UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

PART ONE

WORLD INVESTMENT REPORT 2008

Transnational Corporations, and the Infrastructure Challenge

UNITED NATIONS
New York and Geneva, 2008

PART ONE

RECORD FLOWS IN 2007, BUT SET TO DECLINE

CHAPTER I

GLOBAL TRENDS

Globally, foreign direct investment (FDI) inflows continued to rise in 2007: at $1,833 billion, they reached a new record level, surpassing the previous peak of 2000. The financial and credit crisis, which began to affect several economies in late 2007, did not have a significant impact on the volume of FDI inflows that year, but it has added new uncertainties and risks to the world economy. This may have a dampening effect on global FDI in 2008-2009. At the same time, the global FDI market is in a state of flux, making it difficult to predict future flows with any precision.

This chapter examines recent trends in global FDI, cross-border mergers and acquisitions (M&As) and international production. Section A describes their changing geographical and industrial distribution, the relative positions of countries in terms of their transnationalization and inward FDI performance, and recent developments in FDI policies. Section B focuses on the impact of financial crisis that erupted in 2007 and on the depreciation of the dollar on FDI flows. Section C sheds new light on the rise of sovereign wealth funds as direct investors, and section D presents UNCTAD's latest ranking of the world's largest transnational corporations (TNCs). The final section discusses the prospects for FDI, drawing on an UNCTAD survey of 226 large TNCs.

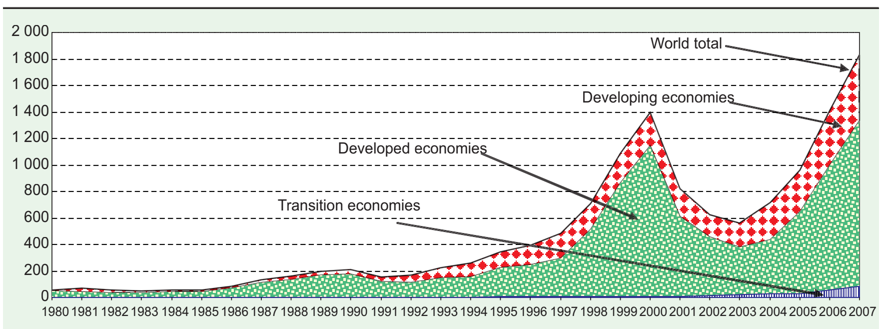
A. FDI and international production

1. Recent trends in FDI

a. Overall trends

Global FDI reached a new record high in 2007, reflecting the fourth consecutive year of growth. With inflows of $1,833 billion, the previous record set in 2000 was surpassed by some $400 billion (figure I.1). All the three major groups of economies – developed countries, developing countries and the transition economies of South-East Europe (SEE) and the Commonwealth of Independent States (CIS) – saw continued growth in FDI.

Figure I.1. FDI inflows: global and by groups of economies, 1980–2007
(Billions of dollars)



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

Since the *WIR* reports the value and growth of FDI flows in United States dollars, their numbers in 2007 could be considered inflated to some extent, due to the significant depreciation of the dollar against other major currencies.[1] Growth rates of dollar-denominated global FDI flows in 2007 diverge from those denominated in local currencies under the current exchange-rate realignment: if denominated in countries' own currencies, the average growth rate of global FDI flows would be 23% in 2006–2007, which is 7% lower than when flows are denominated in United States dollars (table I.1). In all regions and subregions except Central America, FDI inflows grew less in local-currency terms than in dollar terms. The difference was particularly pronounced in the euro zone in 2006–2007, given that the dollar hit a record low against the euro. A similar situation prevailed with respect to flows to South-East Asia, where many Asian currencies (e.g. Malaysian ringgit, Thai baht) appreciated considerably with respect to the dollar. That being said, estimates of global FDI flows in national currencies still point to an increase.

Table I.1.Growth rates of FDI flows denominated in (United States) dollars and in local currencies, 2006–2007
(Per cent)

Host economy	Growth rate of FDI flows denominated in dollars		Growth rate of FDI flows denominated in local currencies [a]	
	2006	2007	2006	2007
World	47.2	29.9	45.5	23.1
Developed economies	53.9	32.6	52.3	24.7
Europe	18.6	41.6	17.3	30.6
EU	12.8	43.0	11.5	31.6
Other developed Europe	421.5	19.9	430.1	14.4
North America	127.3	14.0	124.3	12.1
Developing economies	30.5	21.0	28.9	17.0
Africa	55.3	15.8	53.4	14.1
North Africa	89.2	-3.2	85.9	-5.7
Other Africa	31.2	35.3	30.4	34.4
Latin America	21.6	36.0	18.5	30.6
South America	-3.0	66.9	-7.8	54.9
Central America	1.8	26.6	0.0	27.2
Asia	29.9	17.0	28.9	13.1
West Asia	50.1	11.7	53.4	8.6
South, East and South-East Asia	24.8	18.6	22.6	14.5
East Asia	13.5	18.8	11.8	16.2
South Asia	112.4	18.8	117.5	11.1
South-East Asia	31.1	18.1	25.3	11.8
South-East Europe and CIS	84.6	50.3	78.9	42.2

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

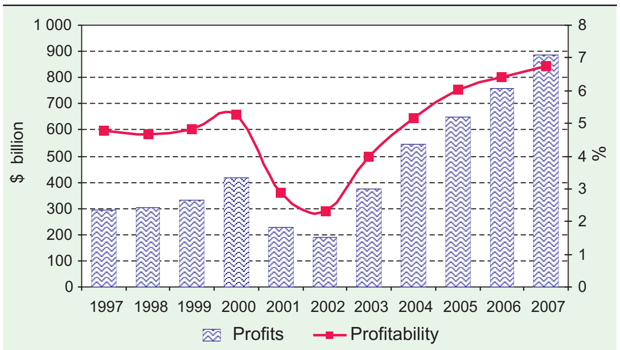
[a] Growth rates for world/region are weighted averages of country growth rates. The weight for each country is its share in the starting year in total FDI flows to the world/region denominated in dollars. Weighted growth rate for world/region is calculated using the following formula:

$$\frac{\sum_i weights_i * growth(x_i)}{\sum_i weights_i}$$

where the growth rate is calculated on the basis of FDI inflows denominated in local currencies.

The continued rise in FDI in 2007 largely reflected relatively high economic growth and strong economic performance in many parts of the world. Increased corporate profits of parent firms (figure I.2) provided funds to finance investment and reduced the impact of decreasing loans from the banks affected by the sub-prime credit crisis. In foreign affiliates, higher profits, amounting to over $1,100 billion in 2007 (figure I.3), contributed to higher reinvested earnings, which accounted for about 30% of total FDI flows in 2007 (figure I.4). These profits are increasingly generated in developing countries rather than in developed countries.[2]

Figure I.2. Profitability[a] and profit levels of TNCs, 1997–2007



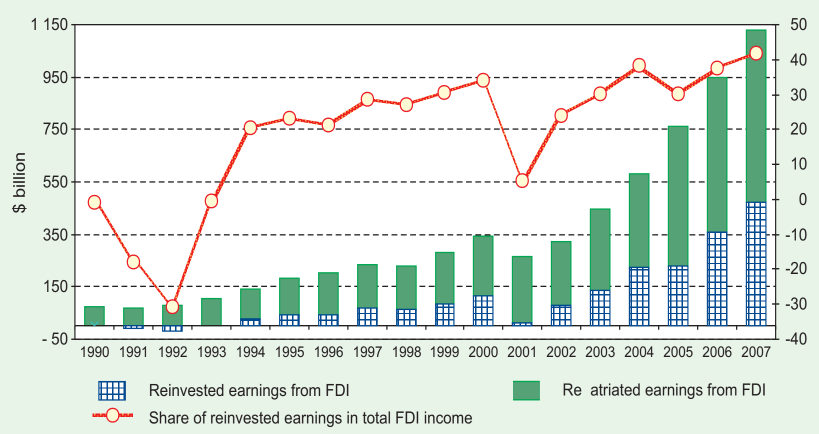
Source: UNCTAD, based on data from Thomson One Banker.
[a] Profitability is calculated as the ratio of net income to total sales.

Note: The number of TNCs covered in this calculation is 989.

The growth in FDI flows was also driven by cross-border M&A activity (figure I.5), which expanded in scope across countries and sectors. Its strong growth and a record number of mega deals (i.e. deals with a transaction value of over $1 billion) (table I.2) pushed the value of total cross-border M&As to a record $1,637 billion in 2007 (annex tables B.4 and B.6) – 21% higher than even the value in 2000 (figure I.5). The number of such transactions grew by 12% to 10,145 (annex tables B.5 and B.7). While the value of cross-border M&As does not exactly match the value of FDI flows, due to different data collection and reporting methodologies (*WIR00*), UNCTAD's revamping of its database and redefining of "cross-border" (box I.1) should improve the relevance of these data from an FDI perspective.

In addition, large TNCs in most industries remained in good financial health, reporting rising profits. In the financial industry, however, liquidity problems of several transnational banks spurred further consolidation, with participation by a number of sovereign wealth funds (SWFs). Meanwhile, the number of greenfield FDI projects decreased from 12,441 in 2006 to 11,703 in 2007 (annex tables A.I.1-A.I.2).[3]

Figure I.3. Worldwide income on FDI and reinvested earnings, 1990–2007



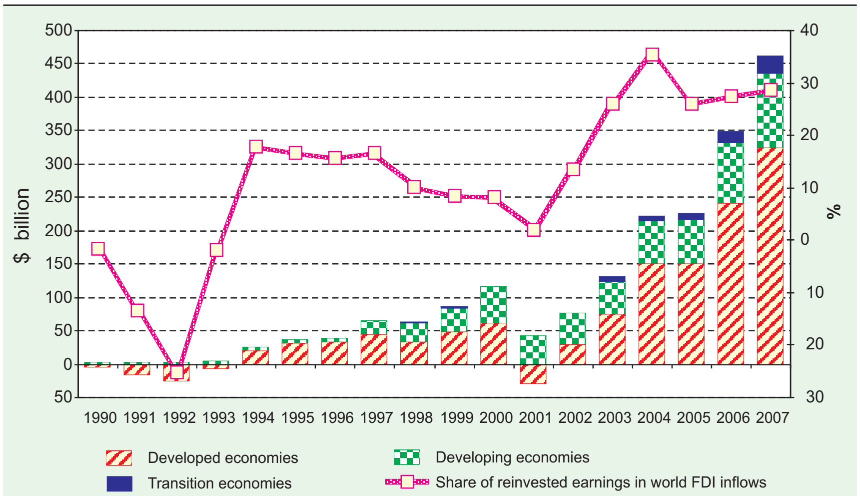
Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

Overall, the financial crisis that began in the second half of 2007 in the United States sub-prime mortgage market did not exert a visible dampening effect on global cross-border M&As that year. The largest deal in 2007, and the largest in banking history – the acquisition of ABN-AMRO Holding NV by the consortium of Royal Bank of Scotland, Fortis and Santander through RFS Holdings BV – took place in late 2007. This period also saw other major mega deals, including the second largest cross-border M&A, which was between Alcan (Canada) and Rio Tinto (United Kingdom) (annex table A.I.3).

However, the current crisis has led to a liquidity crisis in money and debt markets in many developed countries. This liquidity crisis has begun to depress the M&A business in 2008, especially leveraged buyout transactions (LBOs), which normally involve private equity funds. Indeed, the buyout activities by private equity funds, a major driver of cross-border M&As in recent years, are currently slowing down. This contrasts with the situation in

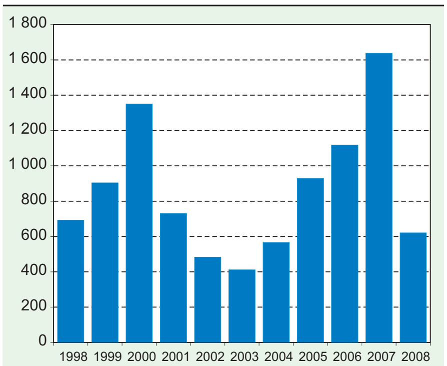
The growth of cross-border M&A activity in recent years, including 2007, was due to sustained strong economic growth in most regions of the world, high corporate profits and competitive pressures that motivated TNCs to strengthen their competitiveness by acquiring foreign firms. In addition, financing conditions for debt-financed M&As were relatively favourable. Despite a change in lending behaviour since mid-2007, caused by a general reassessment of credit risk, the growth of cross-border M&As in the second half of 2007 reached a peak of $879 billion. This was essentially due to the completion of large deals, many of which had begun earlier. More cautious lending behaviour of banks hampered M&A financing in the first half of 2008 (figure I.5), especially the financing of larger acquisitions, which plummeted to their lowest semi-annual level since the first half of 2006. The number of greenfield projects remained almost at the same level in the first quarter of 2008 as in the previous quarter.

Figure I.4. Reinvested earnings of TNCs: value and share in total FDI inflows, 1990–2007



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

Figure I.5. Value of cross-border M&As, 1998–2008
(Billions of dollars)



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

Note: Data for 2008 are only for the first half of the year.

Table I.2. Cross-border M&As valued at over $1 billion, 1987–2008[a]

Year	Number of deals	Percentage of total	Value ($ billion)	Percentage of total
1987	19	1.6	39.1	40.1
1988	24	1.3	53.2	38.7
1989	31	1.1	68.2	40.8
1990	48	1.4	83.7	41.7
1991	13	0.3	31.5	27.0
1992	12	0.3	23.8	21.0
1993	18	0.5	37.7	30.5
1994	36	0.8	72.6	42.5
1995	44	0.8	97.1	41.9
1996	48	0.8	100.2	37.9
1997	73	1.1	146.2	39.4
1998	111	1.4	408.8	59.0
1999	137	1.5	578.4	64.0
2000	207	2.1	999.0	74.0
2001	137	1.7	451.0	61.7
2002	105	1.6	265.7	55.0
2003	78	1.2	184.2	44.8
2004	111	1.5	291.3	51.5
2005	182	2.1	569.4	61.3
2006	215	2.4	711.2	63.6
2007	300	3.0	1 161	70.9
Q1	*54*	*2.1*	*153.7*	*53.7*
Q2	*98*	*3.7*	*359.4*	*76.1*
Q3	*73*	*2.9*	*251.3*	*67.1*
Q4	*75*	*3.1*	*396.9*	*78.7*
2008 [a]	137	3.1	439.4	70.7
Q1	*77*	*3.3*	*259.7*	*73.8*
Q2	*60*	*2.9*	*179.7*	*66.6*

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

[a] First half only.

2007: cross-border M&As involving such funds almost doubled, to $461 billion – the highest share observed to date, accounting for over one quarter of the value of worldwide M&As (table I.3).

With the size of the funds growing, private equity investors have been buying larger, and also publicly listed, companies. Some factors have emerged that raise doubts about the sustainability of FDI activity by private equity funds (*WIR07*). These include a review of the favourable tax rates offered to private equity firms by authorities in some countries and the risks associated with the financial behaviour (e.g. high leverage) of such firms, particularly because of concerns about the availability and cost of credit in the aftermath of the sub-prime mortgage crisis. They also include an ongoing debate in some countries about possible regulation of private equity market participants.[4] An increased regulatory burden could cause the private equity industry to stay away or migrate to more lightly regulated jurisdictions.

Weakened private equity activity reduces the overall amount of FDI in host economies, as such equity can supplement investments by TNCs. In host developing countries, private equity can contribute to the development of a capital market and an equity culture. Such a culture is lacking in many developing-country markets where family-owned and State-owned businesses are dominant. The development of an equity culture can bring in additional capital and lower the cost of funds. From this point of view, the decrease in FDI by private equity funds in 2008 (table I.3) reduces the scope of development of equity markets. However, as long as this slowdown is due to the reduced availability of credit and its increased cost, rather than to tightened regulations, private equity funds are likely to rebound once the financial markets recover, and they should continue to be important direct investors.

Through its dampening effects on cross-border M&As, the decline of buyout transactions in the current financial market crisis is likely to have depressed FDI flows in the beginning of 2008.[5] It is difficult for private equity firms to obtain necessary loan commitments from banks for highly leveraged buyouts. While they raised a new record amount of funds totalling $543 billion in 2007 (Private Equity Intelligence, 2007), their fundraising in the latter half of 2007 declined by 19%, to $254 billion, compared to the first half of that year. However, the decline can be seen as a normalization or return to a more sound and much more sustainable situation (IMF, 2007; ECB, 2007), and a shift towards distressed debt and infrastructure funds from buyout funds. Several institutions had warned for some time that the credit standards for corporate credits, particularly for highly leveraged buyout loans, were too loose and could represent a danger for the financial system.

Table I.3. Cross-border M&As by private equity firms and hedge funds, 1987–2008 [a]
(Number of deals and value)

	Number of deals		Value	
Year	Number	Share in total (%)	$ billion	Share in total (%)
1987	158	13.5	13.4	13.7
1988	203	10.8	12.6	9.2
1989	292	10.7	26.2	15.7
1990	531	15.8	41.0	20.5
1991	648	16.6	28.1	24.0
1992	652	17.5	34.9	30.9
1993	707	17.8	45.3	36.7
1994	720	15.8	35.5	20.8
1995	722	13.1	33.6	14.5
1996	715	12.2	44.0	16.6
1997	782	11.6	55.4	14.9
1998	906	11.3	77.9	11.2
1999	1 147	12.7	86.9	9.6
2000	1 208	12.0	91.6	6.8
2001	1 125	13.9	87.8	12.0
2002	1 126	17.2	84.7	17.5
2003	1 296	19.6	109.9	26.7
2004	1 613	22.2	173.7	30.7
2005	1 707	19.9	211.0	22.7
2006	1 649	18.2	282.6	25.3
2007	1 813	17.9	461.0	28.2
Q1	*441*	*17.1*	*75.1*	*26.2*
Q2	*520*	*19.7*	*181.8*	*38.5*
Q3	*417*	*16.6*	*115.4*	*30.8*
Q4	*435*	*18.0*	*88.8*	*17.6*
2008 [a]	715	16.4	193.7	31.2
Q1	*338*	*16.8*	*131.5*	*37.4*
Q2	*327*	*15.9*	*62.2*	*23.1*

Source: UNCTAD cross-border M&As database.

[a] First half only.

Note: Private equity firms and hedge funds refer to acquirers whose industry is classified under "investors not elsewhere classified". This classification is based on that used by the Thomson Finance database on M&As.

Box I.1. Revision of the UNCTAD database on cross-border M&As

Starting with this year's *WIR*, data on cross-border M&As have been revised to cover all cases for which at least one of the four entities (immediate acquiring company, immediate target company, ultimate acquiring company and ultimate target company) is located in an economy other than that of the other entities. Previously, and including the data reported in *WIR07,* cross-border M&As were defined as those deals in which the target company was not located in the same country as the ultimate acquiring company. The data therefore excluded the following kinds of deals: (a) deals where the acquiring domestic company is located in the same country as the acquired foreign company (referred to as case 2 in annex table A.I.4); and (b) deals where the ultimate acquiring foreign company is located in the same country as the acquired domestic company (referred to as case 9). These cases were not considered "cross-border" in the M&A database, even if the economy of the ultimate target company was different from that of the ultimate acquiring company (case 2). (For a brief description of all 11 cases, see annex table A.I.4.) Indeed, there were many transactions categorized under case 2 in Latin America, and these have become an important element of the FDI trend in the region (see section on Latin America and the Caribbean in Chapter II).

International standards for reporting FDI data, as compiled for balance-of-payments purposes, recommend that data be compiled also on the basis of ultimate host and home economy in addition to those on the immediate basis (paragraph 346 of OECD's Benchmark Definition of FDI).[a] In reality, compilation based on immediate host and home economy is a common practice used in many countries. All transactions between the direct investor (parent firm) and the direct investment enterprise (foreign affiliate) are recorded as either assets or liabilities in balance-of-payments transactions. Following this recommendation, on the ultimate host/home country basis, although they are undertaken within the same economy, the deals under cases 2, 3, 7 and 8 in annex table A.I.4 should be reflected in FDI flow data.[b] In the UNCTAD cross-border M&A database, all transactions are now recorded on the basis of ultimate host (target) and acquiring (home) country. Thus, for example, a deal in which an Argentine domestic company acquired a foreign company operating in Argentina, in the new system this deal is recorded showing Argentina as the acquiring country, and the foreign country is the target country.

The data on cross-border M&As presented in this *WIR* are not strictly comparable to those presented in previous *WIRs*, as there are significant differences in the total number and value of the deals included under the old and new methodologies.

Source: UNCTAD.

[a] "FDI statistics should be compiled by immediate partner country using the debtor/creditor principle… (I)n addition, it is strongly encouraged that supplemental inward FDI position statistics be compiled on an ultimate investing country basis" (OECD, 2008a, paragraph 346).

[b] Value of deals under case 2 would be recorded as negative FDI inflows to the host economy (i.e. the economy where the acquired firm is located or from which the sale takes place), while those under cases 3 and 8 would be recorded as (positive). In case 7, as the ultimate host and home country is the same, the value of the deal would be recorded as both divestment and new investment in this economy, and, overall, the net impact on the level of FDI in the host/home country is null.

b. Geographical patterns

Virtually all the major geographical regions registered record inflows as well as outflows in 2007. However, higher growth rates of FDI inflows to developed countries than to developing countries reduced the share of developing countries in FDI inflows from 29% to 27% (annex table B.1). Regarding outflows, the share of developing countries also declined from 16% to 13%. By contrast, the share of economies in transition (i.e. South-East Europe and CIS) rose for both inflows and outflows.

(i) Developed countries

FDI inflows into developed countries grew once again in 2007, for the fourth consecutive year, to reach $1,248 billion – 33% more than in 2006 (figure I.6; annex table B.1). Flows to the United Kingdom, France and the Netherlands were particularly buoyant. The United States maintained its position as the largest FDI recipient country, while the European Union (EU) as a whole continued to be the largest host region within the developed-country group, attracting almost two thirds of total FDI inflows to the group in 2007. The increase in FDI inflows to developed countries reflected relatively strong economic growth in those countries in 2007. Continued robust corporate profits and rising equity prices further stimulated cross-border M&As, particularly in the first half of 2007.

Outflows from developed countries in 2007 grew even faster than their inflows. They increased by 56% to the unprecedented level of $1,692 billion, exceeding inflows by $445 billion. The continued upswing of outward FDI was mainly driven by greater financial resources from high corporate profits (figure I.2). While the United States maintained its position as the largest source of FDI in 2007, outflows from the EU countries nearly doubled, to $1,142 billion.

The various risks prevailing in the world economy are likely to influence FDI flows to and from developed countries in 2008. High and volatile commodity prices and food prices may cause inflationary pressures, and a further tightening of financial market conditions cannot be excluded. The growing probability of a recession in the United

States and uncertainties about its global repercussions may cause investors to adopt a more cautious attitude (see section E below). These considerations point to a dimming of FDI prospects in developed countries.

(ii) Developing countries

FDI inflows into developing countries rose by 21% (figure I.6), to reach a new record level of $500 billion (chapter II). Those to least developed countries (LDCs) alone reached $13 billion, a 4% increase over the previous year.

- In *Africa*, FDI inflows in 2007 rose to a historic high of $53 billion. The inflows were supported by a continuing boom in global commodity markets. Cross-border M&As in the extraction industries and related services continued to be a significant source of FDI, in addition to new inbound M&A deals in the banking industry. Nigeria, Egypt, South Africa and Morocco were the largest recipients (chapter II). These cases may illustrate a trend towards greater diversification of inflows in some countries, away from traditional sectors (e.g. oil, gas and other primary commodities).
- FDI inflows to *South, East and South-East Asia, and Oceania* maintained their upward trend in 2007, reaching a new high of $249 billion, an increase of 18% over 2006. They accounted for half of all FDI to developing economies. At the subregional level, there was a further shift towards South and South-East Asia, although China and Hong Kong (China) remained the two largest FDI destinations in the region.
- In *West Asia*, overall, inward FDI increased by 12% to $71 billion, sustaining a period of steady growth in inflows. Turkey and the oil-rich Gulf States continued to attract the most FDI, but geopolitical uncertainty in parts of the region affected overall FDI. Saudi Arabia became the largest host economy in the region, overtaking Turkey.
- FDI inflows into *Latin America and the Caribbean* increased by 36%, to a record level of $126 billion. Significant increases were recorded in the region's major economies, especially Brazil and Chile where inflows doubled. Contrasting with the experience of the 1990s, the strong FDI growth was driven mainly by greenfield investments (new investments and expansion) rather than cross-border M&As. This pattern was the result of strong regional economic growth and high corporate profits due to rising commodity prices. Natural-resource-based manufacturing accounted for a large proportion of inward FDI to Brazil, for example.

FDI outflows from the developing world remained high in 2007 at $253 billion.

- More *African* TNCs expanded their activities within and outside the region, driving FDI outflows from the region to $7 billion on average in the past two years.
- *South, East and South-East Asia and Oceania*, with FDI outflows of $150 billion in 2007, has become a significant source of FDI, particularly for other developing countries both within and outside the region.
- With the doubling of FDI outflows from *West Asia* to $44 billion, this region remains an important source of FDI, led by the countries of the Gulf Cooperation Council (GCC). SWFs based in the subregion have also accounted for a major proportion of FDI.

Figure I.6. FDI flows, by region, 2005–2007
(Billions of dollars)

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

- FDI outflows from *Latin America and the Caribbean* fell by 17% in 2007, to around $52 billion. This was due to the decline in outflows from Brazil to $7 billion following the exceptionally high level of $28 billion reached in 2006.[6]

(iii) South-East Europe and CIS

FDI inflows into the transition economies of South-East Europe and CIS increased significantly by 50% to reach a new record of $86 billion in 2007 – the seventh year of uninterrupted growth of FDI flows to the region. Inflows to the region's largest recipient, the Russian Federation, rose by 62% (annex table B.1). Interest in the Russian Federation as an FDI destination does not seem to have been greatly affected by the tightening of Russian regulations relating to strategic industries, including natural resources, or by disputes over environmental protection and extraction costs. Thus, overall, FDI inflows into the region remained buoyant.

FDI outflows from South-East Europe and CIS also rose to record levels in 2007, reaching $51 billion – more than twice as high as the previous year. FDI from the Russian Federation reached a new high in 2007 ($46 billion).

c. Sectoral patterns

In recent years there has been a significant increase in FDI flows to the primary sector, mainly the extractive industries, and a consequent increase in the share of that sector in global FDI flows and stock (*WIR07*: 22 and annex tables A.I.5-A.I.8). The primary sector's share in world FDI is now back to a level comparable to that of the late 1980s. The services sector still accounts for the largest share of global FDI stocks and flows, while the share of manufacturing has continued to decline.

In 2006, the primary sector's share of the estimated total world inward FDI stock stood at 8%, and the sector accounted for 13% of world FDI inflows in the period 2004–2006. There has been some recent levelling off of FDI flows to the primary sector, as indicated by FDI flow data as well as data on cross-border M&As and greenfield investment projects. The value of cross-border M&As in the sector declined from $156 billion in 2005 to $109 billion in 2006, and recovered only partially (to $110 billion) in 2007 (annex table B.6). The increase in FDI in the primary sector in 2007 was more evident in greenfield investments. Their number rose from 463 in 2005 to 490 in 2006 and 605 in 2007 (annex table A.I.2).

Manufacturing accounted for nearly one third of the estimated world inward FDI stock in 2006, but for only a quarter of world FDI inflows in the period 2004–2006 (annex tables A.I.5 and A.I.7). Its share in world inward FDI stock has fallen noticeably since 1990 – in both developed and developing economies – declining by more than 10 percentage points. In 2007, there was a significant upsurge of cross-border M&As in manufacturing, with cross-border M&A deals in that sector rising by over 86%, compared with increases of 1% and 36% in the primary and services sectors respectively (annex table B.6).

The services sector accounted for 62% of estimated world inward FDI stock in 2006, up from 49% in 1990 (annex table A.I.5). Nearly all of the major service groups have benefited from the shift of FDI towards services that began more than a quarter century ago. In the case of some services, such as trade and financial services, the increase began well before 1990, when they accounted for 12% and 20%, respectively, of total inward FDI stock globally. While trade, financial services and business activities continue to account for the lion's share of FDI in the sector, other services, including infrastructure, have begun to attract increasing shares of FDI since the 1990s. For example, the value of cross-border M&As worldwide in electricity, gas and water rose from $63 billion (about 6% of total sales) in 2006 to $130 billion (nearly 8% of the total) in 2007 (annex table B.6). The slow but steady increase in the share of infrastructure industries in FDI, including in developing countries, raises questions as to how FDI can contribute to development in general and to progress towards meeting the Millennium Development Goals (MDGs), in particular, through more and better infrastructure services for the poor. These issues are examined in Part Two of this report.

2. International production

Indicators of international production, such as sales, value added, assets, employment and exports of foreign affiliates, enable a better assessment of the impact of FDI (table I.4). They throw direct light on host-country production activity associated with FDI worldwide, and the importance of foreign affiliates in the world economy. Today, an estimated 79,000 TNCs control some 790,000 foreign affiliates around the world (annex table A.I.9). Their production continues to grow. For example, the value-added activity (gross product) of foreign affiliates worldwide accounted for 11% of global GDP in 2007. Sales amounted to $31 trillion, about one fifth of which represented exports, and the number of employees reached 82 million.

However, the above discussion at the global level conceals country differences in international production as measured by various indicators. This is why, as of 2007, the *World Investment Report* (*WIR)* started to analyse one specific indicator of international production: employment in foreign affiliates. This variable was examined to show the direct impact of FDI on host economies. This year's *WIR* considers another variable frequently used to examine the level of international production: sales of foreign affiliates.

Country-level data show significant differences between countries in the relationship between sales of foreign affiliates and inward FDI stock as well as affiliates' output (table I.5). They also show a noticeable difference between the three sectors: the ratio of sales to inward stock is generally the lowest in the primary sector, and the highest in manufacturing, while that for the services sector falls in between. Sales are generally 5-6 times higher than value added, but there are differences by sector, with a given amount of sales corresponding to more value added in manufacturing than in services. In Latvia, Slovakia and Slovenia, for example, manufacturing generates more value added than in other countries, judging from data on value added per dollar of FDI stock (table I.5). Country and/or sectoral differences reflect the nature of the sales data, which include value added in production in the host country as well as the value of purchased inputs (imported as well as domestic suppliers). Thus the implications of an increase or decrease in sales for host and home countries may differ somewhat, depending on which of the factors mentioned are relevant. An analysis with regard to exports should be also examined in this context.

The UNCTAD Transnationalization Index of host economies, incorporating both FDI and international production indicators (value added and employment), measures the extent to which a host country's economy is transnationalized (figure I.7). The ranking has not changed much over the years, with Belgium, Hong Kong (China) and the former Yugoslav Republic of Macedonia being the most transnationalized of the developed, developing and transition economies, respectively, in 2005 (the most recent year for which data are available).

