep.gov.co/economia/flujos/flujoinv.xls; for Peru, *Proinversión*, 2007 and *Business Latin America*, 23 April 2007 (London: EIU); for Bolivia, *Business Latin America*, 15 January 2007 (London: EIU); for Guyana, *Business Latin America*, 30 October 2007 (London: EIU); for Suriname, *Business Latin America*, 31 July 2006 (London: EIU).

[100] *Sources: Business Latin America*, 18 September 2006, 14 August 2006 and 9 October 2006 (London: EIU); and www.thyssenkrupp-steel.com.

[101] In 2007 Nissan began using its Mexican operations to supply cars to 18 European countries. Volkswagen is another automaker that exports to Europe from its Mexican factory ("Horisly's space", *Automotive News*, 9 April 2007, at: http://horisly.blogspot.com/2007/04/nissan-to-supply-europe-from-mexico.html).

[102] ADEFA, *Press Release*, December 2006 and *Página 12*, 1 October 2006.

[103] Including FDI in automotive engines and other transportation equipments *(source*: Banco Central do Brasil).

[104] Fiat is proceeding with a $1.4 billion modernization plan for its operations in Brazil that will extend until 2008. General Motors has announced it might double its annual investment of $500 million by the end of the decade if GDP growth in Brazil improves. Ford has unveiled plans to invest $1 billion by 2011, and Volkswagen (Germany) intends to invest $1.2 billion by 2012 (*Business Latin America*, 22 January 2007 (London: EIU)). However, Volkswagen plans to phase out exports of its Fox model from Brazil to Europe, and will supply it at a lower cost from the Russian Federation (*Business Latin America*, 2 October 2006 (London: EIU)).

[105] Mexico's share in total apparel exports to the United States fell from 8.8% in 2005 to 7.4% in 2006, and that of DR-CAFTA countries from 14% to 12.5%. In contrast, the share of China, for example, increased from 22% to 25.9%, and that of Indonesia from 4.2% to 5.1%.

[106] Examples include the acquisition of Verizon's (United States) assets in the Dominican Republic by América Móvil for $2.1 billion, Telmex's acquisition of shares in Embratel (Brazil) for $809 million, and the acquisition of the Brazilian Tevecap (cable TV) by Telefónica for $467 billion.

[107] Verizon sold its assets in Venezuela to the State and its assets in the Dominican Republic to América Móvil (Mexico), while Telecom Italia sold its assets in Venezuela to the local group Cisneros.

[108] *Reuters América Latina*, 10 May 2007, and *Business Latin America*, 15 January 2007 (London: EIU).

[109] *Business Latin America*, 30 October 2006 and 29 January 2007 (London: EIU).

[110] *Clarín*, 9 January 2007 (www.clarin.com.ar), *Business Latin America*, 7 August 2005, 13 November 2006 and 25 December 2006 (London: EIU).

[111] *Business Latin America*, 25 December 2006 and 29 January 2007 (London: EIU).

[112] *Business Latin America*, 22 January 2007 and 27 November 2006 (London: EIU).

[113] The accord with China has already been implemented, but it does not include chapters on services and investments.

[114] The region is expected to achieve a GDP growth rate of 4.7% in 2007 (UNCTAD, 2007). Regarding prospects for commodity prices, see chapter III of this *WIR*.

[115] In addition to the sale of the local assets of AES and CMS (both United States companies) to the Government of Venezuela, CMS announced that it would sell its assets in Brazil, and Union Fenosa (Spain) announced plans to sell its assets in Nicaragua back to the State. In the telecom sector, Verizon (United States) agreed to sell its assets in Venezuela to the Government.

[116] *Source*: Central Bank of Brazil.

[117] Bulgaria and Romania which became new EU member States on 1 January 2007 are classified under South-East Europe and CIS in this Report. For more on geographical grouping, see *WIR06*, p 6.

[118] In 2006, the $4.7 billion purchase of Banca Comerciala Romana by the Austrian bank Erste Bank was the largest deal in the country so far (annex table A.I.3).

[119] For more on the rise of Russian TNCs, see Kalotay, 2007.

[120] *Source:* UNCTAD cross-border M&A database. Cross-border M&As of foreign affiliates in 2006 included the acquisition in Croatia by Société Générale (France) of HVB Splitska owned by Unicredito Italiano for $1.2 billion, and in Ukraine, the merger of the affiliate of OTP Bank (Hungary) with the affiliate of Raiffeisen Bank (Austria) for $833 million.

[121] In March 2006 the Government of the Russian Federation released a preliminary list of 39 industries deemed to be strategic, including energy and metals.

[122] In June 2007, TNK-BP, agreed to cede its controlling 62.9 % stake in the vast Siberian Kovytka gas field to Gazprom ("BP submits to Kremlin pressure and hands Kovytka to Gazprom" *Financial Times*, 23 June 2007).

[123] The sale of PetroKazakhstan to CNPC, a Chinese State-owned oil company (*WIR06*: 58) was allowed to go through only after CNPC agreed to sell a 33% stake in PetroKazakhstan to State-owned KazMunaiGaz.

[124] "Mining groups feel the heat in central Asia", *Financial Times*, 2 August 2006.

[125] However in some countries such as Romania the previous privatization deals were disputed (see Hunya, 2007 for the Petrom privatization-related dispute).

[126] In Serbia, for instance, a new Free Zone Law was enacted, while in Albania, in 2006, an initiative "Albania one Euro" was launched to attract foreign investors especially in energy generation. For more on this latter initiative, see: http://www.albinvest.gov.al/dokumenti.asp?id=304&menu=96.