3. Indices of FDI performance and potential

Since *WIR02*, UNCTAD has provided indicators to measure the amount of FDI countries

Table I.4. Selected indicators of FDI and international production, 1982–2007

Item	Value at current prices ($ billion)				Annual growth rate (Per cent)						
	1982	1990	2006	2007	1986-1990	1991-1995	1996-2000	2004	2005	2006	2007
FDI inflows	58	207	1 411	1 833	23.6	22.1	39.9	27.9	33.6	47.2	29.9
FDI outflows	27	239	1 323	1 997	25.9	16.5	36.1	63.5	-4.3	50.2	50.9
FDI inward stock	789	1 941	12 470	15 211	15.1	8.6	16.1	17.3	6.2	22.5	22.0
FDI outward stock	579	1 785	12 756	15 602	18.1	10.6	17.2	16.4	3.9	20.4	22.3
Income on inward FDI	44	74	950	1 128	10.2	35.3	13.1	31.3	31.1	24.3	18.7
Income on outward FDI	46	120	1 038	1 220	18.7	20.2	10.2	42.4	27.4	17.1	17.5
Cross-border M&As [a]	..	200	1 118	1 637	26.6[b]	19.5	51.5	37.6	64.2	20.3	46.4
Sales of foreign affiliates	2 741	6 126	25 844[c]	31 197[c]	19.3	8.8	8.4	15.0	1.8[c]	22.2[c]	20.7[c]
Gross product of foreign affiliates	676	1 501	5 049[d]	6 029[d]	17.0	6.7	7.3	15.9	5.9[d]	21.2[d]	19.4[d]
Total assets of foreign affiliates	2 206	6 036	55 818[e]	68 716[e]	17.7	13.7	19.3	-1.0	20.6[e]	18.6[e]	23.1[e]
Export of foreign affiliates	688	1 523	4 950[f]	5 714[f]	21.7	8.4	3.9	21.2	12.8[f]	15.2[f]	15.4[f]
Employment of foreign affiliates (thousands)	21 524	25 103	70 003[g]	81 615[g]	5.3	5.5	11.5	3.7	4.9[g]	21.6[g]	16.6[g]
GDP (in current prices)	12 083	22 163	48 925	54 568[h]	9.4	5.9	1.3	12.6	8.3	8.3	11.5
Gross fixed capital formation	2 798	5 102	10 922	12 356	10.0	5.4	1.1	15.2	12.5	10.9	13.1
Royalties and licence fee receipts	9	29	142	164	21.1	14.6	8.1	23.7	10.6	10.5	15.4
Exports of goods and non-factor services	2 395	4 417	14 848	17 138	11.6	7.9	3.8	21.2	12.8	15.2	15.4

Source: UNCTAD, based on its FDI/TNC database (www.unctad.org/fdi statistics), UNCTAD, *GlobStat*, and IMF, *International Financial Statistics*, June 2008.

[a] Data are only available from 1987 onward.

[b] 1987-1990 only.

[c] Data for 2006 and 2007 are based on the following regression result of sales against inward FDI stock (in $ million) for the period 1980-2005: sales=1 484.6302+1.9534* inward FDI stock.

[d] Data for 2006 and 2007 are based on the following regression result of gross product against inward FDI stock (in $ million) for the period 1982-2005: gross product=591.8813+0.3574* inward FDI stock.

[e] Data for 2006 and 2007 are based on the following regression result of assets against inward FDI stock (in $ million) for the period 1980-2005: assets= -2 874.9859+4.7066* inward FDI stock.

[f] For 1995-1997, based on the regression result of exports of foreign affiliates against inward FDI stock (in $ million) for the period 1982-1994: exports=138.9912+0.6414*FDI inward stock. For 1998-2007, the share of exports of foreign affiliates in world exports in 1988 (33%) was applied to obtain the value.

[g] Based on the following regression result of employment (in thousands) against inward FDI stock (in $ million) for the period 1980-2005: employment=1 7164.7284+4.2372* inward FDI stock.

[h] Based on data from the IMF, *World Economic Outlook*, April 2008.

Note: Not included in this table are the values of worldwide sales by 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 world outward FDI stock.

receive or invest abroad relative to the size of their economies (Inward FDI Performance Index and Outward FDI Performance Index respectively), and their potential to attract FDI flows (Inward FDI Potential Index).[7] In 2007, among the top 20 economies listed by the Performance Indices for both inward and outward FDI, relatively small countries continued to rank high (table I.6; annex table A.I.10). The trend has not changed significantly over the past few years. Notable changes include the move upwards of Cyprus, Egypt and the Republic of Moldova among the top 20 rankings for inward FDI performance, and Austria, Denmark and the United Kingdom for outward FDI performance.

The ranking of countries according to the UNCTAD Performance and Potential Indices yields the following matrix: front-runners (i.e. countries with high FDI potential and performance); above potential (i.e. countries with low FDI potential but strong performance); below potential (i.e. countries with high FDI potential but low performance); and under-performers (i.e. countries with both low FDI potential and performance). In 2006 (not 2007 because of data limitations for deriving the Potential Index), Oman, Saudi Arabia, Sweden and Tunisia joined the group of front-runners, and Nigeria, Peru and Togo joined the above-potential group (figure I.8).

4. New developments in FDI policies

a. Developments at the national level

Despite growing concerns and political debate over rising protectionism,[8] the overall policy trend continues to be towards greater openness towards FDI. UNCTAD's annual survey of changes in national laws and regulations that may influence the entry and operations of TNCs suggests that policymakers are continuing to seek ways of making the investment climate in their countries more attractive. In 2007, only 98 policy changes that affect FDI were identified by UNCTAD – the lowest number since 1992. The nature of the changes was similar to that observed over the past few years: 24 of the 98 changes were less favourable, most of which were related to extractive industries or reflected national security concerns; the remaining 74 changes were in the direction of making the host-country environment more favourable to FDI (table I.7).

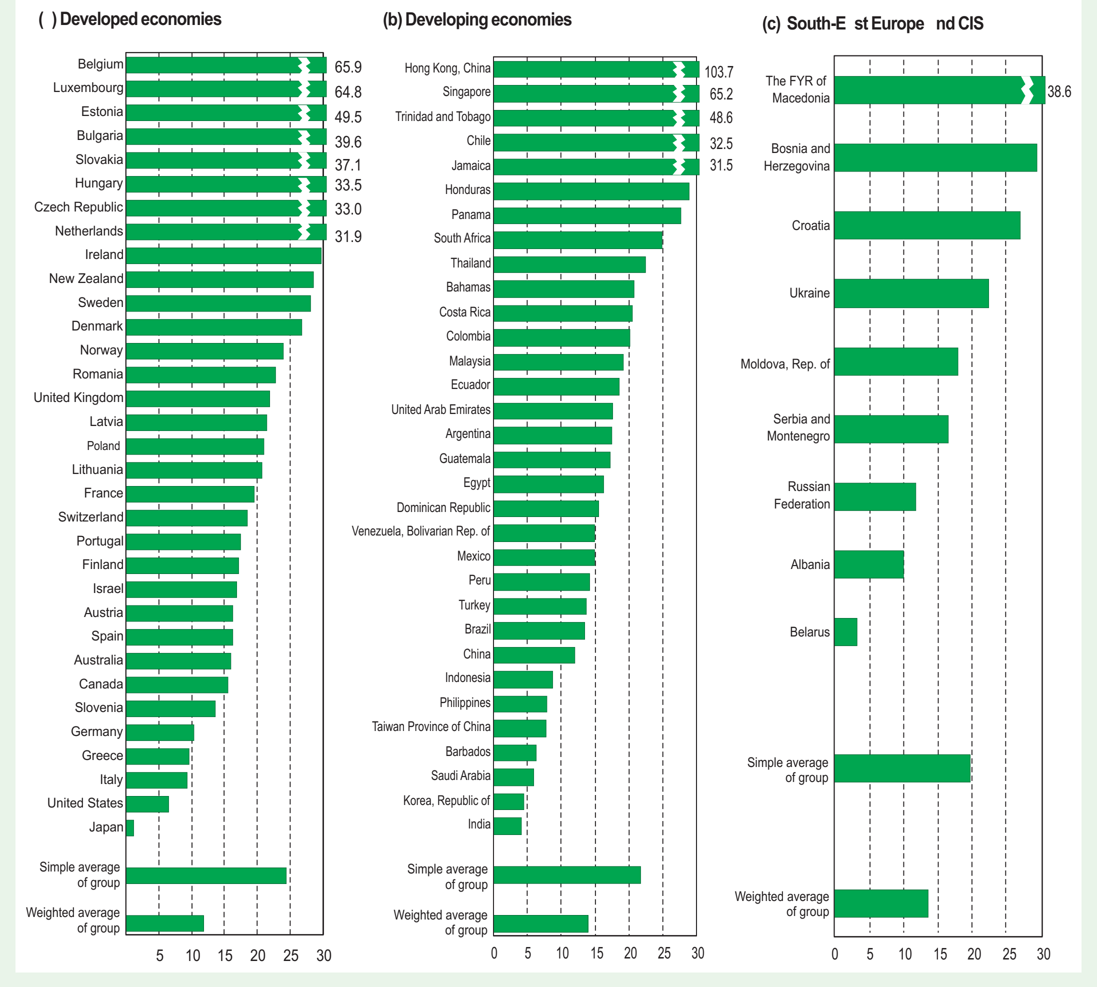
Many countries adopted new measures to attract FDI, such as offering various incentives or the establishment of special economic zones (SEZs). There was an ongoing trend to lower corporate income taxes in both developed and developing countries, and the number of countries with flat tax systems[9] continued to grow (table I.8). For example, while Iceland's corporate income tax rate has been cut steadily, from 50% in the late 1980s to the current level of 18%, in 2007 the country introduced a flat rate of

Table I.5. Sales and value added of foreign affiliates and inward FDI stock in host developing and former transition economies, most recent available year

Host economy	Year	Sector	Sales ($ million)	Value added ($ million)	Inward FDI stock ($ million)	Ratio of sales to inward FDI stock (in $)	Ratio of value added to inward FDI stock (in $)
Bulgaria	2004	Total	17 861	3 000	10 108	1.8	0.3
		Primary	..	..	156	..	..
		Manufacturing	8 593	1 387	2 611	3.3	0.5
		Services	9 269	1 613	7 263	1.3	0.2
China	2004	Total	698 718	..	245 467	2.8	..
		Primary	3 259	..	10 637	0.3	..
		Manufacturing	676 445	..	163 645	4.1	..
		Services	19 014	..	71 185	0.3	..
Czech Republic	2005	Total	112 535	22 347	60 662	1.9	0.4
		Primary	360	106	363	1.0	0.3
		Manufacturing	56 768	11 404	23 112	2.5	0.5
		Services	55 407	10 836	37 188	1.5	0.3
Estonia	2004	Total	8 362	1 789	10 064	0.8	0.2
		Primary	42	12	102	0.4	0.1
		Manufacturing	3 130	796	1 686	1.9	0.5
		Services	5 190	980	8 250	0.6	0.1
Hong Kong, China	2004	Total	232 772	45 760	453 060	0.5	0.1
		Manufacturing	9 362	2 051	8 836	1.1	0.2
		Services	223 399	43 707	435 890	0.5	0.1
Hungary	2005	Total	104 502	16 949	61 886	1.7	0.3
		Primary	..	45	271	..	0.2
		Manufacturing	56 583	11 525	22 847	2.5	0.5
		Services	47 919	5 379	31 116	1.5	0.2
Latvia	2004	Total	8 380	1 648	4 529	1.9	0.4
		Primary	..	..	97	..	..
		Manufacturing	1 402	420	534	2.6	0.8
		Services	6 978	1 228	3 382	2.1	0.4
Lithuania	2005	Total	14 008	2 444	8 211	1.7	0.3
		Primary	..	..	113	..	..
		Manufacturing	6 957	1 289	3 250	2.1	0.4
		Services	7 051	1 155	4 847	1.5	0.2
Romania	2005	Total	39 864	7 354	25 818	1.5	0.3
		Primary	..	..	1 890	..	..
		Manufacturing	17 999	3 427	9 638	1.9	0.4
		Services	21 865	3 926	14 106	1.6	0.3
Singapore	2002	Total	61 313	..	38 282	1.6	..
		Manufacturing	61 313	..	38 282	1.6	..
Slovakia	2005	Total	42 308	6 814	13 053	3.2	0.5
		Primary	..	..	138	..	..
		Manufacturing	26 719	4 605	5 235	5.1	0.9
		Services	15 589	2 209	7 680	2.0	0.3
Slovenia	2005	Total	14 954	1 735	7 055	2.1	0.2
		Primary	11	0	6	1.8	0.0
		Manufacturing	7 330	1 735	3 085	2.4	0.6
		Services	7 613	0	3 969	1.9	0.0

Source: UNCTAD, based on data from its FDI/TNC database (www.unctad.org/fdistatsitics) and data provided by Eurostat.

Figure I.7. Transnationality index[a] for host economies,[b] 2005



Source: UNCTAD estimates.

[a] Average of the four shares : FDI inflows as a percentage of gross fixed capital formation for the past three years 2003-2005; FDI inward stocks as a percentage of GDP in 2005; value added of foreign affiliates as a percentage of GDP in 2005; and employment of foreign affiliates as a percentage of total employment in 2005.

[b] Only the economies for which data for all of these four shares are available were selected. Data on value added were available only for Australia (2001), Austria (2003) Belarus (2002), Bulgaria, China (2003), Czech Republic, Estonia (2004), France, Hong Kong (China), Hungary, Italy (2004), Ireland (2001), Japan, Latvia (2004), Lithuania, Republic of Moldova, Netherlands (2004), Singapore (manufacturing only,2004), Portugal, Romania, Slovakia, Slovenia (2004), Spain, Sweden, and the United States. For Albania, the value added of foreign owned firms 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 were available only for Australia (2001), Austria (2003), Bulgaria, China (2004), Czech Republic, Estonia (2004), France (2003), Germany, Hungary, Hong Kong (China) (2004), Italy (2004), Ireland (2001), Japan, Latvia (2004), Lithuania, Luxembourg (2003), Netherlands (2004), Poland (2000), Portugal, Republic of Moldova (2004), Romania, Singapore (manufacturing only, 2004), Slovakia, Slovenia (2004), Spain, Sweden, Switzerland and the United States. 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 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, Bulgaria, Czech Republic, Estonia, Finland, Hungary, Italy, Latvia, Lithuania, Netherlands, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden.

10% on income from interest, dividends, capital gains and rents. Tax reductions were also implemented in Colombia (from 38.5% to 33%), Bulgaria (from 15% to 10%) and the former Yugoslav Republic of Macedonia (flat corporate income tax rate of 10%). Reduced corporate taxes are often justified by the need to stay competitive as locations for inward FDI.

Other countries introduced new promotional measures or improved their existing ones. In March 2007, for example, the United States Department of Commerce launched the Invest in America initiative, the first Federal-level plan to encourage foreign investment since the 1980s (chapter II.C).[10] Besides promoting the United States as an investment destination, it will serve as a contact point for international investors, and support State and municipal level efforts to attract inward FDI. Other countries, including Honduras, Peru and the Russian Federation, introduced special taxes and/or tariff regimes in SEZs and other zones. The overall trend towards providing more incentives to foreign investors was accompanied by continued liberalization of various economic activities, ranging from reinsurance services in Brazil to fixed-line telephony in Latvia.

As in 2006, the extractive industries represented the main exception to the liberalization

Table I.6. Top 20 rankings by Inward and Outward Performance Indices, 2006 and 2007 [a]

Inward FDI Performance Index ranking			Outward FDI Performance Index ranking		
Economy	2006	2007	Economy	2006	2007
Hong Kong, China	2	1	Luxembourg	3	1
Bulgaria	3	2	Iceland	1	2
Iceland	4	3	Hong Kong, China	2	3
Malta	5	4	Switzerland	4	4
Bahamas	8	5	Panama	5	5
Jordan	7	6	Belgium	7	6
Singapore	6	7	Netherlands	6	7
Estonia	9	8	Kuwait	12	8
Georgia	15	9	Bahrain	11	9
Lebanon	13	10	Singapore	8	10
Guyana	20	11	Ireland	9	11
Bahrain	12	12	Sweden	13	12
Belgium	10	13	Spain	14	13
Gambia	11	14	France	18	14
Panama	16	15	Estonia	17	15
Mongolia	19	16	United Kingdom	21	16
Tajikistan	18	17	Israel	15	17
Cyprus	24	18	Norway	16	18
Moldova, Republic of	27	19	Austria	23	19
Egypt	31	20	Denmark	33	20

Source: UNCTAD, annex table A.I.10.

[a] Countries are listed in the order of their 2007 rankings. Rankings based on indices derived using three-year moving averages of data on FDI flows and GDP for the three years immediately preceding the year in question including that year.

a review of all contracts relating to the exploitation of natural resources, ostensibly to ensure that licence terms were not being violated. As a result, foreign investors may face more onerous contract terms. However, to what extent these will deter prospective investors remains uncertain, given Kazakhstan's large oil resources and the high price of oil.

The nature and significance of other changes not favourable to FDI have varied. The most common reasons for countries' concerns over increased foreign ownership were related to national security, especially with regard to investments by SWFs and State-owned firms. For example, in the United States and the Russian Federation, stricter regulations were adopted concerning foreign investment projects with potential implications for national security. Reflecting the changing economic and political conditions in the world economy, the United States Government Accountability Office (GAO) reviewed this trend in a report covering 11 countries (box I.2) and concluded that "each country has changed or considered changing its foreign investment laws, policies, or processes in the last 4 years; many of the changes demonstrate an increased emphasis on national security concerns" (United States GAO, 2008: 3).

The growing role of SWFs as overseas investors has triggered much policy discussion (section C). Germany has been actively working with the EU to establish rules for those funds at the European level. The main concern among some developed countries appears to be that the funds may buy stakes in strategic industries to gain access to and knowledge of latest

Figure I.8. Matrix of inward FDI performance and potential, 2006

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

Source: UNCTAD, based on annex table A.I.10.

trend (see *WIR07*). On the back of further increases in commodity prices, several natural-resource-exporting countries introduced new sectoral or ownership restrictions.[11] In Bolivia, the State-owned oil company, YPFB, reclaimed full control of two main oil refineries from Petrobras (Brazil). The Government also announced plans to increase taxes substantially on mining companies. Ecuador similarly raised the State's share of the profits gained in the hydrocarbons sector. Meanwhile, the Government of the Bolivarian Republic of Venezuela took control of a number of oil projects, including the Cerro Project, resulting in the filing of new claims by the foreign investor, ExxonMobil (United States).[12] While this trend was the most prominent in Latin America (*WIR07* and chapter II of this report), it was also evident elsewhere. In Kazakhstan, for example, the Government announced

Table I.7. National regulatory changes, 1992–2007

Item	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Number of countries that introduced change	43	56	49	63	66	76	60	65	70	71	72	82	103	92	91	58
Number of regulatory changes	77	100	110	112	114	150	145	139	150	207	246	242	270	203	177	98
More favourable	77	99	108	106	98	134	136	130	147	193	234	218	234	162	142	74
Less favourable	0	1	2	6	16	16	9	9	3	14	12	24	36	41	35	24

Source: UNCTAD database on national laws and regulations.

technology (box I.2). In addition to the above national security concerns, resistance to investment in 2007 was also a response to planned takeovers of "national champions", as illustrated by the failed bid by E.ON (Germany) for the national utility company, Endesa (Spain).

Developed countries accounted for 36 of the identified regulatory changes (26 of which were in Europe), while in developing and transition economies, there were 15 identified changes in Africa, 14 in South, East and South-East Asia, 10 in Latin America and the Caribbean, 8 in West Asia, 8 in CIS and 7 in South-East Europe. A relatively high proportion of the observed regulatory changes were "less favourable" in Latin America and the Caribbean. This mainly reflected regulatory amendments (discussed above) for the extractive industries (figure I.9). Notable regional differences remain. FDI policy changes at the regional level are described in more detail in the respective regional trend sections in chapter II of this *WIR*.

Table I.8. Countries with a flat tax, 2007
(Percentage tax rate)

Economy	Individual	Corporate
Estonia	22	24
Georgia	12	20
Hong Kong (China)	16	17.5
Iceland	36	18
Kyrgyzstan	10	10
Latvia	25	15
Lithuania	27	15
Mongolia	10	25
Romania	16	16
Russian Federation	13	24
Slovakia	19	19
The FYR of Macedonia	12	10
Ukraine	15	25

Source: UNCTAD, based on Mitchell, 2007.

b. Developments at the international level

In 2007, the universe of international investment agreements (IIAs) continued to expand, with a marked variation among regions. Fewer bilateral investment treaties (BITs), double taxation treaties (DTTs) and other international agreements that include investment provisions were concluded than in previous years, particularly BITs.

(i) Bilateral investment treaties

In 2007, 44 new BITs were signed, bringing the total number of agreements to 2,608. The number of countries now parties to such agreements has reached 179 following the BIT concluded by Montenegro (its first BIT ever as an independent State) with the Netherlands (figure I.10).

Asian countries were the most active, concluding 29 new BITs. This confirms a sustained high level of commitment from policymakers in this region for closer economic integration and investment

Box I.2. FDI and national security: report of the United States Government Accountability Office

In February 2008, the United States Government Accountability Office (GAO) published a report that reviews the foreign investment regimes of 10 other countries.[a] The aim was to identify the mechanisms and criteria which countries use to balance the benefits of foreign investment with national security concerns, and to compare them with the United States.

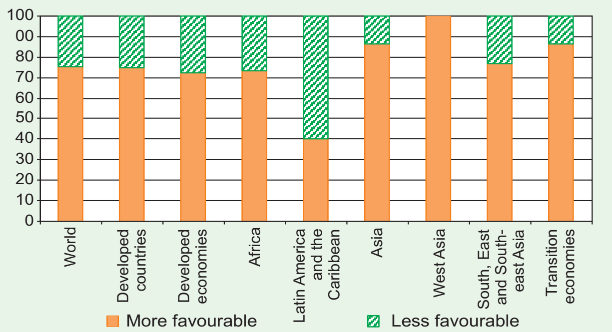
The GAO report concluded that all the countries reviewed had enacted laws and instituted policies regulating foreign investment, many to address national security concerns. However, each of the 11 countries had its own concept of national security that influenced what investments may be restricted. Restrictions ranged from requiring approval of investments in a narrowly defined defence sector, to broad restrictions based on economic security and cultural policy. In addition, some countries have recently made changes to their laws and policies to identify national security more explicitly as an area of concern, following some controversial investments. The report also noted that several countries had introduced lists of strategic sectors that required government review and approval.

Eight countries use a formal process to review transactions; only the Netherlands and the United Arab Emirates do not have a formal review process. The Netherlands, however, restricts entry into certain sectors such as public utilities, and the United Arab Emirates limits ownership in all sectors. During the formal review process, national security is a primary factor or one of several factors considered. All countries were reported to share concerns about a core set of issues, including, for example, the defence industrial base, and, more recently, investment in the energy sector and investment by State-owned enterprises and SWFs. Most countries have established time frames for the review and placed conditions on transactions prior to approval. For example, a country may have national citizenship requirements for company board members. Most countries' reviews are mandatory if the investment reaches a certain size, or if the buyer would achieve a controlling or blocking share in the acquired company. Five countries (France, Germany, India, Japan and the Russian Federation) allow decisions to be appealed through administrative means or in court. In addition to the formal mechanisms, there are unofficial factors that may influence investment in each of the 11 countries. For example, in some countries an informal pre-approval by the government may be needed for sensitive transactions.

Source: UNCTAD, based on United States GAO, 2008.

[a] The countries were Canada, China, France, Germany, India, Japan, the Netherlands, the Russian Federation, the United Arab Emirates and the United Kingdom.

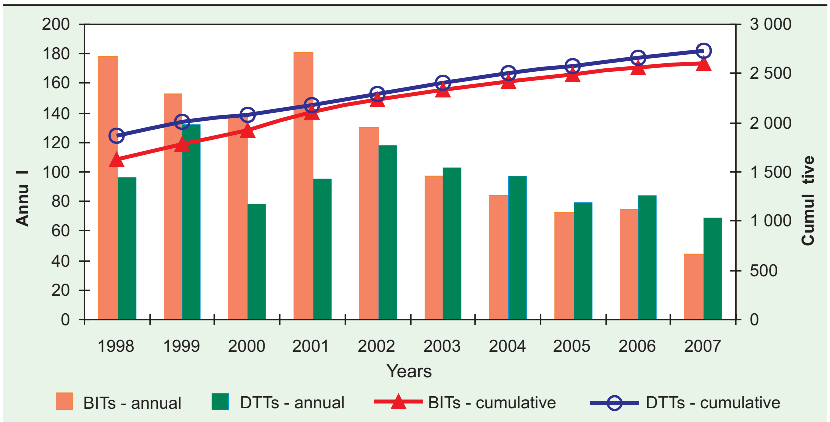
Figure I.9. Regulatory changes, by nature and region, 2007
(Per cent)



Source: UNCTAD database on national laws and regulations.

protection and liberalization. China, Oman and Qatar concluded the largest number of new agreements, with five BITs each in 2007. Asia and Oceania are now party to 41% of all BITs. *Developed countries* were involved in 25 of the new BITs and continue to figure prominently among the top 10 signatories of BITs (figure I.11). At the end of 2007, developed countries were involved in 60% of all BITs. Countries in *South-East Europe and CIS* signed 11 new BITs. With a total of 581 BITs concluded by end 2007, countries in this region were parties to 22% of all BITs. Countries in *Africa* concluded 11 new BITs in 2007. The least active region was *Latin America and the Caribbean* with only 4 new BITs. Noteworthy in this regard is that some countries of the region have withdrawn from the ICSID Convention (Bolivia), announced that consent to ICSID arbitration is no longer available for certain categories of disputes (Ecuador) or are considering such moves (Nicaragua, Bolivarian Republic of Venezuela) (Gaillard, 2008). Some countries in the region are also denouncing or renegotiating existing BITs.

Figure I.10. Number of BITs and DTTs concluded, annual and cumulative, 1998–2007

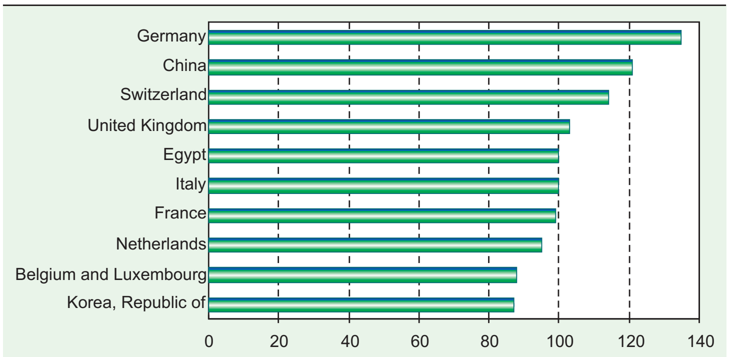


Source: UNCTAD (www.unctad.org/iia).

With regard to developing countries, of the 44 new BITs signed in 2007, 13 were between developing countries, thus adding to the trend of enhanced South-South economic cooperation. South-South agreements now represent more than 27% of the total number of BITs (figure I.12). China alone accounts for a large share of these South-South agreements. In 2007, it concluded four new BITs with other developing countries. About 60% of the Chinese BITs concluded from 2002 to 2007 were with other developing countries, mainly in Africa.[13]

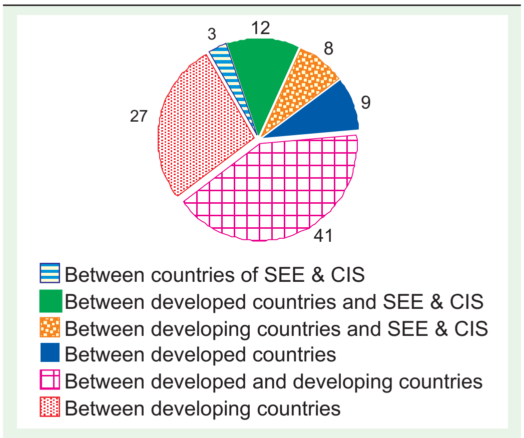
At the same time, a growing number of BITs are being renegotiated. In fact, as many as 10 of the 44 (23%) BITs signed in 2007 replaced earlier treaties. This brought the total number of renegotiated BITs to 121 at the end of 2007. To date, Germany has renegotiated the largest number of BITs (16), followed by China (15), Morocco (12) and Egypt (11). This number may rise, as many BITs are becoming relatively old, and more countries are revising their model BITs to reflect new concerns related, for example, to environmental and social issues, and the host country's right to regulate.[14] Environmental considerations are also featuring in negotiations of new BITs (e.g. one under way between Canada and China).[15] Furthermore, a growing number of recent agreements mark a step towards a better balancing of the rights of foreign investors, on the one hand, and respect for legitimate public concerns on the other.

Figure I.11. Top 10 signatories of BITs by end 2007



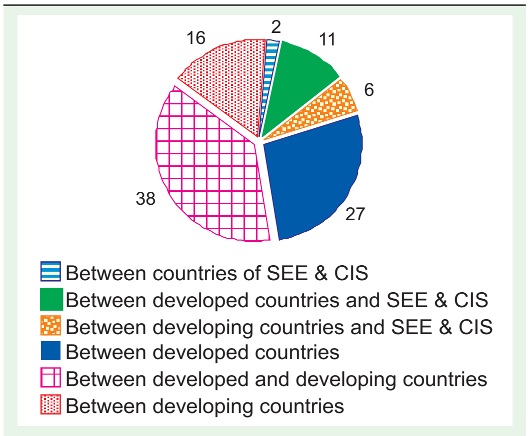
Source: UNCTAD (www.unctad.org/iia).

Figure I.12. Total number of BITs concluded at the end of 2007, by country group
(Per cent)



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

Figure I.13. Total number of DTTs concluded at the end of 2007, by country group
(Per cent)



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

(ii) Double taxation treaties

In 2007, 69 new double taxation treaties (DTTs) were concluded, bringing the total to 2,730 treaties (figure I.10). Developed countries are parties to 52 of them, and 17 of the new DTTs were between developed countries only. Belgium-Luxembourg was the most active with 7 new DTTs, followed by the United Kingdom and the United States (5 each). Developing countries were involved in 36 of the new DTTs, led by Saudi Arabia (5 new DTTs). Eight of the treaties signed in 2007 were among developing countries only. Those between developed and developing countries still account for the largest share (38%) of all the DTTs (figure I.13).

(iii) International investment agreements other than BITs and DTTs

During 2007, 12 IIAs other than BITs and DTTs were concluded, bringing the total of such agreements to 254.[16] Asian economies were among the most active (chapter II). In addition, at least 70 new IIAs other than BITs and DTTs were under negotiation at the end of 2007, involving 108 countries.

Most of the agreements concluded in 2007 establish binding obligations on the contracting parties concerning the admission and protection of foreign investment, in addition to a framework on investment promotion and cooperation. The scope of the protection commitments in the new free trade agreements (FTAs) is comparable to that found in BITs, including with regard to dispute settlement.

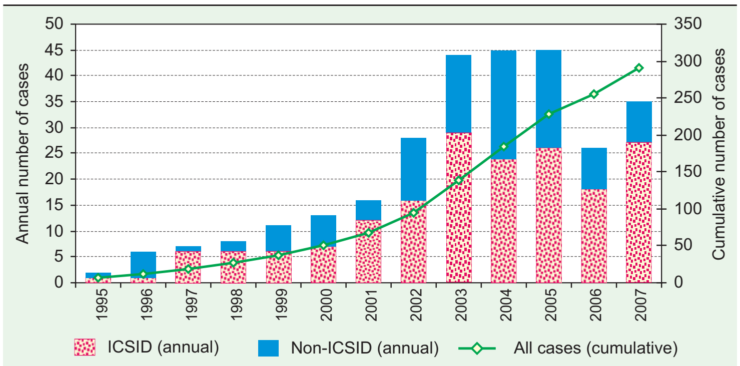
(iv) Investor-State dispute settlement

In parallel with the expanding universe of IIAs with investor protection provisions, the number of investor-State disputes has continued to rise. The cumulative number of known treaty-based cases had reached 288 at the end of 2007 (UNCTAD, 2008a) (figure I.14).[17] In 2007, at least 35 new treaty-based investor-State cases were filed, 27 of which were with the International Centre for Settlement of Investment Disputes (ICSID).[18] While this was a marked increase over 2006, when 26 cases were reported, it is below the peaks reached in 2003–2005. Since ICSID is the only arbitration facility to maintain a public registry, the real number of actual treaty-based cases is likely to be higher.

The rise in disputes has affected many countries to date. In fact, at least 73 governments – 45 of them in developing countries, 16 in developed countries and 12 in South-East Europe and CIS – were involved in investment treaty arbitration by end 2007. Argentina tops the list with 46 claims lodged against it, 44 of which relate at least in part to Argentina's financial crisis in the early 2000s. In 2007, four new cases were brought against that country. Mexico has the second largest number of known claims (18), followed by the Czech Republic (14), Canada and the United States (12 cases each). Six countries faced arbitration proceedings for the first time in 2007: Armenia, Bosnia and Herzegovina, Costa Rica, Guatemala, Nigeria and South Africa.

As many as 90% of known disputes were initiated by firms headquartered in developed countries. The large majority of cases were initiated on the grounds of violating a BIT provision (78%), followed by provisions under the North American Free Trade Agreement (NAFTA) (14%) and the Energy Charter Treaty (6%). In 2007, the first two cases were initiated on the grounds of alleged violations of the Central America-Dominican Republic-United States Free Trade Agreement (CAFTA-DR). A little

Figure I.14. Number of known investor-State arbitrations, annual and cumulative, 1995–2007



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

less than half of the disputes (39%) were related to the services sector, including electricity distribution, telecommunications, debt instruments and water services (chapter V). All primary sector cases related to mining and oil and gas exploration activities.

Tribunals rendered at least 28 awards in 2007, 24 of which were in the public domain. Of all the cases terminated by the end of 2007, 41 awards were rendered in favour of the State, 39 in favour of the investor and 42 were settled amicably;[19] 155 cases were still pending.

(v) Implications of recent developments

A number of features characterize IIA negotiating activity and international investment disputes in 2007. First, the shift in treaty-making activity from BITs towards FTAs and other economic integration treaties that combine trade and investment liberalization appears to be continuing. Second, the most intensive treaty-making activity took place in Asia, reflecting the strong economic performance of the region. Third, there is a relatively robust trend towards the renegotiation of existing IIAs and replacing them with more sophisticated agreements. Fourth, the surge in investor-State disputes continues and involves a growing number of countries, a broad variety of IIA provisions, and in some cases significant amounts of damages awarded. As a result, a few countries are considering or have already decided to terminate their membership in ICSID.

All these developments contribute to rendering the existing IIA universe more complex and more difficult to manage for capacity-constrained developing countries. Thus, seeking to ensure that the IIA universe remains manageable for all countries is becoming an increasingly challenging task. In this respect, reinforcing the development dimension of IIAs to take proper account of developing countries' IIA-related concerns remains a key issue.

One topic that has received more attention lately relates to the question of *arbitration-avoiding strategies for developing countries*. Surprisingly, alternative methods of dispute resolution (ADR) seem hardly ever to be used in investment matters, although they are available under international instruments, such as the ICSID Convention and the UNCITRAL Conciliation Rules.[20] It would be worthwhile considering giving a more prominent role to ADR – such as mediation and conciliation – in future IIAs. Mediation and conciliation could have several advantages over international arbitration. If successful, it might be cheaper, faster, and more protective of the relationship between the foreign investor and the host country – all important aspects for developing countries.

Further, IIAs currently might not be living up to their full potential in *promoting inward investment*. They focus on investment protection, with investment promotion primarily perceived as a side-effect of the former. Only a small minority of existing IIAs actually include *specific* provisions on investment promotion, such as measures to improve the overall policy framework for foreign investment, increase transparency and exchange information on investment opportunities, organize joint investment fairs, grant financial or fiscal incentives to investors or provide for an institutional mechanism that monitors the actual success of promotion efforts (UNCTAD, 2008c). It may be worthwhile to give more consideration to the issue of investment promotion in IIAs.

In the absence of global investment rules, countries continue to conclude investment treaties on a bilateral and regional basis, thereby further perpetuating and accentuating the existing IIA patchwork with its inherent complexities, inconsistencies and overlaps, and its uneven consideration for development concerns. It is in light of this development that, at the *UNCTAD XII Conference* held in Accra in April 2008, member States reiterated that UNCTAD should continue to help developing countries participate in the debate on IIAs, focusing on their development dimension and examining their effects. More specifically, UNCTAD was called upon to provide policy analysis and capacity-building in relation to the negotiation and implementation of current and future bilateral and regional investment agreements, management of investor-State disputes, alternative means of dispute settlement, the approach to investment promotion and the effects of IIAs.

B. Current financial and monetary developments and FDI

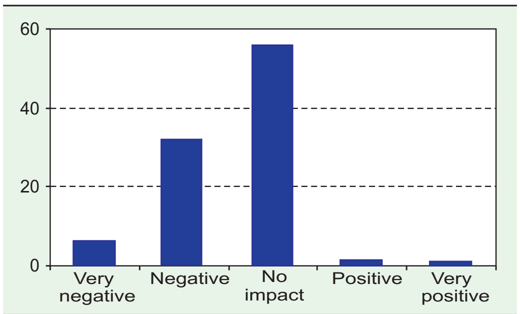
The sub-prime mortgage crisis that erupted in the United States in 2007, which caused property prices to plunge and a slowdown in the United States economy, has had worldwide repercussions. World economic growth in 2007 was relatively strong, but the effects of the crisis had begun to take their toll by mid-2008, and forecasts for 2008 have been revised downwards pointing considerably lower growth rates (e.g. IMF, 2008b). So far, the impact of the crisis on FDI flows has been mixed. The credit crisis in the United States has accentuated the depreciation of the dollar which in turn has stimulated FDI flows into the United States from countries with appreciating currencies (Europe and developing Asia).

1. The current financial crisis and FDI flows

The problems related to sub-prime mortgage lending and their fallout in the United States since the latter half of 2007 have disrupted financial markets, with broad impacts on the United States economy as a whole. The resultant liquidity problems have extended to some European countries as well.[21] These, along with long-term effects in terms of difficulties and higher costs of obtaining credit, are also affecting FDI flows. Such effects can be discerned at the micro (or firm) as well as macroeconomic levels.

At the firm level, given that in developed countries FDI is mostly in the form of M&As, it is mainly the direct impact of the crisis on cross-border M&As that is affecting FDI flows. The degree of the impact depends on the extent to which the sub-prime fallout affects lending to the corporate sector and other foreign investors (e.g. private equity funds). In most sectors, TNCs have ample liquidity to finance their investments, as shown by the high corporate profits reported, at least until 2007 (figure I.2). In the UNCTAD 2008 survey of large TNCs, about one third of respondents envisaged negative impacts on FDI flows in the short term, but about half of them suggested no impacts (figure I.15).

Figure I.15. Impact of financial instability on FDI flows 2008–2010
(Per cent of responses to the UNCTAD survey)



Source: UNCTAD, 2008b.

Note: The survey question was: To what extent have your actual FDI and short-term investment plans been affected by the financial instability following the sub-prime loan market crisis?

At the macroeconomic level, the economies of developed countries could be affected by the slowdown of the United States economy and its subsequent impact on the most important financial centres, affecting bank liquidity and credit supply. It has led to a decline in issuance of corporate bonds, while credit available for investment has fallen not only in the United States, but also in several European countries. Both FDI inflows and outflows to and from these countries may therefore slow down. The question is whether such effects are also being experienced in developing economies, in particular those where there is strong and growing demand for FDI. The fact that economic growth of these economies has remained resilient suggests that this may not be the case. Overall, both microeconomic and macroeconomic impacts that might affect the capacity and willingness of firms to invest abroad were limited, at least in 2007.

To date, the financial crisis has mainly affected North American and European commercial and investment banks, whereas the negative effects on the Asian financial system have been fairly limited. Asian banks, and especially Chinese banks, have gained strength recently. In both 2006 and 2007 three Chinese banks (ICBC, CCB and Bank of China) were among the top seven banks in the world in terms of the value of their market capitalization.[22] In contrast, many banks in developed countries had to bear substantial losses in the market value of their equity.[23] The turmoil in financial markets and the problems faced by several banks has started a new process of consolidation in the banking sector through M&As. Banks that were able to ride out the crisis without suffering large losses are seeing an opportunity for (cheap) investment in banks that were severely hit, and the equity prices of which fell sharply, by 40% to 60%. Chinese banks have started to acquire larger stakes in the banking and other financial industries of developed countries. Minsheng acquired a 20% stake in the United Commercial Bank in the United States for $200 million, while China's Citic Bank invested $1 billion for a 6% stake in Bear Stearns (United States). However, SWFs have played the most active role in recent M&As in the banking sector (though mainly in the form of portfolio investment), as discussed below.

2. Influence of the falling dollar on FDI decisions

In 2007, the exchange rates of the major currencies of developed countries continued their trend that started at the beginning of this decade. The United States dollar, in particular, further depreciated against the euro and the pound sterling (figure I.16). From 2000 to 2007 the United States dollar lost 33% of its nominal value against the euro and 24% against the pound sterling.[24] Large exchange rate changes have taken place in the past five years between the currencies of the United States, Japan and the EU. However, the effects of exchange rate changes on aggregate FDI flows are not straightforward.[25] The UNCTAD survey revealed that more than one third of TNC respondents reported negative impacts, while 58% of TNCs said there had been either a positive impact or no impact from dollar deprecation (figure I.17).

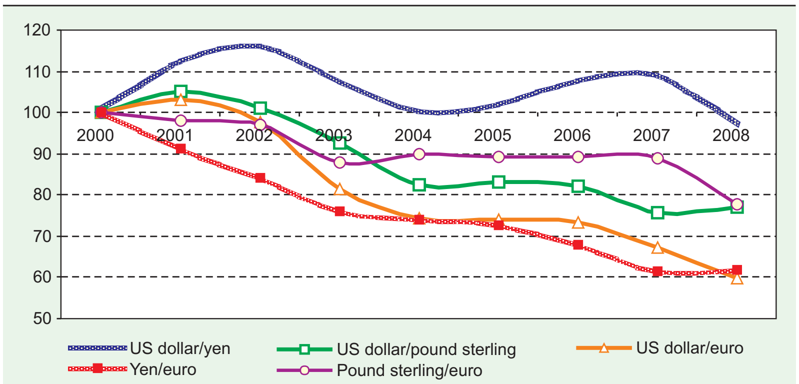
While it is difficult to isolate the effects of exchange rate changes from the effects of other determinants on FDI flows, there are some discernible cases of European firms that increased their FDI in the United States in reaction to the appreciating euro (box I.3). As already noted, FDI inflows into the United States have increased considerably in the past four years, from a low of \$53 billion in 2003 to \$233 billion in 2007. The bulk of the inflows – around 60% – originated from EU countries. The increase in investments in the United States by European companies in reaction to the falling United States dollar can be explained by two factors.[26] First, the sharp appreciation of the euro and the pound sterling increased the relative wealth of investors from Europe and reduced their investment costs in the United States, which have to be paid largely in United States dollars. Second, European companies suffer if they are highly exposed to exchange rate risks stemming from exports to the dollar zone, when costs are fixed to the euro. Revenues of European firms from sales in the United States have shrunk as a result of the sharp depreciation of the United States dollar against the euro and the pound sterling.

Examples abound: several European carmakers like BMW, Fiat and Volkswagen are following a strategy of building new production facilities or expanding existing plants in the United States to create a natural hedge against a sharp appreciation of the euro. BMW plans to increase United States production by more than 70%,[27] and in January 2008, the German carmaker, Volkswagen, announced plans to produce engines and transmission systems in North America and to establish an assembly plant in the United States in order to reduce its exposure to changes in the United States dollar exchange rate. The plant is set to produce 250,000 cars in 2008.[28]

Similar plans exist in other industries as well. The French manufacturer, Alstom, announced plans in December 2007 to build a \$200 million plant in the United States to reduce the impact of the low dollar on its margins.[29] In November 2007, the chief executive of EADS, the European aircraft maker, indicated that EADS would have to move more production to dollar-zone economies.[30]

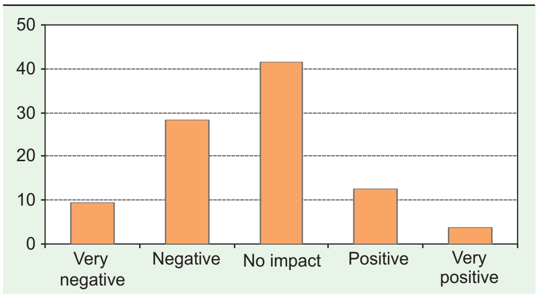
In contrast, in 2008 Porsche decided not to move production to the United States as it has already hedged its dollar exposure until 2013.[31] Porsche is the European carmaker most exposed to dollar-

Figure I.16. Nominal bilateral exchange rate changes of selected currencies, 2000–2008 [a]
(2000=100)



Source: UNCTAD, based on OECD, *Economic Outlook*, No. 83, June 2008.
[a] 2008 data are projections by OECD.
Note: A falling curve indicates a depreciation of the exchange rate of the first mentioned currency against the second currency.

Figure I.17. Impact of depreciation of the United States dollar on global FDI flows for 2008–2010
(Per cent of responses to the UNCTAD survey)



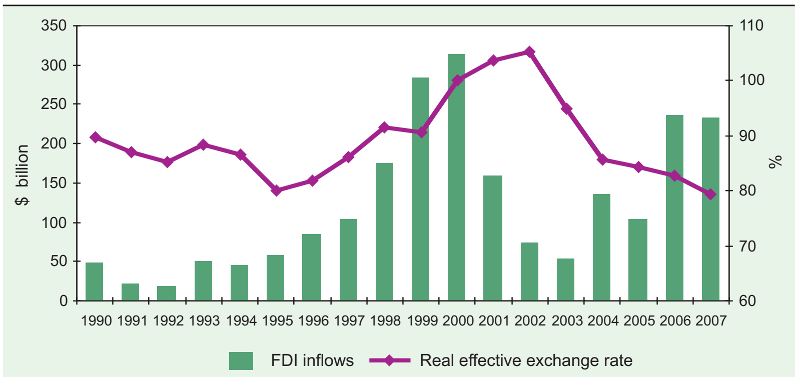
Source: UNCTAD, 2008b.
Note: The survey question was: To what extent have your actual FDI and short-term investment plans been affected by the depreciation of United States dollar?

euro exchange rate changes, as NAFTA countries account for around 40% of its total sales (Eiteman, Stonehill and Moffett, 2007) and the company has no manufacturing or assembly bases in the NAFTA region.

Increasing investments in the United States by European companies also partly reflect a reallocation of production within their networks of production units. For example, exports by foreign affiliates in the United States to Mexico grew by more than 40% between 2002 and 2005,[32] reflecting increased intra-firm flows of exports from foreign companies in the United States to Mexico (in the context of NAFTA).

The effects of the current depreciation of the dollar on FDI inflows into the United States (figure I.18) are similar to those that occurred in the second half of the 1980s. At that time also inflows into the United States sharply increased in reaction to the strong devaluation of the United States dollar against the yen and several European currencies (Froot and Stein, 1991; Klein and Rosengren, 1994). An empirical test on this relationship also shows a similar result (box I.3).

Figure I.18. FDI inflows to the United States and the real effective exchange rate, 1990–2007



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and IMF's *International Financial Statistics*, June 2008 (for data on exchange rate).

Note: Real effective exchange rate is based on relative normalized unit labour costs.

The fact that TNCs can raise funds in the capital markets in host countries or in international capital markets suggests that they may avoid effects from currency change movements. As some TNCs are also skilful in using derivatives (such as futures, forwards, options and swaps) to hedge against exchange rate changes, FDI flows into tax havens (e.g. Caribbean island economies) and special purpose entities are increasing for this purpose. The current depreciation of the dollar has stimulated this type of FDI as well. For example, FDI flows to tax havens in the Caribbean more than trebled in 2006, and continued to be high in 2007 (annex table B.1).

C. FDI by sovereign wealth funds

A growing number of individual and institutional investors invest in collective investment institutions (e.g. hedge funds, private equity funds), which have become direct investors by acquiring 10% or more of equity, with voting power, in enterprises abroad. These institutions are incorporated investment companies or unincorporated undertakings, and in most cases private. However, sovereign wealth funds (SWFs) have also begun to expand abroad as a result of a rapid accumulation of reserves in recent years.

1. Characteristics of SWFs

Various governments have created special investment funds to hold foreign assets for long-term purposes. In recent years, a number of these SWFs have emerged as direct investors. There is no universally agreed-upon definition of such funds, but their original objective was wealth preservation (box I.4). Their objectives vary, but their investment strategies tend to be quite different from those of traditional TNCs and private equity funds.

A comparison of SWFs with private equity funds shows several differences (box I.5). Not only is the volume of SWFs about nine times larger than that of private equity funds, they are also growing more rapidly due largely to fast increasing trade surpluses and foreign exchange reserves. The size of these funds (or assets under management) is estimated to be about $5 trillion today[33] (annex table A.I.11), compared to $500 billion in 1990. With the further rise in oil prices and other commodities, SWFs are continuing to accumulate foreign exchange reserves. There are some 70 such funds in 44 countries with assets ranging from $20 million (Sao Tome and Principe) to more than $500 billion (United Arab Emirates) (annex table A.I.11). However, their holdings are concentrated in China, Hong Kong (China), Kuwait, Norway, the Russian Federation, Saudi Arabia, Singapore and the United Arab Emirates (figure I.19).

2. Investment patterns

Despite their larger size, FDI by SWFs was only $10 billion in 2007 (figure I.20), accounting for a mere 0.2% of their total assets and only 0.6% of total FDI

Box I.3. Dollar depreciation and FDI flows to the United States: recent empirical findings

To test empirically the hypothesis that the depreciation of the United States dollar has been accompanied by an increase in FDI flows to the United States – a similar situation as was found in the 1980s – a model developed by Froot and Stein (1991) is used here. FDI flows as a dependent variable take into account the host country market size (GDP). Thus the dependent variable is FDI inflows over GDP, which is postulated to be a function of the real exchange rate and a time trend.[a] The investment behaviour of other forms of capital inflows, such as foreign official flows and foreign portfolio investments in United States treasuries or corporate bonds, is compared with that of FDI inflows. Given that the euro was introduced in 1999, the period for this exercise is limited to 1999–2007.

There are several noteworthy features of the estimates reported in box table I.3.1. First, FDI inflows in the United States are statistically negatively correlated with the value of the dollar. Second, the coefficient of real exchange rate is higher for FDI inflows than for portfolio flows (corporate stocks and bonds) and other capital flows, and is statistically significant. This implies that FDI inflows are more responsive than portfolio investments to dollar depreciation. The econometric result, that FDI inflows are statistically correlated with the value of the dollar, may support the wealth-effect argument with respect to the FDI-exchange rate relationship and intra-firm reallocation of production for the period in question, as discussed in the text.

Box table I.3.1. Regression of changes in foreign assets in the United States on the value of the dollar, quarterly data, 1999–2007

Form of gross capital inflows into the United States	Coefficients on		DW	R^2 (adjusted)	DF
	log (REER)	T			
Total foreign capital flows	-3.1 (1.98)	-0.0 (0.01)	2.1	0.2	33
Foreign official flows	0.1 (2.64)	0.1 (0.02)***	1.6	0.5	31
Foreign private flows	-4.0 (2.33)*	-0.0 (0.02)	2.1	0.1	33
FDI flows	-6.7 (2.23)***	-0.1 (0.02)***	2.1	0.3	30
United States corporate stocks and bonds	-2.3 (1.49)*	-0.0 (0.01)	1.4	0.0	32

Source: UNCTAD estimates, based on data from UNCTAD (for FDI flows); United States Bureau of Economic Analysis (for other capital flows and GDP) and JP Morgan for the real effective exchange rate.

Note: The following model $\log(Y_t) = \alpha_1 + \alpha_2 * \log(REER) + \alpha_3 * T_t$ is estimated, with OLS and standard errors calculated to allow for conditional heteroscedasticity (White, 1980) in the regression residuals. Standard errors are in parenthesis and *, **, *** represent statistical significance at the 10%, 5% and 1% levels, respectively. REER is the JP Morgan index for real effective exchange rate - a rise in the index indicates a real appreciation of the dollar. T is time trend. Dependent variable Y_t is expressed as a per cent of United States GDP in logarithm value. DW is Durbin-Watson statistic and DF is the degree of freedom.

Source: UNCTAD.

[a] There are many other variables influencing FDI flows (*WIR99*), but the purpose is simply to discern the impact of exchange rate levels on FDI.

flows. By comparison, private equity funds, although much smaller in size, invested more than $460 billion in FDI that year. Most of the SWFs invested heavily in low-yield government bonds in the United States and Europe. While they are increasingly investing in stocks and higher yielding assets, their acquisitions normally constitute ownership shares of less than 10%, which is the threshold for an investment to be classified as FDI. Nevertheless, growth of FDI by SWFs during the period 2005–2007, the majority originating in the United Arab Emirates, was dramatic. Of the $39 billion of FDI invested by SWFs during the past two decades, as much as $31 billion was committed in the past three years. From 1990 to 2004, average annual cross-border M&A outflows by SWFs amounted to only $0.5 billion (figure I.20). The number of cross-border M&A deals by SWFs increased from only 1 in 1987 to 20 in 2005, and 30 in 2007 (figure I.20).

FDI by SWFs has been geographically and sectorally concentrated. About three quarters of their investments were in developed countries, mainly, the United Kingdom, the United States and Germany (figure I.21), and 73% were in the services sector at end 2007 (figure I.22). Developing countries (notably in Asia) received $10.5 billion, or 27% of the total, but there was very limited SWF activity in Africa and Latin America. A specific feature of these investments has been their high concentration in business services (24% of the total), with much less going to the primary and manufacturing sectors and financial services. But, there were some important exceptions. For example, in 2005 IPIC (United Arab Emirates) acquired

Box I.4. What are SWFs?

SWFs are government investment vehicles that are funded by the accumulation of foreign exchange assets and managed separately from the official reserves of the monetary authorities. They usually have a higher risk tolerance and higher expected returns than traditional official reserves managed by the monetary authorities. They aim at systematic professional portfolio management to generate a sustainable future income stream. Their portfolio investment includes bonds, equities and alternative asset classes.

SWFs are not a new phenomenon. They have existed since the 1950s, especially in countries that were rich in natural resources (particularly oil), but had largely gone unnoticed until the middle of the present decade. Two of the largest of these funds, Kuwait Investment Authority and Temasek Holdings of Singapore, were founded in 1953 and 1974 respectively. In recent years, the assets of SWFs have grown considerably, reflecting the rapidly growing current-account surpluses of many developing countries and the accompanying accumulation of foreign exchange reserves.

Some examples of SWFs are the Abu Dhabi Investment Authority, China Investment Corporation, Kuwait Investment Authority, GPFG Norway and GIC fund from Singapore. Recently, the Libyan Arab Jamahiriya launched a fund as well (annex table A.I.11). Equivalent to 2% of the total global value of traded securities,[a] SWFs are becoming aggressive investment vehicles. Some of them take on management stakes, such as Singapore's Temasek, Qatar's Investment Authority, Abu Dhabi Mudabala, Dubai International Capital and Istithmar – the latter two of which are the investment vehicles of the Dubai Government. However, the distinction among different funds is not clear. Certain funds are prohibited by law from acquiring a large equity share such as FDI (e.g. Norwegian funds whose investments in equity stakes are limited to a maximum of 5%). Some governments also have stabilization funds, the only purpose of which is to stabilize revenues from commodity exports, and they do not usually engage in the purchase of shares.

Since SWFs hold more financial resources than private equity or hedge funds, they could have a significant influence on financial markets worldwide.

Source: UNCTAD.

[a] "The invasion of the sovereign wealth funds", *The Economist*, 17 January 2008.

Box I.5. How are SWFs different from private equity funds?

Both SWFs and private equity firms have become increasingly important players in global investment activities. They have diversified the investor base and contributed to a better environment for managing risks and absorbing shocks during crises. They can play a complementary role to TNCs as important sources of much-needed investment in the developing world. Potentially, this could have a positive impact in helping to reduce disparities in the global economy. Taken as a whole, the activities of SWFs are also increasing the stake of developing countries in the global economy.

Both SWFs and private equity funds have generated significant benefits through their investments, but they have also given rise to some important concerns. Significant challenges at both the systemic and national levels relate largely to regulatory issues and the need to strengthen transparency and oversight without undermining the benefits that these institutions generate. This requires policy development at both national and multilateral levels (see section C.3 below).

There are some major differences between SWFs and private equity funds (box table I.5.1 for details):

- Unlike private equity funds, SWFs are controlled directly by the home country government.
- SWFs can hold stakes for a longer period than private equity funds.
- Non-economic rationale sometimes combines with economic motivations in investment decisions by SWFs.

These differences manifest themselves in the investment strategies of SWFs.

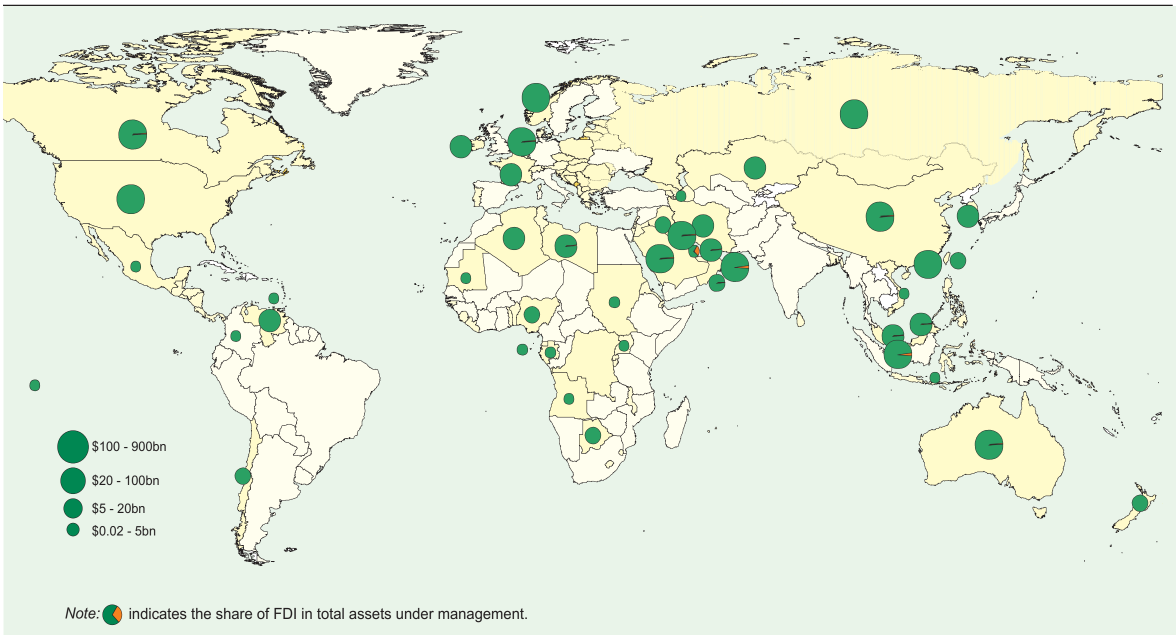
Box table I.5.1. Comparison between SWFs and private equity funds, 2007

Item	SWFs	Private equity funds
Volume	$5,000 billion	$540 billion
FDI	$10 billion	$460 billion [a]
Main source economies of FDI	United Arab Emirates, Norway, Saudi Arabia, Kuwait, Singapore, China, Hong Kong (China) and Russian Federation	United States, United Kingdom
Largest funds involving FDI	Istithmar PJSC (United Arab Emirates), Dubai Investment Group, Temasek Holdings(Pte)Ltd (Singapore), GIC (Singapore)	KKR, Blackstone, Permira, Fortress, Bain Capital, Carlyle (United States)
Investment strategy	Shifting from passive to active investors. Have tended to hold investment-grade, short-term, liquid sovereign assets in the major currencies, particularly United States treasury securities, but are now becoming strategic investors, with a preference for equities. Also investing in bonds, real estate, hedge funds, private equity and commodities. Still limited involvement in FDI. Concentrated in developed countries.	Shorter time frame (exit within 5-8 years) than public companies and traditional TNCs, but play a more active role in the management of invested companies than SWFs. At the same time, inclined to look for options that offer quick returns, akin to those of portfolio investors. Buy larger and also publicly listed companies, but also invest in venture capital. Undertake FDI through buyouts. FDI is expanding in developing countries.

Source. UNCTAD.

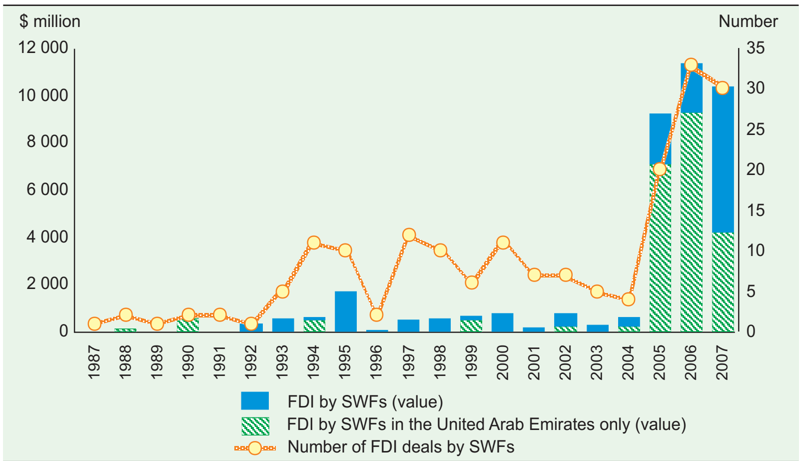
[a] Cross-border M&As only.

Figure I.19. Major FDI locations of sovereign wealth funds, 2007



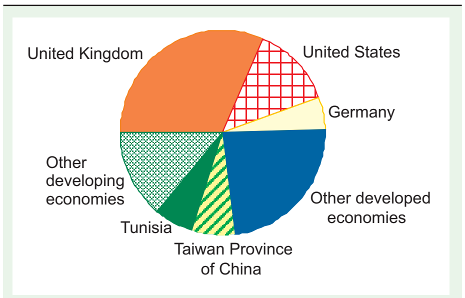
Source: UNCTAD, based on annex table A.I.11.

Figure I.20. FDI flows[a] by sovereign wealth funds, 1987–2007



Source: UNCTAD cross-border M&A database (www.unctad.org/fdistatistics).
[a] Cross-border M&As only. Greenfield investments by SWFs are assumed to be extremely limited.

Figure I.21. FDI[a] by SWFs, by main host groups and top five host economies, end 2007[b]
(Per cent)



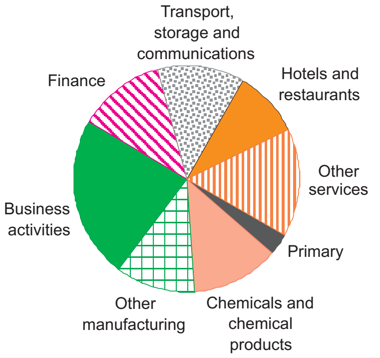
Source: UNCTAD, based on annex table A.I.13.
[a] Cross-border M&As only. Greenfield investments by SWFs are assumed to be extremely limited.
[b] Cumulative investments (M&As) between 1987 and 2007.

Kuokwang Petrochemical Co Ltd (Taiwan Province of China) for $2.4 billion (table I.9). In financial services, Temasek Holdings of Singapore acquired a 12% stake in the British bank Standard Chartered. In other industries, FDI by SWFs includes investments in telecommunications (in Tunisia), and plastics (e.g. Denmark, Germany).

In portfolio investment, in which SWFs are more active, there are a number of significant investments. In the manufacturing sector, for example, the Kuwait Investment Authority (KIA) is the largest single investor in Germany's Daimler Benz, though its share is quite small.[34] In 2007, however, the most active investments took place in the financial services of developed countries, due to the financial market crisis and the associated liquidity needs of numerous banks in the United States and the EU. In the latter half of 2007, three of the largest financial services companies in the United States, Citigroup, Merril Lynch and Morgan Stanley, actively sought new investors and fresh capital. Sharply falling stock prices made these investments relatively cheap for SWFs:

- China Investment Company (CIC) invested $5 billion in Morgan Stanley;
- Abu Dhabi Investment Authority acquired a $7.5 billion stake in Citigroup;

Figure I.22. FDI[a] by SWFs, by main target sectors and top five target industries, end 2007[b]
(Per cent)



Source: UNCTAD, based on annex table A.I.14.
[a] Cross-border M&As only. Greenfield investments by SWFs are assumed to be extremely limited.
[b] Cumulative investments (M&As) between 1987 and 2007.

- KIC (Republic of Korea), together with Kuwait Investment Authority, invested $5.4 billion for an equity capital stake in Merril Lynch; and
- The Government of Singapore Investment Corporation (GIC) acquired a $9.8 billion stake in the Swiss bank UBS.