[127] For example, in July 2007 the French oil company Total agreed to form a consortium with Gazprom to develop one of the world's largest natural gas deposits (see "Gazprom and Total strike a deal on gas", *International Herald Tribune*, 13 July 2007).

[128] In the survey, Romania and Bulgaria were not included as part of the South-East Europe and CIS region.

[129] For example, Teva Pharma Inds Ltd (Israel) bought Ivax Corp for $7.4 billion, and Novartis AG (Switzerland) acquired Chiron Corp. for $6.2 billion.

[130] For example, Telefonica (Spain) acquired O2 Plc for $31.7 billion, Ferrovial (Spain) bought a 14% stake in airports operator BAA for $21.8 billion, and Linde AG (Germany) acquired BOC Group Plc for $14.1 billion (annex table A.I.3).

[131] "Coordination centre" status is granted by Royal decree to very large industrial conglomerates which meet certain criteria. Multinational companies with coordination centre status, accounted for one third of Belgium's FDI inflows and 36% of its outward FDI in the period 1995-2005 (Piette, 2007). These conglomerates enjoy special fiscal advantages (e.g. although they pay normal Belgium corporate income tax rates of up to 33.99%, they are taxed on their trading profits at the rate of 4%-10% of their total "business expenses").

[132] For example, MOL (Hungary) sold a natural gas storage and wholesale trading business, to E.ON (Germany) for $1.3 billion, and the power generator, Slovenske Elektrarne (Slovenia), was taken over by Enel (Italy) for $1.1 billion (annex table A.I.3).

[133] For example the acquisition of Winthertur by AXA (France) "AXA buys Winterthur for Euro 7.9 billion" *Financial Times,* 15 June 2006.

[134] Vodafone bought TELSIM Mobil Telekomunikasyon in Turkey for $4.6 billion and VenFin Ltd. in South Africa for $2.9 billion; HSBC bank acquired Grupo Banistmo SA in Panama (annex table A.I.3).

[135] Major deals included the following: Japan Tobacco acquired Gallagher (United Kingdom) for $14.7 billion in what was not only the largest acquisition in the tobacco industry, but also the largest foreign takeover by a Japanese manufacturing company. The deal was recorded in 2007 ("Buying overseas: executives

discover that the developed world is their oyster", *Financial Times*, 13 March 2007). Toshiba bought Westinghouse Electric Co. (United States) for $5.4 billion, and Nippon Sheet Glass Co Ltd. acquired Pilkington PLC (United Kingdom) for $3 billion.

136 In 2006, two large acquisitions took place in telecommunications, that of the United Kingdom firm O2 PLC by Spain's Telefonica, and Lucent Technologies by France's Alcatel.

137 For instance, Ford (United States) announced that it would invest up to $1.8 billion over the next six years in its R&D projects in the United Kingdom, while Novartis (Switzerland) plans to create a research facility with 400 scientists in China ("Ford to invest £1 billion in UK R&D", *Financial Times,* 17 July 2006 and "Novartis in China R&D push", *Financial Times,* 3 November 2006).

138 For example, in 2006 Morgan Stanley opened a Business Services & Technology Centre in Budapest (Hungary) ("Eastern Europe becomes a centre of outsourcing", *The New York Times*, 19 April, 2007).

139 *Source*: UNCTAD, database on national laws and regulations.

140 The Austrian Government sold, through an initial public offering (IPO), a 49% stake in the previously 100% State-owned mail service provider, Österreichische Post, while in Portugal, the Government sold, through an IPO in October 2006, 25% of Galp Energia, a large State-owned oil and gas utility. The French Government announced the partial privatization of Gaz de France and the State-owned Aéroports de Paris, and, similarly, the Irish Government announced the offering of a major part of the State-owned national airline, Aer Lingus, to private investors.

141 This is further stimulated by a tax deferral, as shareholders of Japanese acquired firms receiving new shares do not necessarily pay the tax at the time of receipt of the shares. However, stock-swapping M&As by foreign companies are allowed only when their affiliates in Japan make deals on behalf of their parent firms.

142 "Business in Austria: not so welcome in Vienna", *The Economist*, 31 March 2007.

143 The so-called "Volkswagen Law" prevents mergers and investment in Volkswagen, the largest carmaker in the EU, as it caps voting rights and limits board seats at Volkswagen.

144 In addition to the Economic Report of the President, the Department of Commerce launched the *Invest in America* initiative in March 2007. This initiative will reach out to the international investment community, serving as ombudsman in Washington, DC, for the concerns of the international investment community, and will support state and local governments engaged in foreign investment promotion ("Commerce to launch new Federal Initiative to attract foreign investment", *Press Release* 7 March 2007, Department of Commerce, Washington, DC).

145 The Sarbanes-Oxley Act is a federal law in the United States which establishes new and enhanced standards for all United States public company boards, management and public accounting firms.

146 The new EU-12 group comprises the 10 members that joined the EU in 2004, plus Romania and Bulgaria that joined in 2007.

147 In the 10th Annual Global CEO Survey, 43% of the CEOs preferred Europe as their M&A destination, followed by Asia and then North America (PricewaterhouseCoopers, 2007a); a survey by Ernst and Young indicated that Western Europe maintained its lead as the most attractive global investment region with the United States second, and five countries in Europe figured among the global top 10, and Poland and the Czech Republic ranked 7th and 10th respectively (Ernst and Young, 2007).