Apart from these spectacular investments in the financial sector, SWFs acquired significant stakes in private equity funds and hedge funds in 2007. This is a new strategy of SWFs, which still shy away from larger or complete takeovers of TNCs in other production activities, as they lack the expertise to manage such TNCs. For example, CIC acquired a 9.9% stake in Blackstone (United States), one of the biggest private equity companies. Mubadala Fund of Abu Dhabi invested in Carlyle (United States), the Abu Dhabi Investment Authority acquired a 9% stake in Apollo (United States) and Dubai International Capital bought a 10% stake in Och-Ziff, a hedge fund in the United States. The growing investments of SWFs in private equity and hedge funds could signal an increasing number of joint deals in the future. SWFs are additional and emerging sources of funds for private equity firms as bank loans decline because of the financial crisis.

In sum, the recent behaviour of SWFs has been motivated by various market trends and changes in global economic fundamentals, and by the structural weaknesses in the global financial architecture. Recent investments by SWFs in the financial sector may have exerted a stabilizing effect on financial

Table I.9. Twenty selected large FDI cases by sovereign wealth funds, 1995–2007

Year	Value ($ million)	Acquired company	Host economy	Industry of the acquired company	Acquiring SWF or entity established by SWFs	Home economy	Acquired share (%)
2005	2 359	Kuokwang Petrochemical Co Ltd	Taiwan Province of China	Industrial organic chemicals, nec	International Petroleum Investment Co (IPIC)	United Arab Emirates	20
2006	2 313	Tunisie-Telecoms	Tunisia	Telephone communications, except radiotelephone	Investment Corporation of Dubai	United Arab Emirates	35
2005	1 691	Borealis A/S	Denmark	Plastics materials and synthetic resins	Abu Dhabi Investment Authority	United Arab Emirates	50
2005	1 495	Tussauds Group Ltd	United Kingdom	Amusement and recreation services	Dubai International Capital LLC	United Arab Emirates	100
2006	1 270	Travelodge Hotels Ltd	United Kingdom	Hotels and motels	Dubai International Capital LLC	United Arab Emirates	100
2006	1 241	Doncasters PLC	United Kingdom	Aircraft parts,equipment	Dubai International Capital LLC	United Arab Emirates	100
2005	1 222	CSX World Terminals LLC	United States	Marine cargo handling	Dubai Ports International	United Arab Emirates	100
2006	1 200	280 Park Ave,New York,NY	United States	Operators of non-residential buildings	Istithmar PJSC	United Arab Emirates	100
2007	1 160	Mauser AG	Germany	Plastic foam products	Dubai International Capital LLC	United Arab Emirates	100
1995	1 135	Mediaset SpA(Fininvest)	Italy	Television broadcasting stations	Investor group	Saudi Arabia	18
2006	1 030	Merry Hill	United Kingdom	Operators of non-residential buildings	Queensland Investment Corp	Australia	50
2007	954	Chapterhouse Holdings Ltd	United Kingdom	Real estate investment trusts	GIC Real Estate Pte Ltd	Singapore	100
2007	942	Barneys New York Inc	United States	Men's and boys' clothing and accessory stores	Istithmar PJSC	United Arab Emirates	100
2007	862	Hawks Town Corp	Japan	Department stores	Government of Singapore Investment Corp Pte Ltd (GIC)	Singapore	100
2007	821	Capital Shopping Centres PLC	United Kingdom	Operators of non-residential buildings	GIC Real Estate Pte Ltd	Singapore	40
2007	621	Bank Muscat	Oman	Banks	Dubai Financial LLC	United Arab Emirates	15
2007	612	WestQuay Shopping Center	United Kingdom	Operators of non-residential buildings	GIC Real Estate Pte Ltd	Singapore	50
2007	596	Westfield Parramatta	Australia	Operators of non-residential buildings	GIC Real Estate Pte Ltd	Singapore	50
2005	594	Bluewater Shopping Centre	United Kingdom	Operators of non-residential buildings	GIC Real Estate Pte Ltd	Singapore	18
2006	594	Adelphi	United Kingdom	Operators of non-residential buildings	Istithmar PJSC	United Arab Emirates	100

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics). For those cases ranked between 21 and 50, see annex table A.I.12.

markets, as they seem to have contributed to restoring the capital base of hard-hit banks. However, in many developed countries public and political statements indicate mixed reactions to FDI by SWFs, especially funds from emerging economies as discussed below.

3. Growing concerns about SWFs

Increasing investments of SWFs in the banking industry in 2006–2007 have been generally welcomed in view of their stabilizing effect on financial markets. But they have also aroused some negative public sentiment in several developed countries, provoking new fears of protectionism and policy moves to change legislation on FDI. In particular, concerns by developed as well as developing countries that SWFs could gain control of infrastructure and other strategic industries (e.g. energy, national defence, oil, gas and electricity supply, and other sensitive activities such as sea ports and airports) have led some governments to tighten regulations (or propose such changes) relating to investments by SWFs.

First, it has been argued that since SWFs could pose a threat to national security, governments should erect barriers against these investors. But most States already reserve the right to refuse M&As for national security reasons, even if, overall, they are very open to foreign investors (see *WIR06*: 225f.).[35] National security exceptions mainly relate to economic activities in the military and other strategic sectors. A prominent example is the United States Exon-Florio provision which allows the blocking of an acquisition by a foreign entity if national security is endangered (United States GAO, 2008). In Japan,[36] Germany,[37] France,[38] the United Kingdom[39] and many other countries, the legal framework similarly allows the restriction or withdrawal of a foreign investment for national safety and security reasons.

Opponents of FDI by SWFs further argue that the funds might invest in companies that were privatized in recent years and that the improvements in their efficiency from such privatizations may be rolled back as a result of SWF investment. In addition, some are sceptical about investments by SWFs from countries that lack a free market or respect for human rights and sound environmental standards. However, it should be pointed out that SWFs have to conform to national and international labour and environmental standards, and that if there is a high degree of competition in the market, SWFs have no monopoly power to control or exploit that market.

Also criticized is the lack of transparency of SWFs which, with the exception of the Norwegian (box I.6)[40] and Canadian SWFs, and, recently, Kuwaiti SWFs, do not disclose their asset portfolios and investment decisions (Truman, 2007; IMF, 2008a). Despite their potentially strong impact on the market, SWFs have little accountability to regulators, shareholders or voters, and there are limited data on their investment strategies, portfolio composition and the average annual returns on assets.

On the other hand, the changing investment strategy of SWFs may imply considerable opportunities as well. For example, they recycle the huge dollar inflows of the countries concerned, thereby contributing to the financing needs of the deficit countries, and therefore to stabilization of the global financial system, by injecting more capital. The passive investments of SWFs in dollar-denominated fixed assets in the past were connected with low returns; today their governments are seeking higher returns on their investments. Enhancing transparency and accountability of SWFs is important. If such conditions were to be met, there would be little reason to treat SWFs less favourably than other fund management companies, private equity groups or hedge funds.

Several initiatives are already under way to establish principles and guidelines relating to FDI by SWFs. At the multilateral level, the IMF has been called upon to develop guidelines for SWFs and has created, with some member States, the International Working Group of Sovereign Wealth Funds to agree on a common set of voluntary principles and practices for SWFs; the European Commission (EC) is exploring plans for an EU-wide law to monitor SWFs; and the OECD is developing guidelines for recipient countries. Ministers of OECD countries, at the Council at Ministerial Level on 5 June 2008, endorsed the following policy principles for countries receiving SWF investments:

> "Recipient countries should not erect protectionist barriers to foreign investment.
>
> Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.
>
> Where such national security concerns do arise, investment safeguards by recipient countries should be: transparent and predictable, proportional to clearly-identified national security risks, and subject to accountability in their application" ("OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies", Meeting of the Council at Ministerial Level, 4-5 June 2008, C/MIN(2008)8/FINAL).

At the SWF level, the Abu Dhabi Investment Authority (ADIA), GIC and Norges Bank Investment

Box I.6. Norwegian Government Pension Fund: a "gold standard" for governance of SWFs

The Norwegian Government Pension Fund (NGPF) is considered the "gold standard" for good practice in governance arrangements and operational guidelines that address concerns regarding the accountability and transparency of SWFs. Funds are transferred to the NGPF from the earnings from petroleum. The Norges Bank Investment Management (NBIM) was established in 1998 as a separate department within Norges Bank to manage the pension fund.

The NGPF governance structure seeks to achieve: (i) accountability, through a clear division of responsibilities and a system of checks and balances; (ii) transparency, by providing open information on performance, risks, costs and investments; and (iii) professionalism, by delegating all investment decisions to professionals.

On accountability, the Ministry of Finance decides strategic asset allocation, defines the benchmark portfolio, sets the limit for deviations from the benchmark, identifies companies to be excluded from the investment target, and reports to Parliament. The Norges Bank is responsible for cost-effective transactions and market exposure, active management to achieve "excess" returns (the difference between the return on the Fund and the return on the benchmark), risk management and reporting, and corporate governance, and it advises the Ministry of Finance on investment strategy.

On transparency, NBIM reports on performance, risks and costs on a quarterly basis. These quarterly reports are published on its website and are supported by a quarterly press conference. In addition, an annual report is published listing all investments.

The NBIM's main tasks, as the professional fund manager, are: cost-effective market exposure, creating "excess" returns against the benchmark through proactive management, safeguarding long-term financial interests through corporate governance (as a minority shareholder in invested companies), and risk management, control and reporting. Its strategy for creating "excess" returns involves taking many small positions rather than a few large ones, with the greatest possible independence in position-taking, and diversifying into well-defined strategies. It also emphasizes a high degree of specialization in both internal and external management, and focuses on keeping costs related to trading and portfolio management low.

Source: UNCTAD, based on the NGPF's website at: www.norges.bank.no.

Management (NBIM) are working with the IMF to develop a code of conduct for their activities. Singapore's Temasek Holdings has stated that it will avoid investing in "iconic" companies in developed markets. Clear procedures and guidelines by governments, identifying which industries are regarded as strategically important, should be established to make the investment environment more predictable. Such guidelines will have important implications for the regulatory and legal frameworks of host countries.

D. The largest TNCs

This section looks at the foreign activities of the largest TNCs in 2006. The 100 largest non-financial TNCs worldwide and the 100 largest TNCs from developing economies are ranked by foreign assets. The purpose is not to look at their size per se, but at their internationalization, which is different from other rankings where size in terms of total assets, income or market capitalization, are the determining criteria for ranking.[41] Finally, this section also includes an analysis of the 50 largest financial TNCs worldwide ranked by the Geographical Spread Index (GSI).

The largest TNCs play a major role in international production, both in developed and developing economies. Over the past three years, on average they accounted for 10%, 16% and 12%, respectively, of the estimated foreign assets, sales and employment of all TNCs in the world. At the same time, the rapid increase in FDI in the past decade has been accompanied by a structural change in its sectoral composition towards services, notably telecommunications, electricity and water services. The current UNCTAD lists of largest TNCs include many that are involved in infrastructure development, but this has not always been the case (box I.7). The wave of liberalization and privatization in the late 1980s and throughout the 1990s, especially in the key infrastructure industries, had a particularly marked effect on the internationalization of these services. These industries, which had been mostly State-owned enterprises or nationalized companies subject to tough restrictions and prohibitions on foreign ownership, were also the fastest to become internationalized after privatization and liberalization opened them up to foreign participation, largely through FDI and strategic alliances.

1. The world's top 100 TNCs

Overall, the rankings in the first half of the top 100 list in the past decade have remained relatively stable: General Electric (United States) heads the list with more than 8% of the total foreign assets of the top 100 companies – almost three times as much

Box I.7. Infrastructure TNCs in the top 100 TNCs

In 2006, the world's 100 largest TNCs included eight utility companies and eight telecoms companies, seven of which were headquartered in the EU and are ranked in the first quartile of the top listed companies. Most of these TNCs were not among the top 100 prior to 1998 (box table I.7.1). The industry composition of the top 100 reveals that in 1996 there were only one utility company and five telecoms companies and by 1998 there were three utility companies and six telecoms companies.

Box table. I.7.1. Largest TNCs in infrastructure industries:[a] ranks in 2006 and in the year of entry

TNC	Country	Industry	2006 rank	Year of entry into top 100	Rank
Vodafone	United Kingdom	Telecoms	7	2000	1[b]
EDF	France	Electricity	9	2001	30
Telefonica	Spain	Telecoms	11	1998	52
E.ON	Germany	Electricity	12	2000	23
Deutsche Telekom	Germany	Telecoms	13	2002	56
France Telecom	France	Telecoms	15	2002	9
Suez	France	Water	19	1998	13
RWE	Germany	Electricity	22	1998	66

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] Excluding diversified TNCs.

[b] Following the merger with AirTouch Communications in 1999, Vodafone became the world's largest TNCs ranked by foreign assets.

Source: UNCTAD.

as the second-ranked British Petroleum (United Kingdom). The top 10, with about $1.7 trillion in foreign assets, or more than 32% of the total foreign assets of the top 100, include four petroleum and two motor vehicle companies, two infrastructure companies, one company in the electrical/electronic equipment industry and one retail company. These 10 companies also account for 29% of all foreign sales, but for only 15% of all foreign employment of the 100 largest TNCs, although the retail company Wal-Mart is the world's largest foreign employer.

Table I.10. Snapshot of the world's 100 largest TNCs, 2005–2006

(Billions of dollars, thousands of employees and per cent)

Variable	2005	2006	Percentage change
Assets			
Foreign	4 732	5 245	10.8
Total	8 683	9 239	6.4
Share of foreign in total (%)	54	57	2.3[a]
Sales			
Foreign	3 742	4 078	9.0
Total	6 623	7 088	7.0
Share of foreign in total (%)	56	58	1.0[a]
Employment			
Foreign	8 025	8 582	6.9
Total	15 107	15 388	1.9
Share of foreign in total (%)	53	56	2.7[a]

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] In percentage points.

While a number of new companies from the services sector entered the higher rankings in the list during the decade, some companies in the more traditionally important industries remained among the top. In the petroleum industry, Shell and Exxon, which were number one and two respectively 15 years ago, are still among the top ranked largest TNCs. In 1993, General Electric which was ranked fifth, and motor-vehicle companies such as Toyota and Ford which ranked sixth and seventh respectively, even improved their rankings in 2006.

In 2006, there were few changes in the top 100, with only 10 new entries originating from 8 different countries. By origin, 85 of the companies had their headquarters in the Triad (the EU, Japan and the United States), the United States dominating the list with 21 entries. Of the top 100 firms, 72 came from five countries: the United States, France, Germany, the United Kingdom and Japan, in that order. The number of firms from developing economies in the top 100, which had increased to seven in 2005, fell to six in 2006, but they represented a wide range of activities and diverse origins (two from the Republic of Korea, and one each from Hong Kong (China), Malaysia, Mexico and Singapore).

The activities of the largest TNCs increased significantly, with foreign sales and foreign employment increasing at almost 9% and 7% respectively, faster than that of their domestic activities (table I.10). The ratio of foreign activities to total activities increased again in 2006.

Six industries dominated the list of the largest TNCs. Motor vehicles (13) and petroleum (10) represented more than half of the companies in the first quartile. Electrical/electronic equipment (nine), utilities (eight), telecoms (eight) and pharmaceuticals (seven) followed. These six industries accounted for 55% of the 100 largest TNCs. Metals and non-metallic products, chemical products, retail and wholesale trade, and food and beverages accounted for another 23%.

While the ranking used in UNCTAD's list of the largest TNCs is based on foreign assets, ranking the companies by foreign sales or by foreign employment would give a different picture. If ranked by sales, petroleum TNCs would occupy the top five positions in the list and five automobile manufacturers would be in the top ten. The largest TNC in terms of foreign sales (ExxonMobil) is 10 times larger than the firm ranked 59, based on foreign sales. Ranking the companies by foreign employment gives yet another picture, with two retail companies and two food and beverage companies in the top five positions. The largest retail TNC in terms of foreign employment is 10 times larger than the firm ranked 55 based on foreign employment.

Another aspect of foreign operations is the geographical spread or the number of host countries for foreign affiliates. On average, the largest TNCs have affiliates in 41 foreign countries. The ranking by the number of host countries for foreign affiliates results in a much more diversified list of home countries and industries (table I.11). Deutsche Post (Germany) leads, followed by the Royal Dutch Shell Group. There is a wide range of home countries and activities in this list, which indicates that the form and extent of international diversification differs widely among firms.

Table I.11. Top 15 TNCs, ranked by number of host economies of their affiliates

Company	Home country	Number of host economies [a]
Deutsche Post AG	Germany	111
Royal Dutch/Shell Group	Netherlands, United Kingdom	98
Nestlé SA	Switzerland	96
Siemens AG	Germany	89
BASF AG	Germany	88
Procter & Gamble	United States	75
GlaxoSmithKline	United Kingdom	74
Linde	Germany	72
Bayer AG	Germany	71
Philips Electronics	Netherlands	68
Total	France	66
IBM	United States	66
WPP Group PLC	United Kingdom	64
Roche Group	Switzerland	62
Novartis	Switzerland	62

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] Majority-owned foreign affiliates only.

The preferred locations for foreign affiliates of the top 100 TNCs, measured in terms of location intensity, which takes into account the home country of the TNCs,[42] are the United Kingdom and the United States (figure I.23). The top four positions are similar to those in 2005. China ranks sixth, ahead of France and Canada. Among developing economies other than China, Brazil, Mexico and Singapore rank among the top 20 preferred locations.

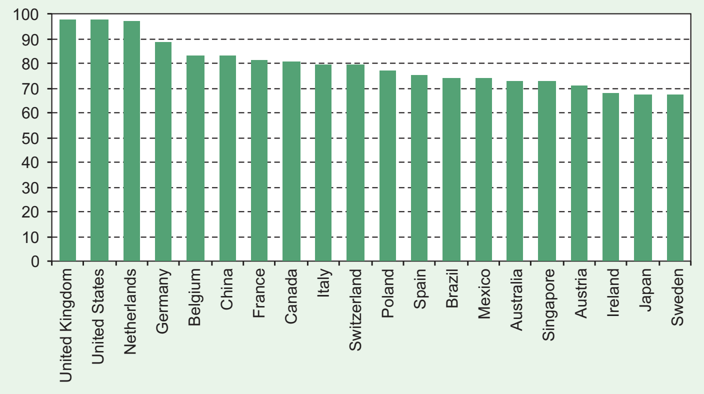
How transnational are the largest TNCs? The degree of international involvement of firms can be analysed from a number of perspectives: their operations, stakeholders and the spatial organization of management. Given the range of perspectives and dimensions that can be considered for each, the degree of transnationality of a TNC cannot be fully captured by a single, synthetic measure. UNCTAD's Transnationality Index (TNI)[43] is a composite of three ratios: foreign assets to total assets, foreign sales to total sales, and foreign employment to total employment. The conceptual framework underlying this index helps to assess the degree to which the activities and interests of companies are embedded in their home country and abroad (UNCTAD, 2007a).

In 2006, the average TNI for the largest TNCs increased by one point value, but it is worth noting that this average value is highly dependent on the companies represented in the top 100. Nevertheless, over the past 15 years the average value has increased by 14 points, with ups and downs not necessarily in phase with the FDI cycle (figure I.24). The home countries and industries of the top companies ranked by TNI are extremely diverse (annex table A.I.15).

It is also important to look at the differences in TNI between the leading TNCs from the major home countries. The value is higher than average for TNCs from France and the United Kingdom, and it is lower than average for TNCs from Germany, Japan and the United States (table I.12).

One aspect of transnationality from the operations perspective, which is not included in the TNI measure, is the intensity of foreign operations according to the number of foreign affiliates. The geographic spread of a company's operations and interests is captured by the number of foreign affiliates and the number of host countries in which a company

Figure I.23. Location intensity of the 20 most preferred host economies, 2007



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

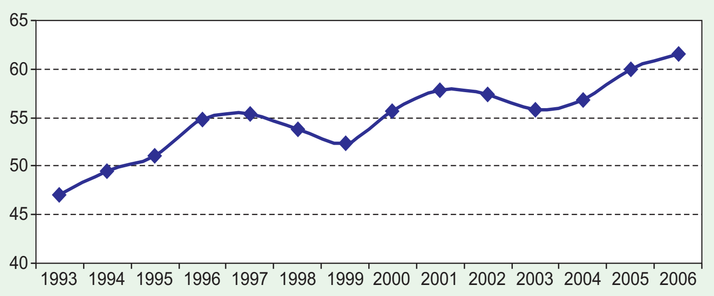
Table I.12. Comparison of TNI values by country, 2005, 2006
(TNI values and number of entries)

Country	Average TNI [a] 2005	Average TNI [a] 2006	Number of entries 2006
Top 100 TNCs	**59.9**	**61.6**	**100**
from:			
United States	52.8	57.8	22
France	62.4	63.8	15
Germany	52.6	54.8	14
United Kingdom	72.5	72.8	13
Japan	48.7	52.1	0.9

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] TNI, the Transnationlity Index, is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

Figure I.24. TNI values of the top 100 TNCs, 1993–2006



Source: UNCTAD/Erasmus University database on largest TNCs.

Table I.13. II values of selected industries, 2005, 2006

Industry	Average II[a] 2006	2005
Motor vehicles	63.4	62.1
Electrical/electronics	74.1	76.2
Petroleum	55.8	60.5
Pharmaceuticals	80.1	81.9
Telecommunications	73.9	71.6
Utilities	71.4	53.1
All industries	70.1	69.5

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] II, the "Internationalization Index", is calculated as the number of foreign affiliates divided the number of all affiliates.

has established its affiliates. The Internationalization Index (II) – the ratio of a TNC's foreign to total affiliates – shows that on average more than 70% of the affiliates of the world's largest TNCs are located abroad (annex table A.1.15). However, there is wide discrepancy between the IIs for TNCs in the different major industries in the top 100: the II for companies in the pharmaceutical, telecommunications, and electrical and electronics industries is much higher than that for companies in the motor vehicle or petroleum industries (table I.13). This signifies that their operations are spread over many more countries, even though FDI may be less important relative to their total assets.

2. The top 100 TNCs from developing economies

In 2006, the foreign assets of the 100 largest TNCs from developing countries amounted to $570 billion. The 10 largest TNCs in the world accounted for almost half of the foreign assets of the top 100. With foreign assets of $71 billion, Hutchison Whampoa (Hong Kong, China) remained in the lead, accounting for as much as 12% of the total foreign assets of the top 100. Petronas (Malaysia), Samsung Electronics (Republic of Korea), Cemex (Mexico), Hyundai Motor (Republic of Korea) and Singtel (Singapore), ranked in that order, also figured among the world's 100 largest non-financial companies.

The top five firms from developing economies in 2006 were already listed among the top 20 on the list of the largest TNCs from developing economies 10 years ago. All TNCs in the top 50 positions have more or less maintained their rankings for the past few years. Overall, the composition of the top 100 has remained relatively stable, at least in the first half of the list, with one exception (a telecoms company from Kuwait). The top 100 TNCs from developing economies operate in a broader range of industries than their counterparts from developed economies, and companies from the electrical/electronic and computer industries still dominate the list with 20 entries. They are followed by TNCs in telecoms (9), petroleum (8) and food and beverages (8).

The regions and countries of origin of the top 100 TNCs from developing economies have changed little over the past 10 years: 76 TNCs are from South, East and South-East Asia, 10 are from Latin America, 11 from Africa, and, for the first time, three new TNCs in the infrastructure industries are from West Asia (Turkey and Kuwait). By economy, Hong Kong (China) and Taiwan Province of China dominate the list with 26 and 16 TNCs respectively. Singapore and China have maintained their relative lead with 11 and 9 companies respectively. South Africa (10), Mexico (6) and Malaysia (6) are the other important home countries for TNCs from developing countries.

In 2006, the foreign assets, foreign sales and foreign employment of the largest 100 increased by 21%, 27% and 12% respectively, compared to the previous year (table I.14). But relatively speaking, their foreign operations, as reflected in the ratio of the foreign component to the total, remained fairly stable compared to 2005, with only small increases.

Table I.14. Snapshot of the world's 100 largest TNCs from developing economies, 2005, 2006
(Billions of dollars, thousands of employees and per cent)

Variable	2005	2006	Percentage change
Assets			
Foreign	471	571	21.3
Total	1 441	1 694	17.6
Share of foreign in total (%)	33	34	1.0[a]
Sales			
Foreign	477	605	26.9
Total	1 102	1 304	18.3
Share of foreign in total (%)	43	46	3.2[a]
Employment			
Foreign	1 920	2 151	12.0
Total	4 884	5 246	7.4
Share of foreign in total (%)	39	41	1.7[a]

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] In percentage points.

Compared to the largest TNCs worldwide, developing-economy TNCs have affiliates in a smaller number of foreign affiliates – only 9 on average. Cemex (Mexico) is present in the largest number of host countries, followed by three companies in electrical/electronics (table I.15). The most preferred locations for the foreign affiliates of the top developing-economy TNCs are the United Kingdom and the United States, as is the case for the largest TNCs worldwide, but China is the third most-preferred location, ahead of Germany, Hong Kong (China), the Netherlands and Brazil.

While a firm like Cemex is truly diversified geographically, with activities in Asia, West Asia, Europe and Latin America, most companies have a more regional focus: Mexican companies tend to have more activities in Latin America and Asian companies in Asia. With the exception of Sappi (South Africa) none of these TNCs in the top 15 have foreign affiliates in African countries.

How transnational are TNCs from developing economies compared to their counterparts from developed countries? The average TNI is higher for the world's 100 largest TNCs, but the gap between the two is closing (UNCTAD, 2007a). In 2006, the average TNI value for the largest TNCs from developing economies increased by three points. This TNI value is larger for companies in Asia than in other developing regions (table I.16). The home countries and industries of the top companies ranked by TNI are highly diversified (annex table A.1.16).

The degree of transnationality is also affected by the extent to which TNCs are expanding their foreign activities in various locations. The Internationalization Index (II), the ratio of a TNC's foreign to total affiliates, shows that, on average, more than 50% of the affiliates of the largest TNCs from developing economies are located abroad, a much lower value than for TNC from developed countries. However, there is wide discrepancy among industries. For TNCs from developing economies, the II of firms in the electrical and electronics and computer industries is very similar to that of their counterparts from developed countries (table I.16).

Table I.15. Top 15 TNCs from developing economies ranked by the number of host economies of their affiliates, 2007

Corporation	Home economy	Number of host economies
Cemex	Mexico	35
Samsung Electronics Co.	Republic of Korea	32
Flextronics International	Singapore	30
LG Corporation	Republic of Korea	24
Singtel	Singapore	24
Acer	Taiwan Prov. of China	23
Neptune Orient Lines	Singapore	20
Hutchinson Whampoa	Hong Kong, China	15
Lenovo Group	China	15
Grupo Bimbo SA	Mexico	14
Orient Overseas International	Hong Kong, China	14
Hon Hai Precision Industries	Taiwan Prov. of China	12
America Movil	Mexico	12
Sappi	South Africa	12
Kia Motors	Republic of Korea	11

Source: UNCTAD/Erasmus University database on largest TNCs.

Table I.16. Transnationality of the largest TNCs from developing economies: TNI and II, by region, 2006

Top 100 TNCs from developing economies	Average TNI[a]		Average II[b]	
Region/economy	TNI	No. of companies	II	No. of companies
of which:				
Africa (South Africa)	45.0	11	47.7	11
South-East Asia	52.3	20	40.4	17
East Asia	58.6	56	56.3	55
West Asia	56.5	3	92.5	1
Latin America and the Caribbean	40.1	10	39.6	10
Total	**53.9**	**100**	**50.8**	**94**

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] For definition of TNI, see table I.12.
[b] For definition of II, see table I.13.

3. Profitability of the largest TNCs

A ratio widely used to evaluate a company's operational efficiency is the return on sales (ROS), also known as a firm's operational profit margin. It is calculated as the ratio of net income (before interest and taxes) to total sales, and provides insight into how much profit is generated per dollar of sales. For firms for which data were available, ROS was calculated, as an average value over the two years 2005–2006.

A comparison by industries suggests that the top TNCs in the pharmaceutical industry have higher returns, on average, than those in all other industries, and they are three points higher than those in the telecoms industry, which ranks second (table I.18). As seen in a previous section, the average II for the top TNCs in this industry is also the highest. At the bottom of the ROS ranking are the largest TNCs from the motor vehicles industry and retail and wholesale trade (table I.18).

The question of whether and how the internationalization of activities affects the performance of a firm is one of the issues most examined in research on strategic management and international business. The importance of international diversification stems from the fact that it represents a growth strategy that has a major potential impact on a firm's performance. The numerous studies – more than 100 investigations in all – that have examined the diversification-performance relationship in the manufacturing sector, have yielded conflicting results (Contractor, 2007; Glaum and Oesterle, 2007; Hennart, 2007). On average, global trends that point in the direction of

Table I.17. Transnationality of the largest TNCs from developing economies: TNI and II, by major industries, 2006

Industry	TNCs from developing economies TNI	II
Motor vehicles	28.7	54.9
Electrical/electronics	64.0	61.4
Petroleum	27.0	20.1
Telecommunications	41.4	55.2
Metals and metal products	46.9	24.4
Food and beverages	61.3	42.4
Transport and storage	62.3	66.6
Computers and related activities	55.6	72.3
Construction	38.2	33.1
Machinery and equipment	50.0	67.7
All industries	**53.9**	**50.8**

Source: UNCTAD/Erasmus University database on largest TNCs.

more foreign activities and more internationalization obscure the fact that the form and pace of insertion in the world economy differs widely across industries and home countries of firms.

4. The world's top 50 financial TNCs

In response to foreign market opportunities created as a result of deregulation and globalization, many financial firms have increased their FDI and acquired other companies. This is partly because they believe that only very large players will have the cost advantages necessary to remain competitive in their home markets.[44] In addition, they see geographical diversification as an advantage in reducing the volatility of risks. They also view market power as giving them the necessary financial strength to be able to conform to the new Basel II agreement, which is designed to establish minimum levels of capital for internationally active banks.

Table I.18. Average return on sales of major industries, 2005–2006

Industry	ROS	Number of entries
Pharmaceuticals	16.1	7
Telecommunications	13.2	6
Food & beverages	12.9	6
Electricity, gas and water	10.6	9
Petroleum	8.3	7
Electric/electronics	6.5	7
Motor vehicles	4.4	9
Retail and wholesale trade	4.4	6
All industries	**10.8**	**85**

Source: UNCTAD/Erasmus University database on largest TNCs.

In the mid-1990s, M&A activity in financial services was dominated by domestic deals in the United States, driven by changes in the regulatory framework.[45] By the early 2000s, cross-border M&As involving European firms accounted for a large share of all cross-border activities in the industry. Over the past five years, the largest deals, of over $10 billion, have been concluded mainly among European banks. Since 2001, M&A deals in the financial sector have been on the rise, in both number and value (table I.19). European banks are also expanding rapidly into South and Eastern Europe and the Balkans (box I.8).

Table I.19. M&A deals of over $1.5 billion in the financial sector, 2001–2007

Year	Number of deals	Total value
2007	13	140
2006	13	65
2005	8	44
2004	5	34
2003	3	19
2001–2002	3	21

Source: UNCTAD cross-border M&A database.

During the last quarter of 2007, many banks, mortgage lenders, investment funds and hedge funds suffered significant losses as a result of defaults on mortgage or devaluation of mortgage assets in the United States. By the end of 2007, banks announced $60 billion worth of losses, as many of the mortgage bonds backed by sub-prime mortgages had fallen in value. As of April 2008, financial institutions had suffered sub-prime-related losses or write-downs exceeding $245 billion. Two banks – Northern Rock (United Kingdom) and Bear Stearns (United States) – were effectively rescued by their governments.[46] Many institutions escaped bankruptcy with merger deals. Banks also sought and received additional capital from SWFs: an estimated $69 billion has been invested by these entities in large financial institutions over the past year (section C).

Large groups continue to dominate world financial services, not only in terms of total assets but also in terms of the number of countries in which they operate. The 50 largest financial TNCs in terms of total assets in 2006 are ranked by UNCTAD's Geographical Spread Index (GSI), since data on foreign assets, foreign sales and foreign employment are not available for all groups of financial service TNCs (annex table A.I.17). This index is significantly higher for the largest financial groups and for firms from Switzerland, due to the small size of the home country market in the case of the latter.

In 2006, Citigroup (United States) was the top-ranked financial TNC and was more internationalized than any other group in terms of the number of host economies of its affiliates. Overall, European groups dominated the list of the world's top 50 financial TNCs with 34 entries, compared to 9 from the United States, 4 from Japan and 3 from Canada. Japanese banks, after increasing in size through domestic M&As, have gradually regained their positions in the international financial markets from which they had almost completely withdrawn in the 1990s. Despite M&A activity, the ranking of these groups has remained relatively stable: all groups except two were already ranked in the top 50 last year. However, the purchase of ABN AMRO in 2007 by a consortium of three of the largest financial groups will certainly have a strong impact on future rankings.

Information on the location of foreign affiliates suggests that the most preferred host country for the largest financial TNCs remains the United Kingdom followed by the United States (figure I.25). China is ranked third, while three other developing countries, Singapore, Brazil and Mexico, are also among the top 20 preferred locations. Among the new EU member countries, Poland confirmed its importance as a major location for financial activity in Europe, with increased FDI by European financial groups (including, in 2006, by Fortis and Eurobank from Greece).

E. Prospects

After four years of high GDP growth, a slowdown is expected in 2008 due to the financial and credit crises which are now affecting a number of countries worldwide (e.g. IMF, 2008b). High levels of energy and food prices may aggravate this situation. Economic growth in developing countries could compensate for weaker growth in high-income countries. Although economic growth in developing economies is projected to decline, from 7.8% in 2007

Box I.8. Banking in the Balkans[a]

The creation of a viable and sound financial system in South-East European (SEE) countries has been a fundamental aspect of their transition to a market economy. At the beginning of the 1990s, much of the banking industry in the SEE countries and Turkey remained underdeveloped. The implementation of a reform process improved the banking industry in all the transition countries. In general, the reform process consisted of the establishment of a two-tier system, a new regulatory system conforming with BIS standards, allowing the entry of foreign banks, and the privatization of State-owned banks, which was a crucial element in the effective transition of these countries' banking systems to market-oriented ones.

Substantial inflows of FDI, accompanied by a stable business environment and sound macroeconomic policies, have made investments in the banking industry even more attractive. Over the past few years, the level of financial intermediation has increased significantly in the Balkans due partly to substantial investment by foreign banks, which have acquired local banks through privatizations or M&As. During the period 2006–2007, there were six large M&A deals in the financial industry in this region (box table I.8.1).

Box table I.8.1. Largest cross-border M&A deals in the financial sector in the Balkans, 2006–2007

Year	Acquiring firm	Home country	Target firm	Country	Value ($ billion)
2006	National Bank of Greece	Greece	Finansbank	Turkey	5.0
2006	Erste Bank	Austria	Banca Commerciala Romania	Romania	4.7
2007	Citigroup	United States	Akbank	Turkey	3.1
2006	Credit Agricole	France	Emporiki Bank	Greece	2.7
2007	ING Group	Netherlands	Oyak Bank	Turkey	2.7
2006	Dexia	Belgium	DenizBank FS	Turkey	2.4

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

Austrian and Greek banks are taking the lead in investment in banking in the Balkans, though the expansion of French and Italian banks into these countries is also noteworthy. In addition, Greek banks are extending their reach into neighbouring countries of SEE, which are growing twice as fast as the Greek domestic market. By 2005, Greek banks had spent an estimated $1 billion buying bank assets in the Balkans.[b] In the past three years the number of acquisitions has accelerated, with the five largest Greek banks, National Bank of Greece, Alpha Bank, Eurobank, ATEbank and Piraeus Bank, stepping up their commercial and retail banking investments. Notable acquisitions have been by the National Bank of Greece (NBG) in Turkey (Finansbank), Serbia (Vojvodjanska Banka), Romania (Banca Romaneasca) and Bulgaria; by Eurobank in Turkey (Tekfenbank) and Bulgaria (DZI Bank and Postbanka); by Alpha Bank in Serbia (Jubanka); by ATEbank in Serbia (AIK Banka) and Romania (Mindbank); and by Piraeus Bank in Serbia (Atlas Banka) and Bulgaria (Eurobank). At the same time, NBG is pulling out of Western Europe by closing uncompetitive branches in Frankfurt, Paris and Amsterdam.

But the Greek banks are not alone. Other European banks have also moved in. Bank Austria Creditanstalt (a unit of Germany's HypoVereinsbank), Austria's Raiffeisen, and Italy's Unicredito and Banca Intesa are particularly active in the subregion. At the same time, Crédit Agricole and Société Générale, from France, have acquired Greek banks. Among the largest deals, Erste Bank (Austria) acquired Banca Commercial Romania for $4.7 billion and Dexia (Belgium) acquired Denizbank FS (Turkey) for $2.4 billion.

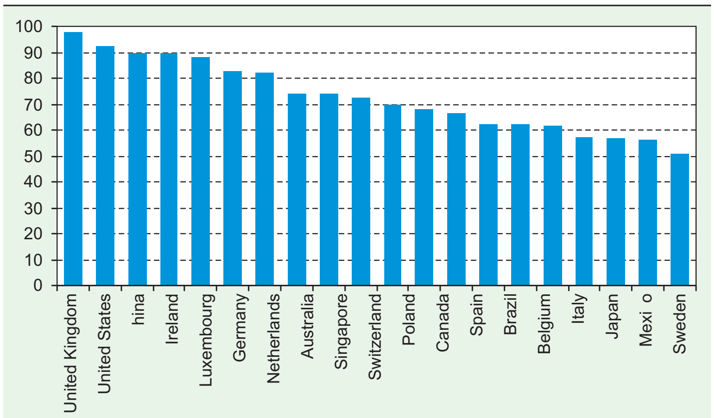
In the new EU accession countries, Bulgaria and Romania, foreign banks have moved rapidly to take dominant positions. In Bulgaria 83% of the banks are controlled by foreign owners. In Romania, Austrian banks are leading (23%), followed by Greek banks (10%) and Italian banks (7%). Romania may offer the best prospects for FDI by foreign banks since, although it is the second largest market in Central and Eastern Europe, it has the least developed banking system.

Source: UNCTAD.

[a] The Association of Balkans Chambers (Albania, Bosnia and Herzegovina, Bulgaria, Cyprus, Greece, Montenegro, Romania, Serbia, the former Yugoslav Republic of Macedonia and Turkey) covers 14.3% of the area of the European continent and 25.3% of its population.

[b] *Business Week*, 20 June 2005.

Figure I.25. Location intensity of the top 20 preferred host countries for financial TNCs, 2007



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

to 6.5% in 2008, it remains well above the average of recent decades (World Bank, 2008a).

Corporate profits are declining[47] and syndicated bank loans to firms during the first half of 2008 nearly halved over the same period of 2007.[48] Corporate survey findings are pessimistic as regards economic prospects. According to the latest *McKinsey Global Survey of Business Executives* (McKinsey, 2008a), a large majority of executives around the world expect a slowdown in the United States to have a negative impact on their national economies, and nearly 90% report at least a moderate link between their economies and the United States economy. CEO respondents to the *11th Annual Global CEO Survey* carried out by Pricewaterhouse Coopers (2008a) fear a global economic downturn, but continue to recognize the strategic importance of overseas expansion. The survey clearly shows that the impact of the recent global credit crunch and the heightened risk of recession are affecting business confidence. A.T. Kearney's survey also shows that investors are concerned about the economic health of the United States (A.T. Kearney, 2008a).

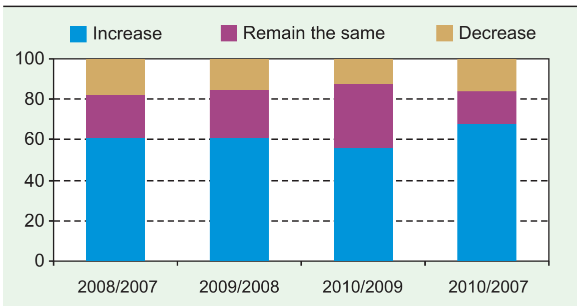
The financial crises could worsen the existing global external imbalances, trigger exchange rate fluctuations, lead to rising interest rates and high and volatile commodity prices, and build inflationary pressure. All of these possible developments pose risks that may also affect global FDI flows.

Will FDI decline in 2008-2009? Based on 75 countries for which data on FDI flows for the first quarter of 2008 were available, annualized FDI flows for the whole of 2008 are estimated to be some $1,600 billion, about 10% less than in 2007. The data on cross-border M&As for the first half of 2008 also show a fall of 29%, compared to the second half of 2007 (figure I.5). However, so far the downswing in FDI flows or cross-border M&As has been much less acute than that of 2001 (figures I.1 and I.5). Some sources point to a fall in FDI flows in 2008 in developed countries (OECD, 2008b), though expectations regarding flows in emerging economies are still upbeat (Institute of International Finance (IIF), 2008a). UNCTAD's *World Investment Prospects Survey 2008–2010*[49] points to lower optimism than that expressed in the previous survey (UNCTAD, 2007b), though it suggests a rising trend in the medium term (figure I.26).[50]

In terms of preferred regions and country groups for FDI, East, South and South-East Asia remains the most preferred region, followed by the EU-15, North America, and the new EU-12 (countries that joined the EU in 2004 and 2007). China is the most preferred investment location, according to the UNCTAD survey, followed by India, the United States, the Russian Federation and Brazil (table I.20). Viet Nam remains in sixth place because of the availability of skilled and cheap labour and its being the second fastest growing economy in the world behind only China. A.T. Kearney's 2007 FDI Confidence Index shows the same top three countries. In Europe taken alone, the United Kingdom is the most attractive location, followed by France, according to a survey by Ernst & Young (2008a). The JBIC survey of Japanese manufacturing TNCs found that China again ranked at the top, although the number of firms planning to expand production in the country continued to decline (JBIC, 2008). As for long-term prospects, the survey showed for the first time India replacing China as the most promising country for business operations of Japanese TNCs.

Looking at prospects by sector, FDI in natural resources is expected to pick up further. High demand for natural resources, partly caused by China's growing economy, and the opening up of new, potentially profitable opportunities in the primary

Figure I.26. Prospects for global FDI flows over the next three years
(Per cent of responses to the UNCTAD survey)



Source: UNCTAD, 2008b.

sector (e.g. gas and oil in Algeria) will attract more FDI into that sector. FDI in commodity-dependent emerging countries is expected to rise more than other emerging countries (IIF, 2008a). Current high food prices may also affect investment decisions in agriculture and related industries.

In conclusion, while the global outlook for international expansion of TNC operations still looks positive, particularly in developing countries, a lower level of optimism and more prudence are expressed by TNCs in their investment expenditure plans than in 2007.

Table I.20. UNCTAD Survey 2008–2010: the most attractive locations for FDI in the next three years (Responses and comparison with the 2007–2009 survey responses)

Economies	2007-2009 survey	Economies	2008-2010 survey
China	56	China	55
India	45	India	41
United States	38	United States	33
Russian Federation	23	Russian Federation	28
Brazil	14	Brazil	22
Viet Nam	13	Viet Nam	12
United Kingdom	10	Germany	9
Australia	10	Indonesia	8
Germany	7	Australia	7
Mexico	7	Canada	6
Poland	7	Mexico	6
		United Kingdom	6

Source: UNCTAD, 2008b.

Notes

1 For example, if the growth rate of FDI inflows is calculated on the basis of euro-denominated FDI inflows for 2007, it would be 19%.

2 For example, at the company level, Toyota, one of the most profitable TNCs in the world, now earns more than half of its profits in developing countries, up from only 17% in 2004 (*Nikkei*, 6 February 2008).

3 Based on the number of projects from the Locomonitor database (www.locomonitor.com). However, data for the value of such projects were not available. This database includes new FDI projects and expansions of existing projects, both announced and realized. Due to lack of data on the value of most projects, only trends based on the number of investment cases can be examined. This database provides data only from 2003 onwards.

4 In the United Kingdom, for example, Sir David Walker, a prominent banker and former regulator, was commissioned to develop a voluntary code of conduct for private equity firms. In November 2007, he recommended that large businesses acquired by private equity should adopt similar regulatory standards to those of listed companies.

5 Data for FDI inflows in major host countries in the beginning of 2008 showed a decline for Canada, France, Germany, Italy, the Netherlands, Switzerland and the United States (see section E).

6 This included the acquisition in 2006 of Inco (Canada) by CVRD of Brazil for $17 billion, which represented the largest investment by a Brazilian company ever.

7 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. 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. 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 variables: GDP per capita, rate of growth of real GDP, share of exports in GDP, telecoms infrastructure (average no. of telephone lines per 100 inhabitants, and mobile phones per 100 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.

8 See, for example, *Economist Intelligence Unit* (EIU, 2007) and work by the OECD on preventing investment protectionism, at: www.oecd.org.

9 A flat tax system refers to a system that taxes everyone at the same rate, regardless of their income bracket.

10 See: www.trade.gov/investamerica/.

11 Altogether six policy changes relating to the extractive industries were identified in the survey in the following four countries: Bolivia, Ecuador, Kazakhstan and the Bolivarian Republic of Venezuela.

12 ICSID (International Centre for Settlement of Investment Disputes) case ARB/07/27, "Mobil Corporation and others v. Bolivarian Republic of Venezuela".

13 Nine of the 16 BITs China signed from 2003 to 2007 were concluded with African countries: Benin, Djibouti, Equatorial Guinea, Guinea, Madagascar, Namibia, Seychelles, Tunisia and Uganda.

14 Norway, for example, is finalizing a new model BIT that includes, *inter alia*, the promotion of transparency in economic cooperation between the parties, and emphasizes the protection of health, safety, the environment and international labour rights. It also stresses the importance of corporate social responsibility and reaffirms the parties' commitment to democracy, the rule of law, human rights and fundamental freedoms.

15 For more details, see Foreign Affairs and International Trade Canada, 2005.

16 These agreements include, for example, closer economic partnership agreements, regional economic integration agreements or framework agreements on economic cooperation.

17 These disputes were filed with ICSID (or the ICSID Additional Facility) (182), under the United Nations Commission on International Trade Law (UNCITRAL) (78), the Stockholm Chamber of Commerce (15), the International Chamber of Commerce (5), and ad-hoc arbitration (5). Another case was filed with the Cairo Regional Centre for International Commercial Arbitration, one was administered by the Permanent Court of Arbitration, and for one case the exact venue was unknown at the time of writing.

18 This number does not include cases that are exclusively based on investment contracts (State contracts) and cases where a party has so far only signalled its intention to submit a claim to arbitration, but has not yet commenced the arbitration (notice of intent). If the latter cases are submitted to arbitration, the number of pending cases will increase. All data concerning investor-State dispute settlement (ISDS) cases are based on UNCTAD's online ISDS database at www.unctad.org/iia.

19 For 11 cases that were decided, the decision is not in the public domain.

20 For ICSID Rules of Procedure for Conciliation Proceedings (Conciliation Rules), see http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp. For the UNCITRAL Conciliation Rules, see http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1980Conciliation_rules.html.

21 Examples include bailed out banks in Germany (IKB, Sachsen LB), a bank run in the United Kingdom (Northern Rock) and massive losses by some of the largest banks (e.g. UBS of Switzerland).

22 "Global 500", *Financial Times*, 29 June 2007 and 28/29 June 2008.

23 For example, the MSCI (Morgan Stanley Capital International) bank index plummeted by nearly 20% in 2007.

24 In real effective terms, the United States dollar depreciated by 28%, whereas the euro and the pound sterling appreciated by 26% and 16% respectively.

25 Empirical studies of the effects of exchange rate changes on FDI flows show conflicting results, depending on the specific assumptions of the underlying economic models, and the structural characteristics of the home and host economies. It is therefore difficult to generalize about the effects of exchange rate changes on FDI flows (Russ, 2007). Indeed, foreign firms did not seem to take advantage of the low exchange rate of the Japanese yen during the 1990s and early 2000s. Record FDI inflows to Japan in 2007 were mainly due to large-scale investments in the financial sector, motivated by strategic considerations other than foreign exchange movements (see section on developed countries in chapter II).

26 It is difficult to determine to what extent exchange rate changes have influenced recent FDI decisions. In recent years, European TNCs have invested heavily within the euro zone as well as in the EU accession countries, as the creation of the euro and greater economic integration in the EU have promoted a concentration of economic activity (*WIR07*). Therefore, increased intra-EU FDI flows to some extent have been at the expense of FDI outflows to other regions and countries, such as the United States.

27 "The declining dollar – how the companies are coping", *CFO Magazine*, 1 February 2008.

28 "Volkswagen plans production in North America", *Reuters*, 22 January 2008 (http://www.reuters.com/article/ousiv/idUSL2665653620080126), and *Nikkei*, 31 May 2008.

29 "The declining dollar – how the companies are coping", *CFO Magazine*, 1 February 2008.

30 "Low dollar threatens the life of Airbus", *Financial Times*, 22 November 2007.

31 "Porsche denies U.S. Cayenne production", *Automotive News*, 15 May 2008 (www.autonews.com).

32 Data from United States Bureau of Economic Analysis (www.bea.gov).

33 These UNCTAD estimates are based on information from Edwin Truman, Peterson Institute for International Economics, JPMorgan Research, Sovereign Wealth Fund Institute and Global Insight. Other agencies report different estimates. For example, JPMorgan estimated $3–3.7 trillion in 2007, and it is expected to reach $5–9.3 trillion in 2012 (Fernandez and Eschweiler, 2008).

34 KIA has had an equity capital stake in Daimler Benz since 1974. This share accounted for 6.9% of the total stock value in 2007.

35 For example, Thyssen-Krupp, a German steel company, had to buy back shares from the Islamic Republic of Iran to cut its stake to under 5% in 2003, down from the 25% which the Government of the Islamic Republic of Iran had acquired in the predecessor company, Krupp, in 1976 when the firm was nearly bankrupt.

36 The Government of Japan requires foreign companies to notify the Government 30 days in advance of plans to purchase 10% or more equity in Japanese high-tech companies.

37 In Germany, a lively debate in 2007 on whether the activities of foreign SWFs should be restricted or controlled led to a proposed change in the German Foreign Trade and Payments Act in 2008. A new paragraph is planned to protect public order and the safety of Germany. FDI from countries outside the EU with an equity capital stake of 25% or more now has to be approved by the German Government (Germany, Bundesministerium für Wirtschaft und Technologie, 2008). The German industry federation, BDI, has repeatedly warned against economic patriotism and supports for a continuing high degree of openness to FDI inflows by the German corporate sector ("Investitionsfreiheit bewahren", *BDI*, 15 August 2007, http://www.bdi.eu/dokumente/positionspapier_investitionsfreiheit_bdi_432584.pdf.

38 In France, for example, President Sarkozy promised to protect French managers from "extremely aggressive" sovereign wealth funds (*Economist*, 17 January 2008:1).

39 The Government of the United Kingdom can restrict foreign investments in specific companies that it considers important to national security through government ownership of majority shares of these companies (United States GAO, 2008).

40 According to its disclosure, NGPF has invested 40% of its assets in more than 3,500 equity capital stakes worldwide. None of these investments is larger than 5% of the total value of outstanding stocks of the target companies, and therefore none can be counted as FDI (Norges Bank Investment Management, 2007).

41 For example in November 2007, PetroChina, first to hit $1,000 billion in value, became the world's largest company, ahead of ExxonMobil and General Electric. The capitalization of PetroChina is much lower in June 2008 but still ranked second according to the Global 500 ranking (*Financial Times*, 28/29 June 2008). However, this firm is not included in the list of the largest TNCs from developing economies in terms of foreign assets. Neither is Microsoft – ranked fifth – listed in the world's largest TNCs by foreign assets.

42 Location intensity is defined as the total number of TNCs having at least one affiliate in the host country, divided by 100, minus the number of TNCs from this country listed in the top 100 (*WIR06*: 34).

43 UNCTAD's TNI was introduced in 1995 as a response to the academic debate on the ways to measure transnationality.

44 According to Vander Vennet (1994 and 2002), the market power motive can better characterize EU banks because they are organized as a system of national oligopolies.

45 The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which in June 1995 allowed nationwide inter-State banking through holding company banks, and the Gramm-Leach-Bliley Act of 1999, which allowed cross-industry mergers between commercial banks and other financial institutions.

46 Northern Rock (United Kingdom) was nationalized by the Government of the United Kingdom and the United States Federal Reserve orchestrated the rescue takeover of the investment bank Bear Stearns by rival firm JP Morgan Chase.

47 For example, earnings of S&P 500 companies have been declining since the last quarter of 2007 (*source*: Standard & Poor's Index Service).

48 According to Dealogic the syndicated loans worldwide in the first half of 2008 were $1.5 trillion, the lowest level in the past four years (*Nikkei*, 7 July 2008).

49 This survey of some of the largest TNCs is conducted worldwide on an annual basis. It was undertaken from March to June 2008 using a sample of 3,000 companies chosen from among 8,000 TNCs. 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, 2008b).

50 An average of 63% of the companies surveyed expressed optimism regarding FDI prospects for the period 2008–2010 (figure I.26), and 59% expected an increase in FDI flows in 2008.

CHAPTER II

REGIONAL TRENDS

INTRODUCTION

This chapter examines FDI flows in 2007, focusing on their changing geographical, and sectoral and industrial patterns, policy developments underlying those patterns, and prospects for FDI flows in 2008.

FDI inflows and outflows grew in all major regions (table II.1) and virtually all subregions in 2007. Inflows to developing countries and the transition economies of South-East Europe (SEE) and the Commonwealth of Independent States (CIS) reached new highs. Among developing economies, while South, East, South-East Asia and Oceania remained the largest regional recipients, accounting for almost half of the total inflows, Latin America and the Caribbean recorded the largest increase (by 36%) in 2007.

Developing countries saw record FDI inflows in 2007, although their share in global FDI inflows continued to decline, accounting for only 27%, down from to 29% in 2006 and 33% in 2005. This was mainly due to the large inflows into developed economies. In contrast, the share of the transition economies rose to 4.7% (table II.1).

FDI outflows in 2007 showed almost the same pattern as inflows: they reached record levels for all the regions and almost all subregions. The share of developed countries in total world FDI outflows increased at the expense of developing countries' share while that of economies in transition, although small, maintained its upward trend (table II.1).

Regarding sectoral distribution, judging from the data on cross-border M&As (as data on FDI flows by sector for 2007 were not available at the time of writing), FDI rose in almost all sectors in all the groups of economies. While FDI in services increased in all regions, the largest increase was in manufacturing in developing and developed economies. On the other hand, in the transition economies FDI in manufacturing fell but increased significantly in the primary sector (table II.2).

Table II.1. FDI flows, by economic group and region, 2005–2007
(Billions of dollars and per cent)

Region	FDI inflows			FDI outflows		
	2005	2006	2007	2005	2006	2007
World	959	1 411	1 833	881	1 323	1 997
Developed economies	611	941	1 248	749	1 087	1 692
Developing economies	316	413	500	118	212	253
Africa	29	46	53	2	8	6
Latin America and the Caribbean	76	93	126	36	63	52
West Asia	43	64	71	12	23	44
South, East and South-East Asia and Oceania	168	210	249	67	118	151
Transition economies (South-East Europe and CIS)	31	57	86	14	24	51
Memorandum: percentage share in world FDI flows						
Developed economies	63.8	66.7	68.1	85.0	82.2	84.8
Developing economies	33.0	29.3	27.3	13.3	16.0	12.7
Africa	3.1	3.2	2.9	0.3	0.6	0.3
Latin America and the Caribbean	8.0	6.6	6.9	4.1	4.8	2.6
West Asia	4.4	4.5	3.9	1.4	1.8	2.2
South, East and South-East Asia and Oceania	17.5	14.9	13.6	7.6	8.9	7.5
Transition economies (South-East Europe and CIS)	3.2	4.1	4.7	1.6	1.8	2.6

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

Table II.2. Cross-border M&A sales, by sector and by group of economies, 2005-2007
(Billions of dollars)

Group of economies	2005 All sectors	2005 Primary	2005 Manu-facturing	2005 Services	2006 All sectors	2006 Primary	2006 Manu-facturing	2006 Services	2007 All sectors	2007 Primary	2007 Manu-facturing	2007 Services
World	929.4	155.8	255.0	518.5	1118.1	108.8	304.8	704.5	1637.1	109.8	567.4	959.9
Developed economies	820.4	150.9	222.4	447.0	969.1	97.8	275.5	595.8	1454.1	85.4	530.5	838.2
Developing economies	95.7	2.4	26.3	67.1	131.8	7.7	22.7	101.4	152.9	14.7	35.2	103.0
Transition economies (South-East Europe and CIS)	12.8	2.5	6.3	4.0	17.1	3.3	6.5	7.3	30.1	9.7	1.7	18.7

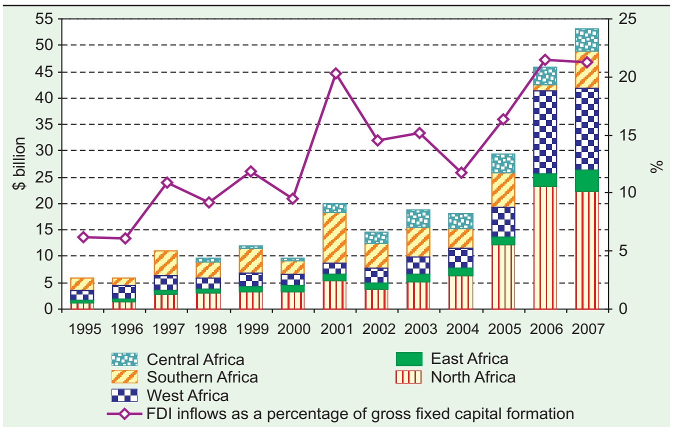
Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics).

A. Developing countries

1. Africa

In Africa, FDI inflows grew to $53 billion in 2007, their highest level so far, despite the global financial crisis. Strong FDI growth in the region for the third consecutive year (figure II.1) was driven by a booming global commodities market, rising corporate profitability of investment and an increasingly FDI-friendly environment. The commodities-market boom also helped drive FDI outflows from Africa amounting to $6 billion, although this was a decline from 2006 when they reached $8 billion. Inflows relative to the region's gross fixed capital formation stabilized at 21% (figure II.1). In spite of the new policy measures adopted to reduce red tape for business start-ups, privatize more State-owned firms and encourage FDI participation in public projects, still greater policy efforts are needed to enhance national productive capacities in Africa. Given the strong global commodities markets, large project commitments and pending payments for concluded cross-border M&As, prospects for increased FDI inflows to the region in 2008 are good, and could lead to a fourth consecutive year of FDI growth.

Figure II.1. Africa: FDI inflows in value and as a percentage of gross fixed capital formation, 1995–2007



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

a. Geographical trends

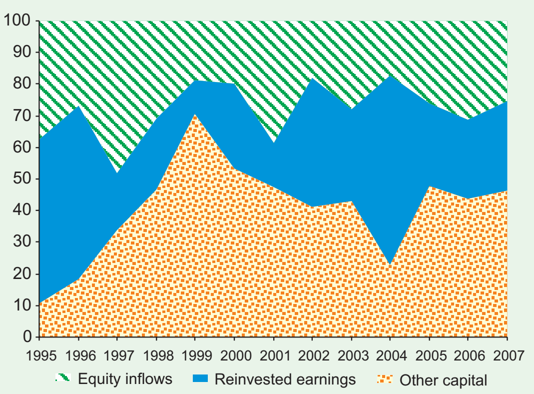
i. Inward FDI: increased flows, not just to oil producers

In 2007, FDI inflows to Africa grew by16% to reach $53 billion, increasing the region's FDI stock to $393 billion. TNCs took advantage of good returns on investment in the region (figure II.2)[1] and high global commodity prices to expand their regional operations, opening various exploration projects in new territories and disbursing payments for a line-up of acquisition deals concluded in 2006, in addition to new ones initiated in 2007. The growth of FDI inflows was spread across 35 countries, and included many natural resource producers that have been attracting flows in the past few years, as well as new host countries. The distribution of the inflows changed slightly: the 6 countries of North Africa attracted 42% of the FDI to the region in 2007 compared with 51% in 2006, and the 47 countries of sub-Saharan Africa attracted 58% of the flows, up from 49% in 2006. While most countries of North Africa continued to attract inward FDI, large inflows to Nigeria and South Africa, combined with good performance in Equatorial Guinea, Madagascar and Zambia – each receiving about $1 billion or more inflows in 2007 – boosted overall FDI to sub-Saharan Africa.

The value of cross-border M&As in the region fell in 2007 due partly to the smaller number of mines and exploration projects available for sale. In the case of greenfield FDI, partly because of reduced investments in new mines, the number of investment projects in the region also declined to 380 in 2007, from 473 in 2006 (annex table A.I.1). The fall in cross-border M&As and greenfield projects appears in many cases to have been compensated for by a rise in intra-company loans from parent firms and reinvested earnings – two of the three components of FDI flows that are not necessarily captured in the data on cross-border M&As and greenfield projects used in this report – leading to the rise in total FDI inflows (as measured by balance-of-payments data). The share of reinvested earnings in total FDI inflows to Africa was

28% in 2007, compared with 25% in 2005-2006, and the share of intra-company loans (other capital flows) was 46%, up from 44% in 2006 (figure II.2)

Figure II.2. FDI inflows to Africa, by component, 1995–2007
(Per cent)



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

Note: The number of African countries covered in this figure varies by year from 11 to 26 countries (with 11 countries covered in 2007), for which data on all three components were available.

All the subregions of Africa except North and West Africa experienced growth in FDI inflows in 2007, with the highest growth rate registered in Southern Africa. In 18 countries, there was a decline in inflows partly because of exploration activities that failed to yield enough reserves for continued investments. Despite the rise of inflows to the region as a whole, the share of Africa in total world FDI inflows in 2007 remained low at about 3%. As shown by cross-border M&A data (table II.3), the leading foreign investors were TNCs from Canada, Europe (mainly France and Switzerland) and the United Arab Emirates.

The 10 leading FDI host countries (figure II.3) in Africa accounted for over 82% of the region's inflows. The number that received FDI inflows of $1 billion or more increased to 9 (table II.4) from 8 in 2006. South Africa and Madagascar rejoined the list of top 10 FDI host countries, displacing Chad and Ghana from the 2006 list, though inflows remained large in those two countries in 2007. In terms of average FDI inflows since the beginning of 2000, Nigeria remained the largest recipient, accounting for 16% (the highest share) of the region's FDI stock. The top 10 host countries in 2007 shared a number of common features: large reserves of natural resources and/or active privatization programmes, liberalized FDI policies and active investment promotion activities. A larger number of African countries, including LDCs (box II.1), attracted higher levels of FDI, though exploration for natural resources in many of them has caused their FDI inflows to fluctuate (table II.4).

Rising FDI inflows have had an impact on host economies in the region. In the major natural resource producers, FDI in natural resource exploitation projects has contributed to accelerated export growth. Foreign-exchange reserves in the region as a whole grew by some 36% in 2007, with Nigeria and the Libyan Arab Jamahiriya registering particularly high increases.[2] Income on inward FDI grew by 31% in 2007, and the rate of return on FDI in Africa, which has increased steadily since 2004, was the highest among developing host regions in 2006 and 2007 (figure II.4).[3]

FDI inflows in 2007 to the five subregions of Africa differed with respect to their level, growth and geographic distribution.

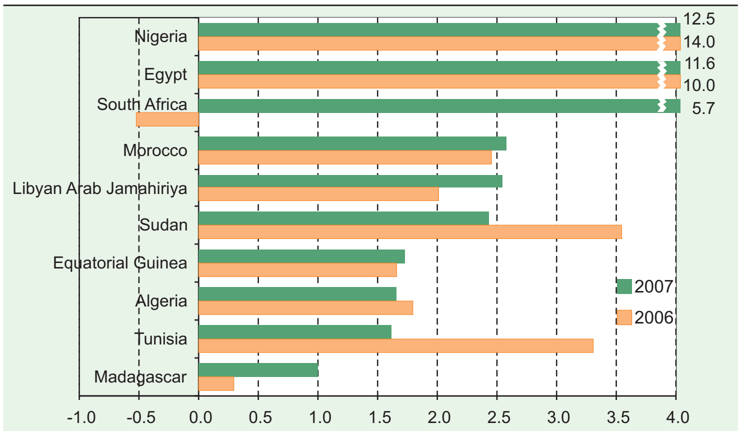
North Africa.[4] Renewed privatization programmes and policies aimed at improving efficiency contributed to maintaining large FDI inflows to North Africa in 2007, at $22 billion. Inflows to Egypt remained very large, reaching nearly $12 billion in 2007, a 15% increase from 2006. The major industries that attracted FDI to that country included textiles, oil and chemicals, and generic pharmaceutical production. Privatization of several State-owned enterprises also played a role in the subregion. For example, in Algeria privatization

Table II.3. Africa: cross-border M&As, by region/economy, 2005-2007
(Millions of dollars)

	Sales of African firms			Purchases by African firms		
Region/economy	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
World	11 259	19 806	10 217	18 496	24 295	5 501
Developed economies	9 561	9 505	7 160	15 795	16 934	3 897
Europe	8 843	8 566	5 014	14 847	15 038	2 376
European Union	8 843	8 566	3 945	14 808	15 038	2 376
France	2 217	805	2 591	-	2	-
Italy	590	1 600	23	12 799	5 062	-
United Kingdom	5 885	4 812	250	1 499	9 293	2 191
Other developed Europe	-	-	1 069	39	-	-
Switzerland	-	-	1 069	39	-	-
North America	657	798	1 755	178	1 856	1 356
Canada	318	389	1 719	-	1 839	854
United States	339	409	36	178	17	502
Developing economies	1 444	10 093	2 808	2 679	7 280	1 439
Africa	1 008	724	547	1 008	724	547
Other Africa	1 008	724	248	1 008	724	248
South Africa	1 001	724	247	954	724	247
Asia	436	9 224	2 261	1 671	6 134	737
Kuwait	-	2 337	-	-	-	-
Lebanon	103	-	-	-	5 948	-
United Arab Emirates	-	2 849	1 430	-	-	-
China	-	2 692	-	1	-	-
Hong Kong, China	-	901	65	1 302	-	-
South-East Europe and CIS	-	-	250	22	81	165

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

Figure II. 3. Africa: top 10 recipients of FDI inflows,[a] 2006–2007
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of 2007 FDI flows.

of Crédit Populaire d'Algérie (CPA) was completed. The entry of HSBC (United Kingdom) and Deutsche Bank (Germany) into the country's financial services industry and the acquisition by Linde (Germany) of a controlling stake in a State-owned industrial gas company, also contributed to the surge in FDI inflows. In the Libyan Arab Jamahiriya, the State-owned Oilinvest Group sold a 65% stake in Tamoil to Colony Capital (United States) for $5.4 billion, in addition to other investments in the oil industry.[5] In Morocco, FDI inflows grew as a result of some privatizations.[6]

West Africa.[7] The FDI boom in the primary sector and privatization schemes of telecommunications companies led to another year of large inflows to West Africa ($15.6 billion in 2007, slightly lower than the $15.8 billion in 2006). The subregion's share of FDI inflows to Africa however declined to 29% from 34% in 2006. FDI mostly reflected expansion projects in Nigeria's oil industry,[8] and project upgrades by TNCs already operating in Burkina Faso,[9] Côte d'Ivoire[10] and Mali.[11]

East Africa.[12] In East Africa, new prospects in the primary sector in non-traditional producer countries drove FDI inflows in 2007 to $4 billion, compared with $2.4 billion in 2006. A sluggish performance in the traditionally largest recipients of FDI inflows was offset by increased FDI in exploration activities in new recipients. However, the subregion ranks the lowest in FDI inflows to Africa. The United Republic of Tanzania received increased FDI in several natural-resource exploitation projects already in operation. There were significantly higher inflows to Djibouti, Kenya, Madagascar, Mauritius, Seychelles and Somalia, while in Uganda, FDI declined marginally. Inflows to Madagascar were exceptionally high due to investment in nickel exploitation projects,[13] and in Kenya they increased due to large privatization sales in the telecommunications industry and investments in railways. FDI inflows to Mauritius targeted the tourism sector, in particular the hotel industry which has gathered momentum lately under the Integrated Resorts Scheme. The main sources of FDI inflows to this country were the United Kingdom and the United States. Inflows to Ethiopia declined because of oil exploration projects that failed to yield sufficient reserves to warrant more investments.

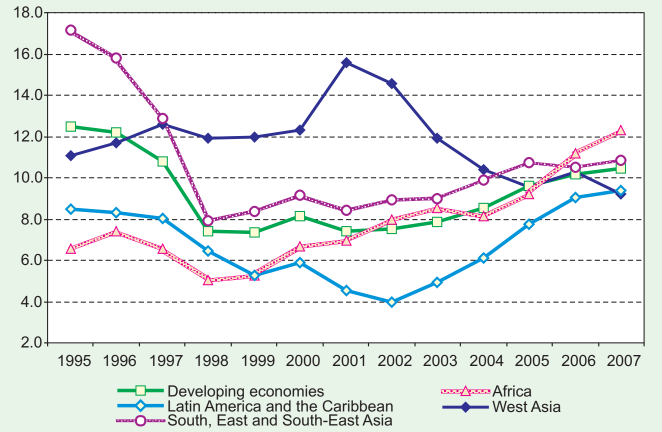
Central Africa.[14] In the Central African subregion, Asian TNCs and a few others from developed countries contributed to the 26% increase in FDI inflows, to $4 billion in 2007. Nevertheless, the subregion accounted for less than 8% of total FDI inflows to Africa, most of it from developing countries. As in the past, much of those inflows went into the primary and services sectors, including infrastructure development, with a large part of the increase reflecting greater spending by TNCs on oil and mining exploration. Equatorial Guinea, the Democratic Republic of the Congo, Chad, Congo and Cameroon, in that order, were the leading FDI destinations in the subregion. In Equatorial Guinea, FDI

Table II.4. Africa: distribution of FDI flows among economies, by range,[a] 2007

Range	Inflows	Outflows
Over $3.0 bn	Nigeria, Egypt and South Africa	South Africa
$2.0 bn to $2.9 bn	Morocco, Libyan Arab Jamahiriya and Sudan	..
$1.0 bn to $1.9 bn	Equatorial Guinea, Algeria and Tunisia	..
$0.5 bn to $0.9 bn	Madagascar, Zambia, Ghana, Kenya, Democratic Republic of Congo, Namibia, United Republic of Tanzania, Chad and Burkina Faso	Egypt and Morocco
$0.2 bn to $0.4 bn	Botswana, Mozambique, Côte d' Ivoire, Uganda, Mali, Congo, Mauritius, Cameroon, Gabon, Ethiopia and Seychelles	Liberia, Angola, Algeria and Nigeria
Less than $0.2 bn	Djibouti, Cape Verde, Mauritania, Somalia, Guinea, Lesotho, Sierra Leone, Senegal, Togo, Zimbabwe, Rwanda, Gambia, Malawi, Benin, Liberia, Swaziland, São Tomé and Principe, Central African Republic, Niger, Guinea-Bissau, Comoros, Burundi, Eritrea and Angola	Mauritius, Gabon, Botswana, Kenya, Tunisia, Rwanda, Sudan, Senegal, Seychelles, United Republic of Tanzania, Mauritania, Congo, São Tomé and Principe, Zimbabwe, Swaziland, Malawi, Mali, Niger, Cape Verde, Mozambique, Côte d'Ivoire, Benin, Cameroon and Burkina Faso

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

Figure II.4. Rates of return on inward FDI by developing regions, 1995–2007



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

Note: The rate of return is calculated as direct investment income for the current year divided by the average of FDI stock of the previous year and the current year. The figures for 2007 rates of return are based on 39 countries in Africa, 33 in Latin America and the Caribbean, 11 in West Asia and 18 in South, East and South-East Asia.

inflows remained high despite the fact that some TNCs, such as Devon Energy (United Kingdom), divested their interests, including in new oil block allocations.

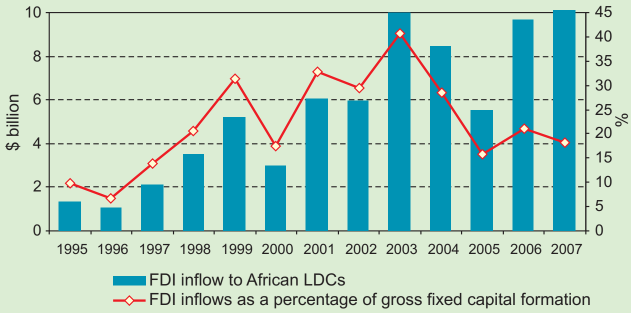
Southern Africa.[15] FDI inflows to Southern Africa grew more than fivefold, the highest among the subregions, to $7 billion in 2007. A major increase in FDI to the top five host countries – South Africa, Zambia, Namibia, Botswana and Mozambique – accounted for this impressive growth. There was an increase in FDI from Asia, particularly China. For example, the Standard Bank Group (South Africa) sold a 20% stake, worth about $6 billion (36.7 billion Rand) to State-controlled Industrial and Commercial Bank of China (ICBC).[16] In Mozambique, inflows increased significantly as a result of increased investment in the aluminium industry because of demand for alumina in China. Higher FDI inflows into Zambia have largely been

Box II.1. FDI in African LDCs:[a] resource exploitation leads to a second year of growth in inflows

In 2007, FDI inflows to the LDCs in Africa increased to $10 billion, from $9.6 billion in 2006 (box figure II.1.1) as TNCs responded to the continued rise in global commodity prices. This growth of inflows marks a second year of consecutive growth in their FDI inflows, most of them in greenfield and expansion projects prospecting for reserves of base metals and oil, in addition to some investments in infrastructure development. Some of the inflows went into the privatization schemes in the telecommunications and electricity industries in the LDCs. However, the share of LDCs in FDI inflows to Africa declined to 19% in 2007 from 21% in 2006, mainly due to large inflows to the non-LDCs, particularly Nigeria, Egypt and South Africa.

The top 10 destinations for FDI inflows among the African LDCs in 2007 were Sudan, Equatorial Guinea, Madagascar, Zambia, the Democratic Republic of the Congo, Chad, Burkina Faso, the United Republic of Tanzania, Mozambique and Uganda, in that order. TNCs that were active investors in these countries in 2007 included a relatively large number from developing countries, such as CNOOC (China), Sonatrach International Petroleum (Algeria), PT Medco Energi International (Indonesia), Eximbank (Republic of Korea), Sainik Coal Mining (India) and Ophir Energy (South Africa).

Box figure II.1.1. African LDCs: FDI inflows in value and as a percentage of gross fixed capital formation, 1995–2007



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

Only two African LDCs (Angola and Eritrea) registered negative FDI inflows in 2007, the same number as in 2006. The fewer number of countries registering negative inflows in recent years may suggest the emergence of opportunities for FDI in these countries as the prices of their resources have appreciated dramatically, investor confidence has risen and civil strife decreased. In addition, the international community has created various market access initiatives over the years, such as the Generalized System of Preferences (GSP), Everything but Arms (EBA) and the African Growth and Opportunity Act (AGOA), to help them attract FDI in the manufacturing sector. However many of these host countries are impeded from exploiting these opportunities by a number of persistent constraints relating to domestic costs and capacities. Some investments aimed at taking advantage of the market access initiatives (textile exports to the United States under AGOA, for instance) were withdrawn because the advantages were outweighed by the cost of production in the host economies compared with other production locations, for instance in Asia (UNCTAD, 2008a: 6).

Source: UNCTAD.

[a] The 33 African LDCs are: Angola, Benin, Burkina Faso, Burundi, 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 (Cape Verde graduated out of LDC status in 2008).

attributed to a surge in the copper mining industry, particularly at Lumwana Mine, as well as at Konkola Deep Mining Project.[17]

ii. Outward FDI: mainly driven by South Africa

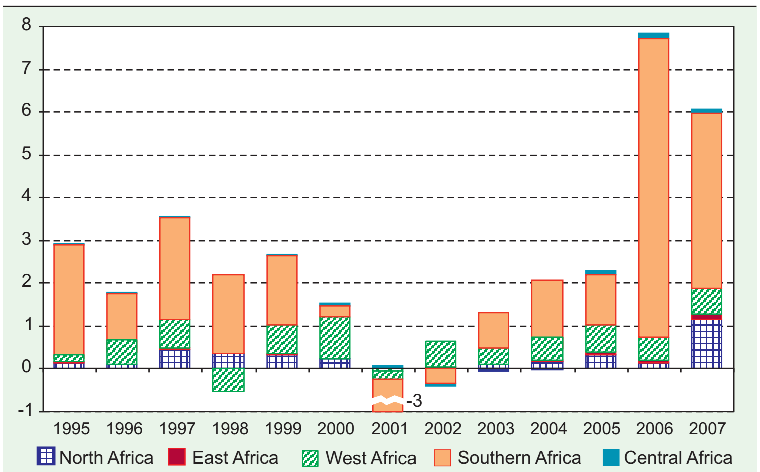
FDI outflows from Africa in 2007 remained large compared to previous years, at $6 billion, though they were short of their peak of $8 billion in 2006 (figure II.5). This was mainly due to expansion of operations by TNCs, mainly from South Africa but also from some new home countries that benefited from revenues from high commodity prices.

The top 10 contributors to outward FDI from the region were South Africa, Egypt, Morocco, Liberia, Angola, Algeria, Nigeria, Mauritius, Gabon and Botswana, in that order (annex table B.1). They invested in natural resource exploitation and the services sector. Of these countries, South Africa was the most important (annex table B.1), with many of its TNCs acquiring stakes in major projects both within the region and outside, particularly in banking, information and communications technology, infrastructure development and natural resource industries.

b. Sectoral trends: a rise of inflows to services

Regarding the sectoral distribution of FDI inflows to Africa, those to the manufacturing sector lagged behind the other two sectors. However, cross-border M&As in manufacturing performed better in 2007 (table II.5) as some countries made efforts to shift towards higher value-added production (box II.2) and services. Higher labour costs relative to other developing countries, especially in Asia, and increasing costs of production in manufacturing are in many cases a deterrent to investors.[18]

Figure II.5. Africa: FDI outflows, 1995–2007



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

Primary sector. A large number of enterprises and projects for sale led to an increase in cross-border M&As in the sector, to $4.6 billion in 2007 (table II.5). All of these were in the mining, quarrying and petroleum industries. So far, FDI flows in this sector have had little impact on downstream activities, although some countries are initiating programmes. In the petroleum industry, some African countries such as Côte d'Ivoire, Egypt and Nigeria are significantly expanding their refinery capacities. Botswana is also moving towards higher value-added activities through FDI (box II.2). A major challenge for African host governments is to channel petroleum and mining revenues for investment in physical and human capital that could benefit economic growth and development. For example, they could attract FDI into diversified and higher value-added activities (see also *WIR07*).

Manufacturing. In 2007, data on cross-border M&As point to a slow recovery of FDI in the manufacturing sector in Africa from its decline in the 1990s. The value of M&A sales in the sector amounted to 28% of the region's total cross-border M&A sales, rising to $2.9 billion in 2007, from $0.8 billion in 2006. Cross-border M&A sales by TNCs in some key manufacturing industries such as chemicals and pharmaceutical products and non-metallic mineral products picked up in 2007 (table II.5). The automobile industry in Morocco and South Africa attracted sizeable greenfield investments, and flows to the latter country may increase further following a new pact with the EU.[19]

Within Africa, new textile and apparel firms from Mauritius have moved to Madagascar, and South African clothing companies[20] have invested in Lesotho. TNCs from the Libyan Arab Jamahiriya have purchased textile factories in Uganda. Yet, wages in a typical African country striving to attract FDI in this industry, such as Lesotho, are much higher than those in Bangladesh and China, for example. As a result, TNCs in this industry in Africa are not able to compete in markets abroad with cheaper imports from other developing countries. Lack of resources for enhancing technical skills continues to pose a problem in the manufacturing sector.

Services sector. In the services sector, finance was the largest FDI recipient in 2007, according to cross-border M&A data (table II.5). The Industrial Bank of China (ICBC) made one of the largest investments in the Standard Bank Group of South Africa. Barclays Bank (the United Kingdom) and ABSA (South Africa) continued to acquire banks in other African countries. Increased financing of FDI projects by the affiliates of some major global banks in Africa, such as Barclays Bank, required capital from parent banks. FDI in other services such as business and health services is still small.

TNCs continued to invest in infrastructure projects in areas such as electricity, telecommunications and water. Leading African firms in these services are South African TNCs such as Eskom, MTN, Vodacom, Spoornet and Transnet, although other, non-African TNCs, particularly from the EU, such as Veolia (France) that is involved in a water management project, are also active. In addition, TNCs from China, for instance, are engaged in building hydroelectric stations in African countries.

Table II.5 Africa: cross-border M&As, by sector/industry, 2005–2007

(Millions of dollars)

	Sales			Purchases		
Sector/industry	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
Total	11 259	19 806	10 217	18 496	24 295	5 501
Primary	1 060	3 515	4 638	67	2 176	1 368
Mining, quarrying and petroleum	1 060	3 515	4 638	67	2 176	1 368
Manufacturing	1 479	839	2 858	551	365	1 179
Food, beverages and tobacco	-	661	-	18	191	-
Wood and wood products	158	-	-	164	-	585
Chemicals and chemical products	9	3	1 715	186	-	-
Non-metallic mineral products	967	-	878	54	119	513
Services	8 720	15 453	2 722	17 878	21 754	2 955
Trade	913	1 001	283	1 590	89	166
Transport, storage and communications	1 876	9 686	738	1 395	5 886	318
Finance	5 895	3 509	1 378	14 831	15 170	1 987
Business activities	4	1 038	91	40	187	120

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

c. Policy developments

In 2007, African countries introduced significant FDI-related policy and institutional reforms at both national and regional levels. Their development partners, including major home countries, and regional and multilateral entities, also took significant steps that may influence FDI inflows into Africa.

i. Improving the investment climate

Over the past few years, African countries have increased their efforts to develop or enhance their national policies and laws with a view to improving the investment climate. Ten countries introduced policy measures in 2007, most of which were in the direction of making their regulatory frameworks more favourable to FDI and TNCs (box II.3).

In 2007, 11 African countries signed a total of 11 bilateral investment treaties (BITs), and 10 countries signed 11 double taxation treaties (DTTs), raising the total number to 696 and 459 respectively. Approximately 50% of the BITs and 60% of the DTTs signed by African countries were with developed countries, mainly the United Kingdom, France, Germany and Italy.

African regional entities also introduced a number of FDI-related policy and institutional reforms in 2007. For example:

Box II.2. Some measures to shift FDI towards greater value added activities: the case of diamonds in Botswana

In Botswana, a new diamond-cutting factory operated by Pluczenik (Belgium) opened in Gaborone's industrial zone in 2007, bringing the number of cutting companies in operation in that zone to five. In total, 16 such companies have been issued with licences in the country. The development of the country's diamond-cutting and polishing industry will be greatly boosted by the opening of the Diamond Trading Company (DTC) Botswana in 2008, taking over the aggregation and distribution of much of De Beers' global rough diamond production from the DTC in London. The new investments have been driven by the assurance of an uninterrupted supply of rough diamonds from Botswana at a time of expected global shortages.

However, costs of polishing diamonds in sub-Saharan Africa were $70–$100 a carat compared with $6–$8 a carat in India, a country with roughly one million people in the industry.[a] Measures such as the Diamond Export Levy Bill, enacted in 2007 by the South African parliament, are intended to increase the volume of stones cut and polished in South Africa, which in 2006 produced 11% of the world's supply of rough diamonds.[b]

Applying measures such as those described above, Botswana and South Africa, as well as other diamond-mining countries in the region, could attract diamond-processing firms and capture part of this market, which was worth $69 billion globally in 2006.[c] The benefits of such value-added production would help create jobs and increase the value of export earnings from the gems, which could then be used towards attaining national development goals.

Source: UNCTAD, based on "Oppenheimer warns of limits on SA diamond beneficiation", *BusinessDay*, 9 September 2007 (http://www.businessday.co.za/articles/dailymailer.aspx? ID=BD4A519551); and "Botswana industry: Pluczenik opens new diamond-cutting factory", *EIUViewswire*, 16 May 2007.

[a] Nine out of 10 diamonds in the world are polished in India, according to the industry body, World Diamond Council (www.worlddiamondcouncil.com).

[b] Under the bill, all producers would have to supply a newly created State diamond trader with 10% of their production. Large producer TNCs such as De Beers, with annual gross sales of more than $490 million (3 billion rand), would have to sell 40% of their annual diamond production to local cutting and polishing firms if they want to export the remainder duty-free.

[c] According to figures from New York-based trading platform Rapaport (diamond review, at: www.diamond.info).

- *The Common Market for Eastern and Southern Africa (COMESA)* adopted an investment agreement for the COMESA Common Investment Area, which envisages a free investment area by 2010 (box II.4). Moreover, as part of its efforts to make the region an attractive destination for regional and international investors, the COMESA Regional Investment Agency (RIA) was launched in 2006. It is implementing several activities and projects.[21]
- *The Economic Community of West African States (ECOWAS)* created a department responsible for promoting cross-border investments and joint venture businesses, mandated specifically to: (i) improve the investment climate in the region; (ii) facilitate consultations and the exchange of information; (iii) facilitate the establishment of multinational joint ventures and community enterprises, and of public-private partnerships to promote regional investment; and (iv) encourage West African entrepreneurs to develop and maintain links with relevant regional and international bodies. ECOWAS is also preparing the following: a bill on an investment policy framework aimed at harmonizing and simplifying investment policies within the region, a draft on regional investment rules, and a draft community investment code for consideration by ECOWAS member States (Addy and Samb, 2008: 33).
- *The Southern African Development Community (SADC)* is implementing the Finance and Investment Protocol, a key instrument for deeper regional integration. So far, 10 of its 14 member States have signed the Protocol. SADC is also undertaking a joint investment promotion programme with the EU to facilitate various workshops, meetings and seminars.
- *The African Development Bank (AfDB)* signed an memorandum of understanding with the Export-Import Bank of China in May 2008, which includes the provision of co-financing or guarantee for public sector and possible private sector investment projects. The Bank supports the NEPAD Infrastructure Short Term Action Plan (STAP) and the Medium-Long Term Strategic Framework (MLTSF). It also manages a multi-donor NEPAD Infrastructure Project Preparation Facility (NEPAD-IPPF).

ii. How development partners are promoting investment in Africa

Various countries and international and regional organizations have launched a number of initiatives to promote investment in Africa. *China* expanded its support to Chinese investments in Africa, building on its general investment policy on Africa adopted in 2006.[22] In 2007, the Export-Import Bank of China financed over 300 projects in the region, constituting almost 40% of the Bank's loan book (Davies et al., 2008: 3).

Japan, at the Fourth Tokyo International Conference on African Development (TICAD IV) in May 2008, announced its decision to create a facility within the Japan Bank for International Cooperation

Box II.3. Changes in national laws and regulations in Africa relating to inward FDI in 2007

According to UNCTAD's annual review of changes in national laws and regulations concerning FDI, 10 African countries introduced a total of 14 such changes in 2007. Of these, 11 made regulatory frameworks more favourable to FDI and TNCs:

- *Cape Verde* simplified the procedure for approving new investments. It opened up all of its industries to foreign investment, with emphasis on light manufacturing, tourism and fishing.
- *Egypt* eased procedures for setting up special investment zones.
- *Kenya* finalized regulations that promote the licensing of risk capital companies and eased the requirements for banks (including foreign banks).
- *The Libyan Arab Jamahiriya* allowed foreign investors to repatriate profits and transfer liquidated balances abroad in exchangeable currencies, and offered investors tax reductions for up to five years and exemption from customs duties of equipment, machinery and related goods imported for projects in the country.
- *Mauritius* reduced corporate tax rates from 22.5% to 15%.
- *Nigeria* exempted companies established in the free trade zone or export processing zone from profits tax, provided 100% of their production is destined for export.
- *Sudan* allowed foreigners to own 100% of a company's capital.

According to the UNCTAD review, three African countries introduced regulatory measures that were less favourable to FDI and TNCs:

- *Algeria* subjected all transfers and sales of foreign investments to a national approval mechanism.
- *Mozambique* restricted foreign shares in local companies to minority holdings, and barred foreigners from becoming managers, administrators and directors of companies.
- *Zimbabwe* imposed a 51% local ownership requirement. It is also considering a draft bill that would enable the State to take a 25% stake in mining firms.

Source: UNCTAD database on national laws and regulations.

(JBIC) for investment (i.e. equity investment, guarantees and local financing) in Africa of $2.5 billion over the next five years. This is twice the total FDI flows from Japan to Africa during the past five years (2003–2007) or twice the size of Japanese FDI stock in Africa in 2007.

The United States signed trade and investment framework agreements with three African countries (Mauritius and Rwanda in 2006, and Liberia in 2007).[23] It also negotiated a Trade, Investment and Development Cooperative Agreement (TIDCA) with the Southern African Customs Union (SACU), expected to be signed in mid-2008.[24] This agreement will provide the framework for trade and investment promotion activities that could constitute the "building blocks" for an eventual resumption of free trade negotiations while allowing the two parties to take interim steps for improving their trade and investment relationships. The TIDCA will establish a forum for consultative discussions on a wide range of issues. A Consultative Council will oversee implementation of the agreement, set up working groups and monitor progress towards the negotiation of various trade and investment-related agreements.

The Commonwealth Secretariat has launched a programme of assistance to African countries that includes the review and modernization of national trade-related investment legislation to ensure that it is consistent with international trade commitments and conducive to harnessing foreign investment to economic growth and development. It was also involved in promoting development of professional services in African countries by encouraging investment in those services in the Gambia, Kenya, Namibia, Uganda and the United Republic of Tanzania.

The European Free Trade Area (EFTA)[25] started implementing a free trade agreement (FTA) with Egypt in 2007. The Agreement includes provisions on investment, services, State monopolies and subsidies, protection of intellectual property, capital movements, government procurement and institutional and procedural matters. In May 2008, an FTA between the EFTA States and SACU also entered into force.

Box II.4. COMESA Agreement for a Common Investment Area

In May 2007, COMESA[a] adopted an agreement for a Common Investment Area, which envisages a free investment area by 2010. The Agreement aims, *inter alia,* at attracting and promoting sustainable FDI by gradually eliminating restrictions and conditions relating to investment and operation of projects. The new Agreement is intended to help its members, most of which are too small to attract the investment they need to support their national development processes and regional integration efforts.

The Agreement grants investors[b] in COMESA national treatment, most-favoured-nation treatment, and fair and equitable treatment as of 2010 "with respect to the establishment, acquisition, expansion, management, operation and disposition of investments" in all economic activities except those reserved by each member State. It further grants investors protection against expropriation and taxation measures that could amount to an expropriation.

Member States have committed themselves under the new Agreement to: (i) take appropriate actions to promote transparency, (ii) apply and interpret their investment laws, regulations and administrative procedures in a consistent way, (iii) facilitate, promote and liberalize their investment measures gradually, (iv) enhance the attractiveness of their investment environment for direct investment flows, and (v) ensure observance of the provisions of the Agreement by their regional and local government authorities.

To ensure proper implementation, the Agreement has established a COMESA Common Investment Area (CCIA) Committee with a mandate to supervise the Agreement, decide on applications made by member States for exceptions to national treatment and other obligations, and issue directions concerning its implementation. Since the adoption of the Agreement, the COMESA Co-ordinating Committee on Investment (CCI) has been set up to monitor, review and coordinate implementation of the Agreement. It also prepares and develops action plans for the CCIA. For example in December 2007, it prepared and adopted a two-year Strategic Action Plan for implementation of the CCIA.

The COMESA Secretariat is currently working on a regional strategic policy framework for simplifying the procedures and reducing the costs of starting a business, the issuing of licences as well as for promoting transparency in the region. Based on country studies, COMESA plans to harmonize investments rules, regulations and procedures.

In order to facilitate negotiations, in 2008 COMESA, in cooperation with UNCTAD, established the COMESA Task Force on FDI/TNC Statistics to harmonize data collection among member States.

Source: UNCTAD, based on information provided by the COMESA Secretariat.

[a] Its member States are: Burundi, Comoros, the Democratic Republic of the Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, the Libyan Arab Jamahiriya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

[b] A foreign-owned or controlled firm is considered to be a COMESA investor if it maintains substantial business activity in a member State. "Substantial business activity" is determined, on a case-by-case basis, by taking into account all the circumstances, including, *inter alia* (a) the amount of investment brought into the country; (b) the number of jobs created; (c) its effect on the local community; and (d) the length of time the business has been in operation.

The Organisation for Economic Co-operation and Development (OECD) has taken various initiatives involving the promotion of private and international investment in Africa. For example, following up on the launch of the *OECD Principles for Private Sector Participation in Infrastructure* (box V.1), a round table was organized to discuss their application to water and sanitation in Africa.

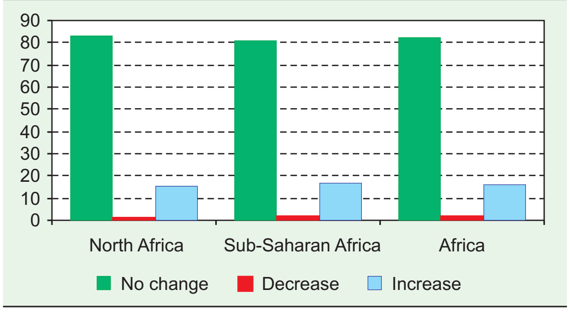
d. Prospects: commodity prices boost FDI

In 2008, FDI inflows to Africa as a whole are expected to grow further as a result of the current boom in commodity markets, notwithstanding the global financial crisis and economic slowdown. That will mark a fourth year of growth of FDI in the region. The expansion of African economies as well as ongoing reforms and the growing confidence of foreign investors should boost investment by TNCs in the region, especially in the primary sector (Jordan, 2007). But the harnessing of FDI to development goals still remains a challenge. FDI in infrastructure development is likely to gain importance, with a high concentration in Southern Africa. Firms and sovereign wealth funds (SWFs) from all parts of Asia are also investing more in Africa's infrastructure. Chinese FDI in particular is noteworthy. For example, China plans to plough at least $5 billion into rehabilitating infrastructure and mines in the Democratic Republic of the Congo in what could be one of its most ambitious ventures in sub-Saharan Africa.[26] West Asian SWFs are also exploring investment opportunities in agriculture (chapter I).

Long-term prospects for FDI will depend on how much of it can be attracted to manufacturing and services in addition to infrastructure. FDI prospects will vary by region and by country. Investments from West Asia, particularly the United Arab Emirates, are likely to grow in *North Africa*, with Algeria and the Libyan Arab Jamahiriya being the major recipients. In *other Africa* (mainly sub-Saharan Africa), Nigeria, the largest FDI recipient in 2007, will benefit from the implementation of major projects in 2008 as Chinese involvement picks up. Gazprom (Russian Federation) is also offering to invest billions of dollars in developing the gas industry in that country, where major Western companies have traditionally invested. Investment in petroleum refineries is expected to significantly boost FDI in Côte d'Ivoire.[27] Cameroon, Chad, Equatorial Guinea and Sao Tome and Principe are also likely to attract increased FDI for oil exploitation. In Southern Africa – the largest recipient subregion in sub-Saharan Africa – Angola, Botswana, South Africa and Zambia are expected to receive FDI inflows mainly in response to global demand for commodities. Inflows to South Africa are likely to be diversified.

UNCTAD's survey, *World Investment Prospects 2008–2010* suggests that FDI in Africa will remain at its present level, with only about 15% of the respondents expecting an increase in FDI (UNCTAD, 2008b) (figure II.6).

Figure II.6. FDI prospects in Africa, 2008–2010
(Percentage of responses to the UNCTAD survey)



Source: UNCTAD, 2008b.

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

FDI flows to South, East and South-East Asia and Oceania rose to another record level in 2007, to reach $249 billion. Most of the subregions and economies received higher inflows. Factors contributing to this performance included a favourable business sentiment about the region's economies, the significant rise in cross-border M&A sales, progress towards further regional economic integration and country-specific attributes. While East Asia continued to account for the lion's share of FDI to the region, flows to South and South-East Asia also increased significantly. Oceania saw a decline in flows, despite substantially higher flows to a few island economies. China and Hong Kong (China) remained the two largest FDI recipients in the region (as well as in developing economies as a group) (table II.6), while flows to India – the largest recipient in South Asia – and to most member States of the Association of Southeast Asian Nations (ASEAN) increased considerably. Prospects for FDI to the region remain promising despite concerns about the impact of the financial crisis.

Outflows from South, East and South-East Asia in 2007 surged to $150 billion – their highest level ever. These subregions together continued to account for the bulk of outflows originating from developing countries (59%) (annex table B.1). Increasing South-South FDI through intra- and inter-regional investment is a particularly important feature of the increasing outflows from the region. Prospects for outward FDI are encouraging because of the strong drive of Asian corporations to internationalize, as well as significant M&As expected to be completed in 2008.

Table II.6. South, East and South-East Asia: distribution of FDI flows among economies, by range,[a] 2007

Range	Inflows	Outflows
Over $50 bn	China and Hong Kong (China)	Hong Kong (China)
$10 bn to $49 bn	Singapore and India	China, Republic of Korea, India, Singapore Taiwan Province of China and Malaysia
$1.0 bn to $9.9 bn	Thailand, Malaysia, Taiwan Province of China, Indonesia, Viet Nam, Pakistan, Philippines, Republic of Korea and Macao (China)	Indonesia, Philippines and Thailand
$0.1 bn to $0.9 bn	Cambodia, Islamic Republic of Iran, Bangladesh, Sri Lanka, Myanmar, Mongolia, Lao People's Democratic Republic, Afghanistan and Brunei Darussalam	Macao (China), Islamic Republic of Iran and Viet Nam
Less than $0.1 bn	Bhutan, Democratic People's Republic of Korea, Maldives, Nepal and Timor-Leste	Pakistan, Sri Lanka, Brunei Darussalam, Bangladesh and Cambodia

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

[a] Economies are listed according to the magnitude of their FDI flows.

a. Geographical trends

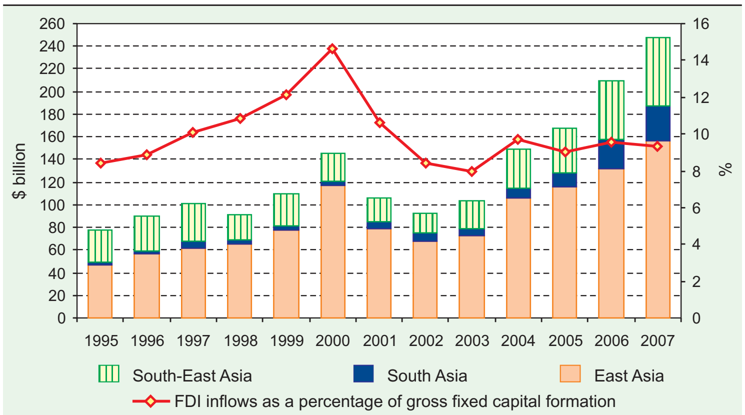
i. Inward FDI: widespread increases

FDI flows into the region rose for the fifth consecutive year, reaching $249 billion (a 18% increase) with higher inflows in most of the subregions (figure II.7) and in 30 out of 44 economies that report data (annex table B.1). The region remained the largest recipient of FDI flows among all developing regions and transition economies, accounting for two fifths of such flows in 2007. The top 10 recipients (figure II.8) accounted for more than 90% of flows to the region in 2007. Improvements in the investment environment, including further liberalization of FDI, resilient economic growth[28] and robust industrial development in some countries contributed to attracting FDI. Strong cross-border M&A sales in the region – which increased by 33% to almost $82 billion in 2007 – also helped (table II.7 and annex table B.4). More than 75% of these sales were concentrated in five economies: Hong Kong (China), China, Singapore, Taiwan Province of China and India in that order (annex table B.4).[29]

FDI flows to *East Asia* increased by 19% to $157 billion. The subregion remained attractive to market-seeking and efficiency-seeking FDI. Inflows to China, increasingly targeted at services, high-tech industries and high value-added activities, rose to $84 billion. The cumulative number of foreign-invested R&D centres in China exceeded 1,200 in 2008, up from 700 in 2004; and the number of TNC regional headquarters in Beijing and Shanghai alone reached more than 220 in 2007.[30] This development reflects both a shift of TNCs' strategy – from viewing China primarily as a low-cost production base to focusing on the country as a large and competitive market and a pool of knowledge manpower – and the Chinese Government's growing policy emphasis on attracting quality FDI. Inflows to Hong Kong (China) – $60 billion in 2007 – benefited from its greater integration with the Chinese economy and a stronger position as a top location for regional headquarters. Flows to Mongolia also rose due to stronger economic growth and an improved investment environment. FDI inflows to Taiwan Province of China increased by only 10% to $8.2 billion, compared to the 3.6-fold increase in 2006. However, inflows to the Republic of Korea dropped for the third consecutive year, to $2.6 billion – the lowest level since 1997 – as a result of slower economic growth, high oil prices, appreciation of the won, and a decline in cross-border M&A sales.

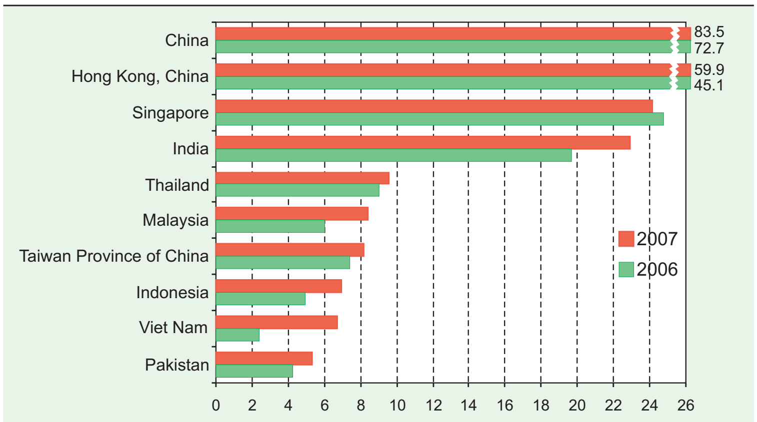
FDI flows to *South Asia* increased by 19% to $31 billion, mainly due to a significant increase in flows to India and Pakistan. Robust economic growth, an improved investment environment and further opening up of the telecommunications, retail and other industries contributed to a 17% increase in FDI inflows to India, which surged to $23 billion in 2007. Strong cross-border M&A sales were a key factor driving up such flows (annex table B.4). Substantial FDI in automobiles, telecommunications, real estate and other service industries, including large-scale investments by TNCs such as Vodafone, Oracle, Holcim and Matsushita, also boosted FDI inflows. The single-brand retail window introduced by the Government of India in 2006 *(WIR07)*, which allows 51% foreign equity ownership, encouraged foreign brands to invest and expand their retail activities in the country. A survey of over 300 international

Figure II.7. South, East and South-East Asia: FDI inflows in value and as a percentage of gross fixed capital formation, 1995–2007



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

Figure II.8. South, East and South-East Asia: top 10 recipients of FDI inflows,[a] 2006–2007
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of 2007 FDI flows.

retailers found that more than a quarter of the retailers surveyed opened their first store in India in 2007 or are planning to do so in the near future (CB Richard Ellis, 2008). In Pakistan, economic growth and privatizations attracted increased inflows in the banking, telecommunications, oil and gas industries.[31] A 17% rise in reinvested earnings also helped.[32]

Flows to Sri Lanka rose as well, boosted by a $328 million investment in telecommunications by Telekom Malaysia – the largest investor in that country in 2007.[33] In Afghanistan, FDI inflows rose particularly in telecommunications, banking, hotels and mining.[34]

Flows to *South-East Asia* or the *ASEAN* subregion increased by 18% in 2007, to $61 billion – resulting in yet another year of robust FDI growth there. Nearly all ASEAN countries received higher inflows. Singapore, Thailand, Malaysia, Indonesia and Viet Nam, in that order, were the largest FDI recipients, together accounting for more than 90% of flows to the subregion. While FDI growth in 2007 differed considerably between countries, the newer ASEAN member countries in particular (Myanmar, Viet Nam, Cambodia and the Lao People's Democratic Republic, in that order) recorded the strongest FDI growth, exceeding 70% in each. Favourable regional economic growth, an improved investment environment, higher intraregional investments, and strengthened regional integration were key contributory factors. Reinvested earnings were particularly strong,[35] highlighting the importance of existing investors as a source of FDI. Increased inflows in Viet Nam were the result of that country's accession to the World Trade Organization (WTO) in 2007, as well as greater liberalization and FDI promotion efforts, particularly with respect to infrastructure FDI. There were higher FDI inflows in extractive industries in Myanmar, in telecommunications and textiles and garments manufacture in Cambodia, and in agriculture, finance and manufacturing in the Lao People's Democratic Republic.

Despite higher inflows to a few island economies, FDI to *Oceania* fell by 17%, to $1.2 billion. Higher inflows to the Marshall Islands, Papua New Guinea, Solomon Islands and Tonga were not enough to increase overall inflows to the subregion, as a larger number of island economies saw a decline in inflows compared to 2006 (i.e. New Caledonia) (annex table B.1). Higher inflows in Tonga were partly due to its WTO membership in 2007 and increased tourism FDI, while the entry of Digicel telecommunication (Jamaica) in Papua New Guinea contributed to increased FDI in that host economy. Inflows to Vanuatu declined in 2007 because of large dividend payouts to investors abroad.

Table II.7. South, East and South-East Asia: cross-border M&As, by region/economy, 2005–2007
(Millions of dollars)

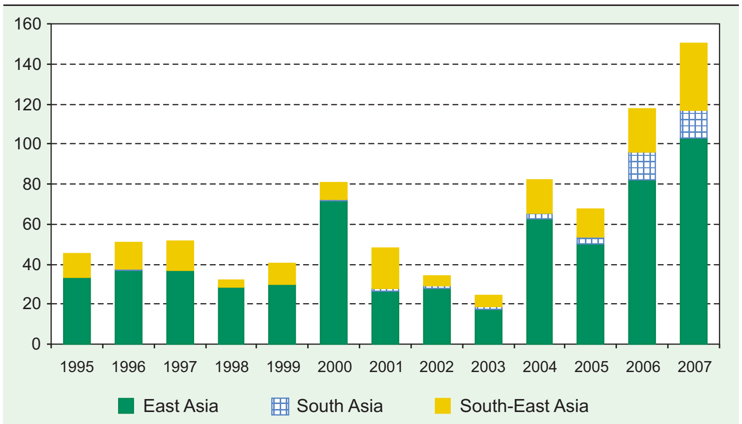
	Sales of South, East and South-East Asian firms			Purchases by South, East and South-East Asian firms		
Region/economy	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
World	52 454	61 402	81 523	49 205	56 721	89 025
Developed economies	28 207	30 879	47 811	31 042	27 745	64 668
Europe	12 029	8 821	23 044	19 540	11 919	22 086
European Union	11 213	8 017	21 835	18 461	11 105	20 202
France	605	558	698	758	2 396	367
Germany	860	690	1 327	591	1 452	1 000
Netherlands	115	411	1 550	433	575	499
United Kingdom	8 557	5 008	14 353	14 887	5 570	17 402
North America	13 692	15 680	17 894	8 265	12 746	29 691
United States	13 436	15 514	14 914	8 035	8 539	26 868
Other developed countries	2 485	6 379	6 872	3 238	3 080	12 891
Australia	1 440	2 941	2 276	2 549	2 195	9 997
Japan	1 041	3 307	4 580	546	595	1 227
Developing economies	21 475	28 874	26 485	17 678	28 895	24 320
Africa	1 671	131	224	333	3 935	456
Egypt	1 302	-	-	-	-	200
Nigeria	-	-	6	-	2 692	-
South Africa	187	-	80	-	972	102
Latin America and the Caribbean	131	1 311	1 815	128	1 119	913
Asia	19 673	27 433	24 446	17 204	23 841	22 948
United Arab Emirates	2 360	3 551	844	12	43	11
China	3 261	3 152	2 036	3 104	3 203	4 298
Hong Kong, China	6 007	4 203	5 669	5 001	8 427	4 947
India	344	531	2 977	501	2 069	1 610
Indonesia	216	191	789	1 298	239	1 957
Korea, Republic of	157	1 036	1 629	1 228	640	183
Malaysia	2 802	2 309	2 247	881	326	2 590
Singapore	3 461	11 726	6 726	4 425	2 463	2 982
Taiwan Province of China	174	116	552	278	686	2 155
South-East Europe and CIS	-	1 043	2 089	-	81	38
Kazakhstan	-	1 000	1 957	-	-	-

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

ii. Outward FDI: growth led by services and extractive industries

With $150 billion in outward flows in 2007 (figure II.9), South, East and South-East Asia subregions have become a significant source of FDI for other developing countries, both within and outside the region. This further strengthens their role in South-South cooperation (UNCTAD, 2007c and 2007f). An increasing number of developed countries are also attracting FDI from economies in the region, and some of their investment promotion agencies (IPAs) are establishing offices for this purpose, including in China, India and Singapore.[36] India is now among the top investors in the United Kingdom. China is rapidly becoming a leading investor in many developing countries, including some African LDCs. Firms from some ASEAN countries and the Republic of Korea have also been actively investing abroad, partly because of improved institutional support, encouragement by their governments and market constraints at home. For the first time in 2007, outflows from Malaysia and the Philippines exceeded inflows of FDI (figures II.8 and II.10). Firms from the region are investing overseas to acquire or build brand names, access markets, technologies, and natural resources and strengthen value chains (UNCTAD, 2007c; *WIR06*; *WIR07*).

Figure II.9. South, East and South-East Asia: FDI outflows, 1995–2007
(Billions of dollars)



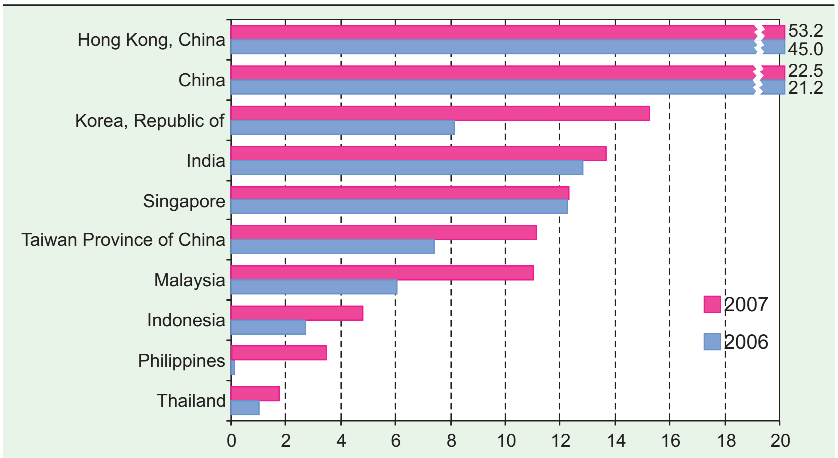
Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

Cross-border M&A purchases by South, East and South-East Asian firms rose by 57% to $89 billion in 2007 (table II.7). The region as a whole accounted for 49% of the total cross-border M&A purchases made by firms from all developing economies. The number of mega cross-border M&A purchases (i.e. with transactions of $1 billion or more) by firms from these subregions rose to 14 with a combined value of $45 billion in 2007 (compared with 13 in 2006 with $25 billion), underlining their growing financial clout. The mega deals accounted for 51% of total M&A purchases from the region in 2007, compared with 44% in 2006.

Firms from the region continued to internationalize more actively than those from other developing regions: 60 of these firms are listed among the *Global Fortune 500* in 2008,[37] compared with only 53 in 2007. Some Asian companies are now among the world's most respected, according to a study of corporate reputations in 27 countries (Reputation Institute, 2008), as a result of their rapid internationalization and a growing role in world business. They also constitute about three quarters of the firms in UNCTAD's list of 100 top non-financial TNC from developing countries, ranked by foreign assets (annex table A.I.16).

Some of the differences between the region's TNCs, with respect to their investment strategies and industrial coverage, reflect in part the influence and encouragement of their home economies' governments and economic development. Chinese and Indian firms, while also investing in manufacturing and services, have relatively greater overseas investments in energy and extractive industries (*WIR07*) than

Figure II.10. South, East and South-East Asia: top 10 sources of FDI outflows,[a] 2006–2007



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of 2007 FDI flows.

firms from Malaysia, Singapore and the Republic of Korea. The latter have ventured abroad, especially in infrastructure services, finance, telecommunications and manufacturing, largely because of saturated or limited markets and increasing competition at home.

The region of South, East and South-East Asia is also home to a growing number of large sovereign wealth funds (SWFs), reflecting rapidly rising foreign exchange reserves and proactive government policies (chapter I). These funds have also contributed to the growth of FDI from the region. For instance, Temasek (Singapore) has significant investments abroad, directly as well as through a number of firms under its control such as Singapore Telecommunications, PSA International and SembCorp Industries. About 40% of Temasek's foreign investments were in Asia as of 31 March 2007, while its overseas investments in developed countries declined from 30% in 2005 to 20% in 2007 (Temasek, 2007). A significant proportion of investment by Khazanah Malaysia (a Malaysian SWF) is in Malaysian companies such as UEM, Telekom Malaysia International, Opus Group Berhad and Bumiputra Commerce Bank, all of which have also considerable direct investments overseas. The China Investment Corporation (China), which was established only in 2007, has a sizeable $200 billion to invest in assets at home and abroad. With growing foreign exchange reserves, India too is planning to establish a multi-billion dollar SWF to invest in energy assets abroad.[38]

East Asia. Rising foreign exchange reserves and proactive government policies continue to boost FDI outflows from East Asia. TNCs from this subregion are also targeting developed-country firms for acquisition, particularly those based in the United States, partly because of a weak dollar and lower asset valuation of United States companies.[39] Outflows from Hong Kong (China) – the largest source of FDI from the developing world – rose significantly, to $53 billion in 2007, more than twice the flows from China, which increased to an estimated $22 billion (figure II.10). Firms from China continued to acquire strategic assets outside Asia, particularly in extractive industries in developed countries, Africa and Latin America.[40] Chinese steel companies, such as State-owned Baosteel and Sinosteel and privately owned Shagang, have been actively investing abroad in iron ore mining, including in Australia, to secure supplies.

South Asia. FDI from this subregion rose by 6% to $14.2 billion, dominated by investments from India which rose to $13.6 billion in 2007, much of it the result of a significant increase in cross-border acquisitions. Indian firms have been active investors in both developed and developing countries, particularly in pharmaceuticals, extractive industries, information technology and other business services. These firms, are actively using cross-border M&As – which rose by 4.6 times, to $30 billion in 2007 – as a mode of entry into host countries. The main industries targeted are steel, mining, energy, property and construction. Their growing outward FDI has been driven by increased corporate reserves, high profitability and a further relaxation of policies and encouragement by the Government. Progress in achieving an FTA with ASEAN and the launching of negotiations on a bilateral trade and investment agreement with the EU in June 2007 will likely further encourage Indian investments in these regions.

South-East Asia. Outward FDI from ASEAN rose by 51%, to $33 billion. Singapore remained the subregion's most active outward-investor, and Malaysia is emerging as a significant player as well (figure II.10). Many Malaysian and Singaporean firms have invested in the infrastructure and construction industries in West Asia and ASEAN. In addition, many Malaysian banks, telecommunications and agro-based companies, and Singaporean telecommunications and financial corporations are increasing their presence in other ASEAN countries. Outward FDI from Indonesia rose by 77% to $4.8 billion in 2007 and that from Thailand increased by 70% to $1.8 billion – the highest ever outflows for the two countries. Internationalization of firms is not just confined to the larger economies in the subregion; firms from Viet Nam are also expanding abroad, although a majority of the overseas investments are by State-owned enterprises.[41] The stronger intraregional investment and an active regionalization drive by ASEAN firms are strengthening the subregion's integration processes.

b. Sectoral trends: rising flows to all sectors

FDI inflows in 2007, as highlighted by M&A activities, rose in all three sectors – primary, manufacturing and services. Most of the investments were in services (primarily in transport and communications, finance and business services), followed by food and beverages (table II.8). There is also increasing demand in the region for more infrastructure-related FDI to support the rapid economic growth of countries such as China, India and Viet Nam. These countries are putting in place institutional support, undertaking reforms and improving their policy environment to attract infrastructure FDI. They are also encouraging public-private partnerships and promoting private sector investments in a wide range of infrastructure development activities. A survey by the Japan Bank for International Cooperation (JBIC) (2008) suggests that the region, especially China, India and Viet Nam, will need to boost investment in infrastructure, particularly in transport, electricity and water.

Table II.8. South, East and South-East Asia: cross-border M&As, by sector/industry, 2005–2007
(Millions of dollars)

Sector/industry	Sales 2005	Sales 2006	Sales 2007	Purchases 2005	Purchases 2006	Purchases 2007
Total	52 454	61 402	81 523	49 205	56 721	89 025
Primary	345	2 365	7 956	4 618	7 433	5 058
Agriculture, hunting, forestry, and fisheries	72	211	3 208	160	110	320
Mining, quarrying and petroleum	272	2 155	4 748	4 457	7 323	4 738
Manufacturing	14 615	13 063	20 386	9 941	12 703	22 976
Food, beverages and tobacco	6 309	1 337	6 680	1 826	1 093	3 020
Wood and wood products	94	213	1 274	44	141	21
Coke, petroleum and nuclear fuel	10	6	3	345	3 500	595
Chemicals and chemical products	3 340	913	1 917	680	1 846	1 773
Non-metallic mineral products	273	810	1 789	55	2	631
Metals and metal products	877	1 071	3 322	1 052	357	2 815
Machinery and equipment	36	2 501	1 325	47	791	5 719
Electrical and electronic equipment	2 641	2 981	2 598	4 496	1 491	6 121
Services	37 495	45 974	53 181	34 636	36 582	60 992
Electricity, gas and water	2 230	296	726	4 490	454	2 612
Construction	311	182	566	226	27	1 088
Hotels and restaurants	2 020	1 718	887	328	1 162	290
Trade	2 981	1 564	1 348	1 581	1 363	1 962
Transport, storage and communications	8 528	17 601	19 339	2 569	9 098	3 832
Finance	16 821	13 349	16 089	22 674	19 347	47 154
Business activities	3 926	8 822	11 311	2 624	4 861	3 442

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

FDI inflows in all three sectors rose in 2007 in ASEAN. The primary sector saw the largest increase, to $5 billion from a little under $2 billion in 2006, due to the significant increase in flows into agriculture and forestry, and mining (table II.9). Most of the FDI in services continued to be in trade and commerce, finance and real estate. Cross-border M&A sales contributed to the increase in FDI inflows to all three sectors.

Firms from South, East and South-East Asia have been active outward investors in finance, telecommunications, extractive industries, real estate and infrastructure activities, including in manufacturing in 2007. Chinese and Indian firms were particularly active investors in extractive industries, both within and outside the region. Finance was the single largest target industry for outward investment, accounting for about 53% of the total cross-border M&A purchases made by firms from the region in 2007 (table II.8). Firms from the region have also emerged as important players in the infrastructure industries both within the region and in other developing countries (chapter III).

In 2007, the share of FDI directed to the services sector in *East Asia* continued to increase. Banks and private-equity firms based in developed countries invested in financial services in Hong Kong (China) and Taiwan Province of China.[42] The share of the services sector in China's total FDI inflows has risen significantly in recent years, from 28% in 2003 to 49% in 2007.[43] Nevertheless, manufacturing still accounts for a significant share of inflows to China, helping China remain the world's manufacturing powerhouse. However, the coastal areas of the country have begun to face competition from low-income countries in South and South-East Asia for FDI in low-end and labour-intensive production activities partly due to rising costs of production.[44] Some foreign firms are turning to inland China or to countries with lower wages in South and South-East Asia, such as Bangladesh and Viet Nam.

In *South Asia,* the increase in FDI was particularly significant in transport and telecommunications, as suggested by available data on cross-border M&As: sales in transport and communications in the subregion surged from $4 billion in 2006 to $14 billion in 2007. These industries accounted for 67% of the total M&A sales in the subregion in 2007. Investment by MTN (South Africa) in Afghanistan, significant Malaysian telecommunications FDI in Sri Lanka, foreign acquisitions of large stakes in Pakistani telecommunications companies (such as Warid Telecom, Pakistan Mobile Communications and Paktel) and the huge investment made by Vodafone (United Kingdom) in India contributed to the high growth of FDI in telecommunications industries in South Asia.

Table II.9. FDI inflows by sector/industry in ASEAN, 2003–2007[a]
(Millions of dollars)

Sector/industry	2003	2004	2005	2006	2007
Primary	4 700	780	2 453	1 717	4 988
Agriculture, fisheries and forestry	185	223	187	341	2 672
Mining	4 514	558	2 266	1 376	2 316
Manufacturing	6 782	14 138	17 137	16 147	20 116
Services	10 613	17 507	15 966	28 913	32 175
Construction	91	- 55	21	523	466
Trade and commerce	3 239	3 995	4 770	6 836	10 043
Financial intermediation and services	5 407	10 039	4 606	12 361	9 366
Real estate	812	1 106	2 432	4 154	6 094
Not elsewhere classified	1 899	2 754	3 602	4 544	2 018
Total	23 993	35 179	39 158	51 322	59 296

Source: Based on ASEAN Secretariat, *Statistics of Foreign Direct Investment in ASEAN, 2008* (forthcoming).

[a] Data are preliminary.

Note: Data do not include the sectoral distribution of reinvested earnings and intra-company loans of the Philippines. The data reported by the Philippines were on an aggregate basis.

c. Policy developments

i. Inward FDI policy

In 2007, economies in the region continued to make national policy changes on inward FDI that were favourable to investors. According to UNCTAD's annual survey of changes in national FDI laws, nine countries introduced 13 policy changes in 2007, of which 10 were favourable to FDI.

Some governments in the region further relaxed ownership restrictions on foreign investors. The Government of India, for example, raised the foreign equity ownership limit in telecommunications to 74% in March 2007 from the previous limit of 49%. Extending its liberalization policies to other industries, India also raised the level of foreign equity ownership permitted in civil aviation, refineries, some mineral mining, construction, industrial parks and commodity exchanges in January 2008.[45] Viet Nam passed a new decree in May 2007 allowing foreign and local investors to participate in investment in the infrastructure sector[46] through build, operate and transfer (BOT) agreements and other similar arrangements.[47] As a result of its WTO membership in January 2007, Viet Nam also made a number of commitments to open up various industries to FDI, or relax restrictions, immediately upon accession or within a certain period of time (box II.5).

A variety of measures were also taken by countries in the region to facilitate investment. Some countries, for instance, increased the level of investment protection provided under their investment laws (e.g. Indonesia),[48] or relaxed foreign exchange controls and improved admission procedures (e.g. Fiji). The Republic of Korea provided clearer criteria for screening acquisitions of local companies by foreign investors that may appear to pose a risk to national security.[49] A number of governments are also offering various types of incentives. For example, Malaysia is promoting investment in the Iskandar Development Region, a special economic zone (SEZ) in the State of Johor, by offering fiscal incentives and investment facilities. India decided to provide fiscal incentives to attract investments from major global companies to develop semiconductor production, and micro and nano technology manufacturing projects. Indonesia, the Republic of Korea and Thailand also introduced new investment incentives.[50] China amended its Catalogue for the Guidance of Foreign Investment Industries in 2007, with 351 industries included in the "encouraged" category, 37% more than the 2004 version. Industries such as electricity transmission and futures trading were opened to FDI for the first time.[51]

However, there were also policy changes that contributed to sectoral restrictions and tightening of the investment policy framework. For instance, China tightened foreign investment in the real estate industry (*WIR07*),[52] and Indonesia extended the list

Box II.5. Liberalization commitments by Viet Nam under its WTO accession agreement, 2007

The liberalization of FDI entry in services under the WTO accession agreement will further improve Viet Nam's investment environment, and is expected to increase FDI flows to the country (box table II.5.1). As noted in chapter I, the country is already among the top destinations for future FDI by large TNCs, and it is the most attractive emerging-market destination for retail investment (A.T. Kearney, 2008b).

Box table II.5.1. Viet Nam: Summary of WTO liberalization commitments on FDI entry in services[a]

Sector	Current restrictions	Commitments to liberalization
1. Business services	For a few types of business services, foreign firms are temporarily restricted to providing services to other foreign investment enterprises (FIEs).	Within 1–3 years from accession, most restrictions will be lifted.
2. Communications	Postal services closed to FDI. Temporary restriction in express delivery services. Significant restrictions in basic telecommunications sector. Only joint ventures are allowed in audiovisual services and no opening up of radio and television.	Full liberalization of express delivery services 5 years after accession. Only partial opening of telecommunications services. Long-term restrictions to remain, mainly in facilities-based services including joint-venture requirement for facilities-based operators, with a maximum foreign ownership of 49%. Liberalization of non-facilities-based services allows foreign ownership of up to 65% by 2010.
3. Construction and engineering	For most types of construction and engineering services, foreign firms are temporarily restricted to providing services to other FIEs.	Full liberalization within 2–3 years of accession.
4. Distribution	In wholesale and retail trade, joint-venture requirement with a cap on share of foreign participation until 2009. Restrictions on certain goods.	Removal of joint-venture requirement by 2009. Establishment of foreign-owned retail outlets beyond the first one, subject to an economic needs test.
5. Education	FDI permitted only in higher education and in technical fields, sciences and technology, business studies, economics, international law and languages. Joint-venture requirement with cap on share of foreign participation until 2009.	Wholly foreign-owned investments allowed from 2009. Restrictions on fields of study to remain.
6. Environmental services	Some services will remain public or private (concession) monopolies. Joint-venture requirement with a cap on share of foreign participation until 2011.	Removal of joint-venture requirement by 2011.
7. Financial services	Temporary restrictions in insurance, banking and other financial services.	Most restrictions will be lifted by 2011, with some opening to FDI immediately upon accession.
8. Health	Few restrictions for hospitals.	Full foreign ownership is allowed.
9. Tourism and travel	FDI not permitted in guide services. FDI in travel agencies and tour operators requires joint-venture participation, without a cap on the foreign share.	Full foreign ownership is allowed in hotel and restaurant services and no limit on the foreign share in joint ventures in tour operator services.
10. Recreation, culture, sports	FDI not permitted in news agencies, libraries and museums.	FDI in entertainment services will be permitted from 2012, but only through joint ventures, with a maximum foreign participation of 49%.
11. Transport	Important restrictions apply, many in the form of requiring joint ventures with a cap on the share of foreign participation.	Increase in the cap on foreign participation in joint ventures or lifting of joint-venture requirement in important services such as maritime transport and services auxiliary to all modes of transport.

Source: *WTO,* "Schedule CLX – Viet Nam, schedule of specific commitments in services" cited in UNCTAD, forthcoming a.

[a] It should be noted that this is only a summary – the restrictions and commitments to liberalization are more detailed and complex than those presented here.

Source: UNCTAD.

of business activities that are closed and partially restricted to foreign investment.[53]

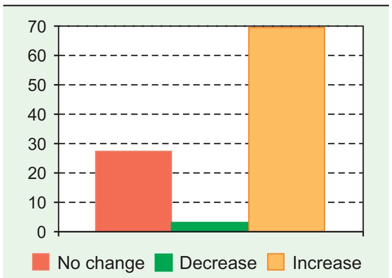
Notable developments in the region included a number of new bilateral agreements among Asian economies. For example, China entered into an investment guarantee agreement with the Republic of Korea and signed the Supplement IV to the Mainland and Hong Kong Closer Economic Partnership Arrangement, which came into effect on 1 January 2008. Under this expanded agreement, China further opened up 11 new services areas to investors from Hong Kong (China), in addition to the 27 areas that had already been opened. New double taxation agreements were signed between Singapore and China, the Republic of Korea and Saudi Arabia; and Myanmar and Viet Nam agreed on strategic cooperation in oil and gas.[54] The region also concluded 12 new BITs, involving six countries, bringing the total number of BITs concluded by countries in the region to 746.

Some developed countries continued to strengthen their ties with economies in the region. For example, the United States signed a trade and investment framework agreement with Viet Nam and an FTA with the Republic of Korea, and Japan concluded separate FTAs with Brunei Darussalam, Indonesia and Thailand.

At the regional level, an ASEAN comprehensive investment agreement is being negotiated among its member States to cover investment liberalization, promotion and protection within a single instrument. ASEAN also concluded a trade in services agreement with the Republic of Korea in 2007.

Figure II.11. FDI prospects in South, East and South-East Asia, 2008–2010

(Percentage of respondents to the UNCTAD survey)



Source: UNCTAD, 2008b.

ii. Outward FDI policy

A number of new measures aimed at encouraging or supporting outward FDI were launched by some countries in 2007. Viet Nam issued a decree governing regulations and procedures on outward FDI in oil and gas. China, India, the Republic of Korea and Thailand introduced or adapted their outward FDI policies and regulations.[55] The objectives of such measures have been primarily to enable these countries to increase the competitiveness of their firms, including to secure access to natural resources. For example, China expanded its support to investments in Africa, by providing loan finance through the Export-Import Bank of China and establishing the China-Africa Development Fund to support African countries' investments in agriculture, manufacturing, energy, transportation, telecommunications, urban infrastructure and resource exploration. It also supports the development of Chinese firms' activities in Africa (see Africa section in Chapter II).[56]

d. Prospects: remaining promising

Despite the general concern over the global economic slowdown triggered by the sub-prime lending crisis in 2007, prospects for both inward and outward FDI flows to and from the region remain promising, as corroborated by recent surveys and studies. However, much will depend on the global economic situation in 2008, the financial health of companies that plan to invest or expand in the region, and progress in economic development and integration in Asia.

Several countries in the region have reported that FDI applications in the first half of 2008 were already significantly higher than in the same period last year.[57] Large investment projects in Afghanistan, India, Indonesia and Viet Nam, in particular, are expected to increase inflows to these countries. A number of recent surveys also point to a likely rise in FDI inflows into the region in 2008 and continued optimism on the part of TNCs concerning the region's business outlook (IIF, 2008a; PricewaterhouseCoopers, 2008a). UNCTAD's survey of investment prospects in 2008-2010 also indicates a promising outlook for the region (figure II.11).

Outward FDI from the region is likely to grow even further in the future, as Asian firms are increasingly aspiring to become significant regional – and global – players in their respective industries, such as telecommunications, banking, manufacturing and other services. Some high-profile cross-border M&A transactions (completed or announced) in the first half of 2008 also point to improving outward FDI prospects for the region.[58]

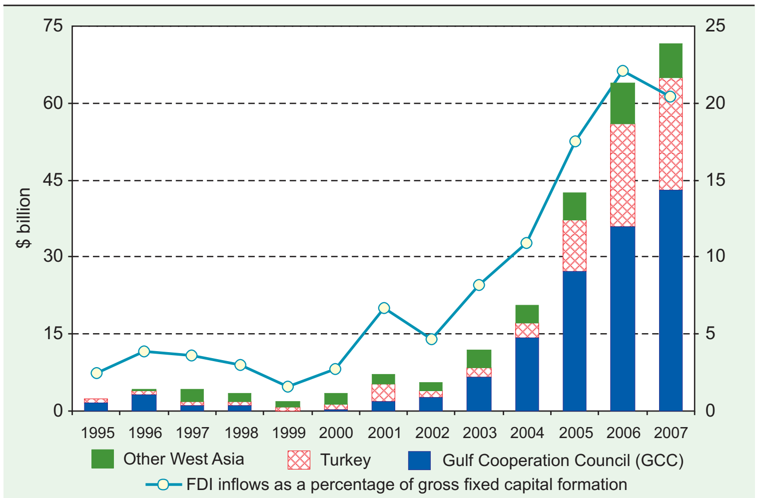
3. West Asia[59]

a. Geographical trends

i. Inward FDI: a sustained increase

In 2007, FDI flows to West Asia rose by 12% to $71 billion, marking the fifth consecutive year of growth (figure II.12). As domestic investment grew faster than FDI, the ratio of inward FDI to gross fixed capital formation fell slightly, from 22% in 2006 to 20% in 2007. Three countries, Saudi Arabia, Turkey and the United Arab Emirates (in that order) accounted for over four fifths of the region's total inflows.

Figure II.12. West Asia: FDI inflows in value and as a percentage of gross fixed capital formation, 1995–2007



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

Saudi Arabia was the leading FDI recipient in the region (figure II.13; table II.11) in 2007. Turkey followed, with inflows of $22 billion – an increase of more than 10% compared with 2006 – despite worsening macroeconomic conditions such as slow growth and rising inflation. The increase in FDI reflected mainly large-scale privatizations and private sector cross-border M&A deals.[60] Major EU countries, particularly the Netherlands, Germany, the United Kingdom, France and Italy, together with the United States, Switzerland and Japan, traditionally have been the main sources of FDI in Turkey. Similarly, in 2007, European TNCs, particularly from the Netherlands, invested $13 billion (Turkey, Treasury, 2008), of which M&A transactions accounted for $7.2 billion (Deloitte Turkey, 2008).[61] The acquisition by the United States private equity firm KKR (Kohlberg Kravis Roberts) of U.N. Ro-Ro, the Turkish shipping company, for $1.3 billion was the largest transaction ever by a foreign private equity firm in Turkey.

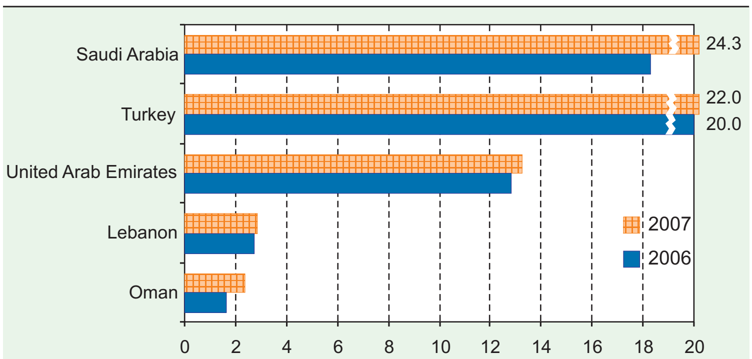
Inflows to Saudi Arabia grew by 33% (figure II.13) reaching a record level of $24 billion. Turkey and the United Arab Emirates also benefited from record high levels, with 10% and 3% increases respectively (figure II.13). Although developed countries continued to be the major sources of FDI flows to the region, FDI by TNCs from developing countries has risen substantially. The major share of flows from developing countries is from other countries in the region, especially in the services sector, and is also concentrated in a few host countries.

In 2007, as in 2006, West Asia attracted greenfield FDI primarily from the United States, the United Kingdom, France and Germany, in that order. Greenfield FDI from South, East and South-East Asian countries, particularly China and India, was also significant, followed by intraregional FDI flows, especially from the United Arab Emirates and Saudi Arabia. Overall, however, the number of greenfield projects in the region decreased by 25% to 551 (annex table A.I.1).

The value of cross-border M&As in West Asia rose by 8% compared to the previous year (annex table B.4 and table II.10). M&As by TNCs from developed countries increased in value by 22% in 2007 (table II.10), with firms from the United States, Sweden and the Netherlands, in that order, accounting for more than half of the total cross-border M&As. The value of cross-border M&As by TNCs from developing countries fell to $7.7 billion (table II.10), and its share in total cross-border M&As also declined to 25%, from 37% in 2006.

FDI inflows to the six Gulf Cooperation Council (GCC) member countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) increased by 20% in 2007, to $43 billion. These countries have seen relatively high inflows in recent years, especially Saudi Arabia, the United Arab Emirates and Qatar, due to a growing number of energy and construction projects, as well as a notable improvement in the business environment. The most significant rise in FDI in the subregion was in Qatar where there was a sevenfold increase from the previous year.

Figure II.13. West Asia: top five recipients of FDI inflows,[a] 2006–2007
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of 2007 FDI flows.

Table II.10. West Asia: cross-border M&As, by region/economy, 2005–2007
(Millions of dollars)

Region/economy	Sales of West Asian firms			Purchases by West Asian firms		
	2005	2006	2007	2005	2006	2007
World	14 100	27 979	30 272	20 293	41 763	43 244
Developed economies	5 098	17 506	21 361	10 321	26 976	32 634
Europe	2 903	16 324	12 261	7 054	18 427	3 462
European Union	2 903	16 324	11 709	5 363	18 427	2 972
France	337	434	1 221	-	747	-
Greece	-	5 136	182	-	490	-
Netherlands	-	751	3 454	3 487	-	836
Sweden	-	1	3 653	-	-	-
United Kingdom	11	5 980	1 204	1 563	16 167	1 372
North America	1 960	885	8 736	3 173	8 549	28 399
United States	1 927	880	8 736	3 173	4 909	26 802
Developing economies	7 399	10 451	7 659	9 972	14 126	10 449
Africa	-	6 003	513	103	5 290	1 805
Egypt	-	505	513	103	640	1 410
Sudan	-	-	-	-	1 332	-
Tunisia	-	-	-	-	2 313	-
Asia and Oceania	7 399	4 448	7 147	9 869	8 039	8 644
Kuwait	90	498	1 065	-	475	3 822
Lebanon	-	1 522	-	236	806	-
Qatar	352	-	4 240	-	-	-
Saudi Arabia	6 550	513	492	-	-	602
Turkey	93	580	-	6 643	1 080	780
Pakistan	-	-	-	150	2 636	12
Singapore	2	130	7	-	-	1 076
South-East Europe and CIS	1 602	22	612	-	661	161
Russian Federation	1 602	22	355	-	629	-

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

Table II.11. West Asia: distribution of FDI flows among economies, by range,[a] 2007

Range	Inflows	Outflows
Over $5 bn	Saudi Arabia, Turkey and United Arab Emirates	Kuwait, Saudi Arabia, United Arab Emirates and Qatar
$1.0 bn to $4.9 bn	Lebanon, Oman, Jordan, Bahrain and Qatar	Turkey and Bahrain
$0.5 bn to $0.9 bn	Syrian Arab Republic	Oman and Iraq
$0.1 bn to $0.4 bn	Yemen, Iraq and Kuwait	Lebanon
Less than $0.1 bn	Palestinian territory	Palestinian territory, Syrian Arab Republic, Yemen 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 their FDI flows.

FDI inflows to the other West Asian economies (Iraq, Jordan, Lebanon, the Palestinian territory, the Syrian Arab Republic and Yemen) were 20% less than in 2006, amounting to just $6.5 billion (figure II.12). This was due to declining flows to two countries – Jordan and Yemen (annex table B.1). However, Lebanon ($2.8 billion) and Jordan ($1.8 billion) were among the major recipients within this subregion. Inflows to Iraq, although still small, reached $448 million in 2007 due to oil and petrochemical projects. The Palestinian territory attracted limited FDI (annex table B.1).

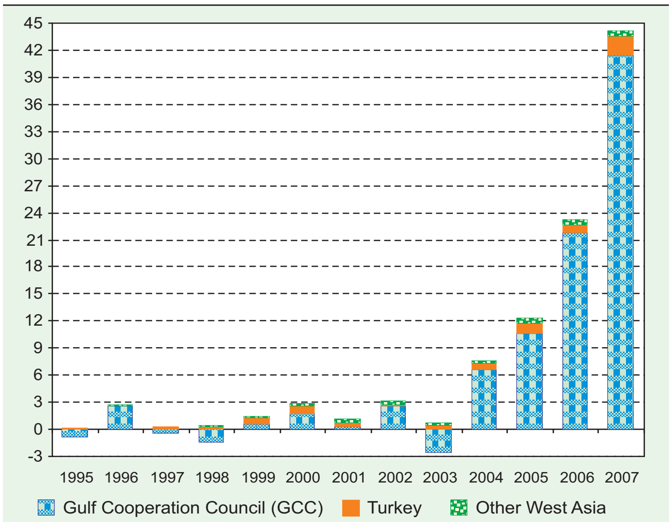
High oil prices have continued to boost economic growth rates in the oil-exporting countries of the region. Rising revenues have encouraged governments of the GCC countries to spend heavily on infrastructure, particularly for revamping water and energy industries and services, often in collaboration with private investors, including foreign ones. In addition, export-oriented economic activity in some West Asian economies, especially in Turkey, benefited from higher demand in European economies. All these factors have contributed to sustaining FDI inflows to the region.

ii. Outward FDI soared

FDI outflows from West Asia in 2007 increased for the fourth consecutive year, to $44 billion. This was nearly six times its 2004 level (figure II.14). The top five outward investors in the region were Kuwait, Saudi Arabia, the United Arab Emirates, Qatar and Turkey (figure II.15). The GCC countries, led by Qatar, accounted for 94% of the region's outward FDI, with about $41 billion in outflows.

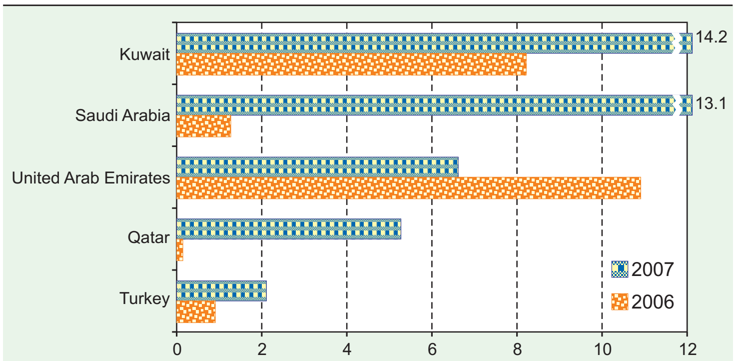
As in the previous year, West Asian companies invested in greenfield projects primarily in developing countries, especially those in South, East and South-East Asia. Major locations were China, India and Malaysia. Intraregional FDI in greenfield projects was also significant, particularly from oil-rich countries such as Saudi Arabia and the United Arab Emirates. The African continent is becoming another popular destination for outward FDI by West Asian TNCs.[62]

Figure II.14. West Asia: FDI outflows, 1995–2007



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

Figure II.15. West Asia: top five sources of FDI outflows, 2006–2007[a]
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of 2007 FDI flows.

The value of cross-border M&A purchases undertaken by TNCs from West Asia amounted to $43 billion in 2007, a 4% increase over 2006 (table II.10). Acquisitions largely targeted firms in developed countries, which accounted for 75% of the value of cross-border M&As by firms from West Asia (table II.10), and particularly those in the United States, Canada and the United Kingdom. Companies in Kuwait were also important targets of acquisitions by firms from other West Asian countries and accounted for 9% of the value of total purchases. The largest cross-border acquirers were from the United Arab Emirates, followed by firms from Saudi Arabia and Qatar.

The GCC countries have built up a substantial windfall from oil exports since 2002 when global oil prices started to rise. This has enabled them to accumulate a huge stock of net foreign assets, estimated at around $1.8 trillion (IIF, 2008b), and to implement their diversification strategy away from oil and gas production. SWFs based in the subregion are playing a key role in this respect (section I.C).

In addition to SWFs, a number of Islamic private equity firms and other alternative asset management companies from the GCC countries are investing abroad, particularly in developed countries. Although the United States has attracted the largest share of investments from GCC countries,[63] a growing number of GCC investors are now moving to Asia, particularly China and India, to diversify their investment portfolios. For example, GCC funds have also been investing in initial public offerings (IPOs) in China and India and in Asian real estate (IIF, 2008b).

A growing amount of GCC capital is being invested in various sectors such as banking, telecom, real estate and manufacturing in West Asia and North Africa, including export-oriented manufacturing activities to supply the European and West Asian markets, as a result of accelerating liberalization, privatization, and the increasing use of Islamic financial instruments. Egypt, Tunisia and Morocco are among the most attractive host countries in North Africa for investors from West Asia, particularly from the GCC countries.

Turkish outward FDI has also been increasing,[64] with $2.1 billion in FDI outflows in 2007. For example, Turkish chocolate manufacturer Ulker Group acquired the Belgian premium chocolate maker Godiva from United States-based Campbell Soup to add a global brand to its business. In addition, a number of Turkish textile and apparel producers have invested first in Eastern Europe, and more recently in Egypt and Jordan (box II.6). Sisecam, the largest Turkish glass manufacturer has made the largest greenfield investment ever in Bulgaria.

b. Sectoral trends: strong focus on services

In West Asia, both inward and outward FDI are heavily concentrated in the services sector, in particular finance and transport and communications as reflected in cross-border M&A activity (table II.12). FDI in manufacturing also accounts for an important share of the region's total outward flows.

Primary sector. Most West Asian countries ban FDI in their hydrocarbon industries, particularly in upstream activities. As a result, though there were some oil and gas investments in 2007, they were mainly related to downstream activities. But there are exceptions: Turkey received FDI inflows of $341 million in the mining industry in 2007, following the Mining Law of 2004 that eased privatizations and foreign ownership (Turkey, Treasury, 2008). In the United Arab Emirates, ConocoPhillips won a $10 billion contract to develop gas reserves at the Shah field.[65]

Manufacturing. FDI in the manufacturing sector has been falling, particularly in energy-related industries, including oil refining and petrochemicals. However, investments in cement and steel production are increasing due to soaring regional demand caused by infrastructure investments. In the manufacturing sector, acquisitions abroad by West Asian TNCs, in particular from Turkey but also from Jordan and Egypt, increased significantly, to $16 billion in 2007 from $1 billion in 2006 (table II.12). There were also major investments in pharmaceuticals.[66]

Services. Services continued to attract the largest inward FDI flows in West Asia in 2007, generally through cross-border M&As. Financial

Box II.6. Turkish outward FDI in textiles

From the late 1990s, Turkish textile and apparel manufacturers began investing in East European countries, such as Romania and Bulgaria, where labour costs were cheaper than in Turkey. Another reason for such investments was United States quota restrictions on imports from Turkey. However, following Romania's and Bulgaria's accession to the EU in 2007, and as a consequence of their rising production costs, Turkish investment in these countries stopped.

Quite recently, Turkish textile and apparel manufacturers, which have traditionally enjoyed a competitive advantage, started again to target foreign countries, particularly Egypt and Jordan. The cheaper energy and labour costs in these countries, as well as incentives such as provision of free land and infrastructure, increased their attractiveness as investment locations. For instance, Polaris International Industrial Park, the first privately owned and run industrial zone in Egypt, is a Turkish-Egyptian joint venture that is aiming to attract $4 billion worth of Turkish investments by the end of 2011, particularly in textile and apparel manufacturing, but also in other industries such as furniture, automotive parts, glass and food processing. Turkish companies invest in Egypt mainly to export, especially to markets in Europe, West Asia and Africa, and to benefit from Egypt's direct access to the United States market through the Qualified Industrial Zones Agreement[a] with that country and Israel. A further impetus has been Turkey's signing of an FTA with Egypt in December 2005. However, Turkey's investments have caused extensive public debate in the country over the issues of capital flight and relocation of competitive national industries abroad.

Source: UNCTAD, based on El Madany, "Turkey sets up its first industrial park in Egypt", *Daily News Egypt*, 17 January 2008.

[a] Qualifying Industrial Zones are specific areas in Egypt that have a duty-free status granted by the United States. Therefore, companies located within such zones have duty-free access to the United States market with unlimited quotas and exemption from tariff and non-tariff barriers, provided that a defined percentage of inputs used derive from Israel and that products comply with international rules of origin.

services and telecommunications have been in the lead. For example, in Turkey, financial services continued to attract the most services-related FDI in 2007, with $11.4 billion in FDI inflows (box I.8), followed by real estate with nearly $3 billion[67] and transportation and telecommunications with $1.1 billion (Turkey, Treasury, 2008). Retailing also attracted foreign investors in Turkey, as demonstrated by the recent acquisition of Migros by BC Partners (United Kingdom).

Regarding outward FDI, GCC investors, including Islamic private equity funds, are investing substantially in real estate in West Asia, North Africa and Asia, particularly in India. For instance, Bahrain-based Gulf Finance House (GFH) raised over $630 million from GCC investors in October 2007 to fund the development of Energy City India. Telecommunications TNCs from West Asia were also very active in outward investments within and outside the region in 2007.[68] In Jordan, a number of major investments from other countries in the region are taking place in real estate and tourism in Amman, the Dead Sea area and Aqaba, and there is growing interest in new infrastructure projects, with financing from the GCC countries. The Government of Saudi Arabia is encouraging its private sector firms to invest in agriculture in some countries, including Egypt, Sudan and Turkey, to secure food supplies.[69]

Table II.12.West Asia: cross-border M&As, by sector/industry, 2005–2007
(Millions of dollars)

	Sales			Purchases		
Sector/industry	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
Total	14 100	27 979	30 272	20 293	41 763	43 244
Primary	46	489	139	70	466	1 783
Mining, quarrying and petroleum	46	485	135	70	466	1 783
Manufacturing	170	5 294	3 112	129	1 268	15 661
Textiles, clothing and leather	-	1 073	-	110	-	-
Wood and wood products	-	1 266	106	-	-	215
Coke, petroleum and nuclear fuel	-	1 054	392	-	-	-
Chemicals and chemical products	-	90	781	-	893	11 645
Metals and metal products	-	418	554	-	-	1 425
Motor vehicles and other transport equipment	55	112	-	-	-	2 261
Services	13 884	22 196	27 021	20 094	40 029	25 800
Construction	0	-	67	45	128	1 253
Trade	139	342	1 313	-	103	40
Transport, storage and communications	8 404	12 675	9 424	11 437	14 743	5 061
Finance	4 842	8 952	8 840	8 262	22 533	19 172
Business activities	351	139	3 220	-	1 797	6
Community, social and personal service activities	33	88	2 470	0	488	-
Amusement and recreation services	-	-	1 974	-	488	-

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

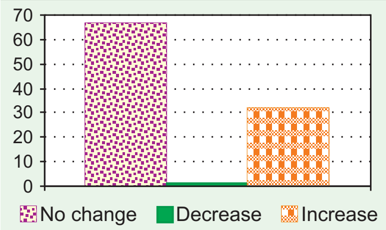
c. Policy developments

In West Asia, the general trend in policy changes over the past few years suggests an easing of FDI restrictions and a more welcoming climate for foreign investment, especially in non-oil industries. Relevant policy measures were introduced in West Asia by three countries: Saudi Arabia, the Syrian Arab Republic and the United Arab Emirates.

In *Saudi Arabia,* the Supreme Economic Council shortened the list of areas that are closed to FDI in March 2007. Among the newly opened areas are services in the mining industry, rail transport of passengers within cities, air transport, satellite-transmission services, distribution services, wholesale as well as retail trade and commercial agencies (except franchise rights). Saudi Arabia also eased conditions for visas for foreign business people.

The *Syrian Arab Republic* took several steps to improve its investment climate. A new law allows foreign investors to own or lease land or property to establish projects in the country, and to repatriate profits and capital just six months after an investment is made. It also provides for new tax exemptions to foreign investors. The Syrian Investment Agency, established by law, is expected to play a key role in the implementation of national investment policies and in streamlining establishment procedures for foreign investors.[70]

Figure II.16. FDI prospects in West Asia, 2008–2010
(Percentage of responses to the UNCTAD survey)



Source: UNCTAD, 2008b.

The *United Arab Emirates* announced in March 2008 a new company law to allow100% foreign ownership of companies in some sectors (compared to the existing 49% limit) outside the free trade zone.[71]

At the international level, West Asian countries concluded 19 BITs involving seven countries in 2007. Oman and Qatar concluded five new agreements, while Jordan concluded four and Bahrain three new BITs. As far as DTTs are concerned, 16 new treaties, involving seven countries were concluded in 2007. Saudi Arabia was the most active with five new DTTs, followed by Qatar with three. In April 2008, the GCC successfully finalized negotiations on an FTA with the EFTA. In addition FTA negotiations are under way between different countries of West Asia and Australia, China, India, Japan, New Zealand, Pakistan and Turkey.

d. Prospects: FDI set to remain stable

According to UNCTAD's *World Investment Prospects Survey 2008–2010*, FDI prospects in West Asia are likely to be less favourable than those in South, East and South-East Asia, and Latin America and the Caribbean (UNCTAD, 2008b). Of the total respondents to this survey, 67% expected no change, while 32% expected an increase in FDI (figure II.16). Access to international/regional markets and the rate of growth of the local market were the most frequently cited reasons for investing in the region, while access to local capital markets, availability of skilled labour and expertise, cheap labour and availability of suppliers were the least cited. Availability of incentives and quality of infrastructure were also less frequently cited than size of market, access to natural resources and government effectiveness. Turkey and the United Arab Emirates are the countries the most favoured by investors in West Asia, according to the survey. The unsettled situation in Iraq and uncertainties in Lebanon and the Syrian Arab Republic may affect investors' confidence in those countries as has long been the case.

4. Latin America and the Caribbean

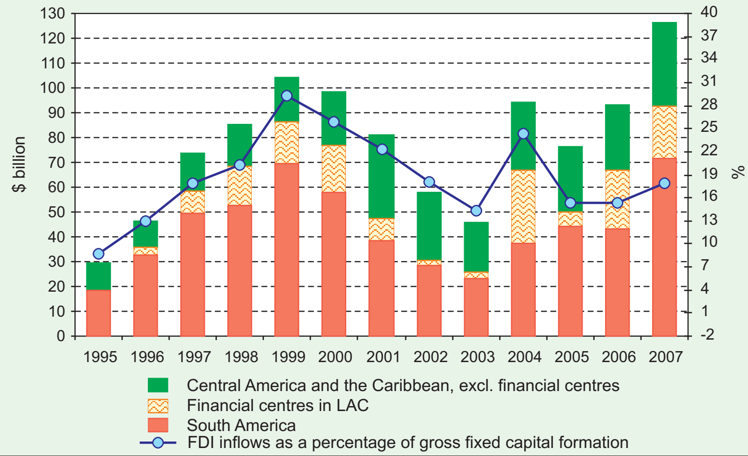
FDI flows to Latin America and the Caribbean (LAC) rose in 2007 by 36%, to a record level of $126 billion. The highest growth was noted in South America, boosted by the persistence of high commodity prices, with a particular upsurge of flows into Brazil. In Central America and the Caribbean (excluding offshore financial centres), FDI inflows also increased. By contrast, inflows to offshore financial centres dropped. At the sectoral level, the primary sector saw the strongest increase in FDI, and most manufacturing-related FDI went to natural-resource-based activities. In the services sector, foreign investors were faced with mounting competition from local firms in several industries. FDI outflows from the region decreased to $52 billion, largely due to a marked decline in outflows from Brazil. Some countries in the region adopted a number of policy measures related to FDI that range from reducing incentives to restricting or prohibiting FDI. While such changes remained concentrated in the extractive industries, they have progressively been extending to other "strategic" industries as well, including infrastructure and food. However, other LAC countries took steps to improve their business environment and attract more FDI.

a. Geographical trends

i. Inward FDI surged mainly in South America

In 2007, the LAC region had record FDI flows: inward FDI surpassed the previous peak of 1999 to reach $126 billion – a 36% increase over 2006. If offshore financial centres are excluded, inflows grew even more, by 53%, to $105 billion. Countries in South America registered the highest average growth rate of inflows (over 66%), which reached $72 billion. Inflows to the Central American and Caribbean countries (other than offshore financial centres) increased by 30% to $34 billion, while those to the offshore financial centres decreased by 13% to $21 billion (figure II.17). FDI inflows to the region as a whole corresponded to 18% of gross fixed capital formation (figure II.17).

Figure II.17. Latin America and the Caribbean: FDI inflows in value and as a percentage of gross fixed capital formation, 1995–2007



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

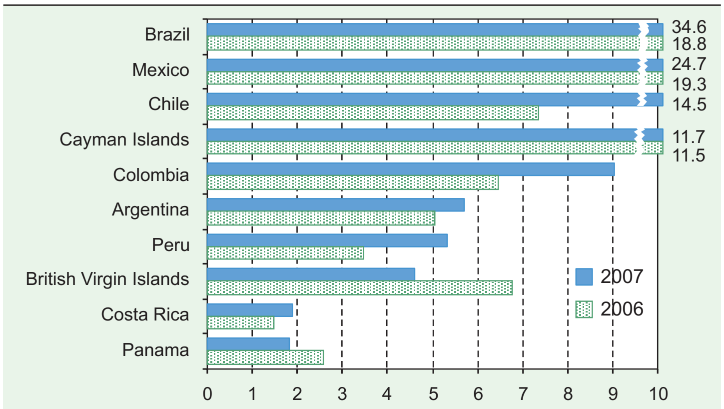
Brazil accounted for a large share of the rise in FDI to become the leading recipient in 2007 with $35 billion, followed by Mexico and Chile (figure II.18). The largest three recipients together accounted for 58% of all inflows to the LAC region, and for as much as 70% if offshore financial centres are excluded.

Cross-border M&A sales contributed to FDI growth in the region. They rose by 37% in 2007 due to increased acquisitions by developed-country firms (table II.13). Acquisitions of locally-owned assets by foreign firms were the type of cross-border M&A deals that increased the most, doubling in 2007. In spite of this strong increase, however, their value remained at a comparatively low level in 2007,[72] indicating that greenfield investment continued to be the main driver of FDI, in contrast to the situation in the second half of the 1990s.

In South America, FDI inflows increased significantly in all the big recipient countries. In the largest three host countries (Brazil, Chile, Colombia) taken together, they soared by 78% and in Peru by 54%, while in Argentina they rose by 14%. In Brazil, the highest increases were registered in the primary sector (mainly in metal mining) and in natural-resource-based manufacturing (basic metallurgy, food and beverages, refineries, chemical products). In Chile, Colombia and Peru, the extractive industries attracted more than half the inflows.[73] In general, FDI inflows continued to be drawn to this subregion by high commodity prices that directly attracted inflows into extractive activities and resource-based manufacturing, and indirectly affected FDI by boosting economic growth. The attractiveness of South America for foreign investors is reflected in the continuous increase in the rate of return on inward FDI since the commodity price boom that began in the early 2000s (see *WIR07*) (figure II.19). The largest increase in 2007 was in Chile and Peru, where it reached 23% and 36% respectively.

In Central America and the Caribbean (excluding the offshore financial centres), the rise of FDI inflows is largely due to the 28% increase registered in *Mexico*, which continued to attract most of the inflows in the subregion (73% in 2007). Flows to Mexico, traditionally sensitive to the economic cycle of the United States, were not affected by the economic slowdown that began in that country in the second half of 2007. This was because the activities that attracted the largest increases in FDI in Mexico were steel manufacturing, financial activities and mining, which are not oriented to the United States market. As for other activities more dependent on that market, delays in adjusting to new market conditions and the capacity of TNCs to diversify their export markets rapidly[74] and to increase their sales in the internal market may have contributed to preventing a decline in FDI in 2007. The next largest host countries were *Costa Rica* ($1.9 billion) and the *Dominican Republic* ($1.7 billion), where inflows increased, particularly in real estate and tourism. *El Salvador*

Figure II.18. Latin America and the Caribbean: top 10 recipients of FDI inflows,[a] 2006–2007
(Billions of dollars)



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

[a] Ranked by magnitude of 2007 FDI flows.

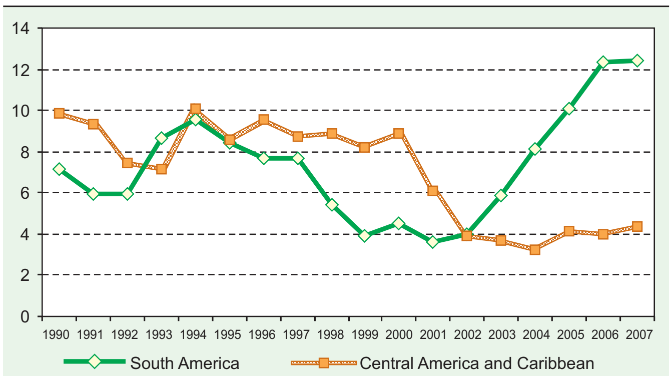
Table II.13. Latin America and the Caribbean: cross-border M&As, by region/economy, 2005–2007
(Millions of dollars)

	Sales of Latin American and Caribbean firms			Purchases by Latin American and Caribbean firms		
Region/economy	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
World	17 905	22 561	30 696	11 458	33 820	41 923
Developed economies	14 824	17 572	25 046	8 425	30 052	35 610
Europe	10 455	8 383	14 129	3 681	3 246	3 078
European Union	9 963	4 952	13 415	3 681	2 656	2 427
France	863	83	2 388	1 195	725	71
Italy	2 080	438	1 933	1 467	605	-
Spain	901	1 153	4 300	554	559	1 124
United Kingdom	5 411	1 974	1 836	43	12	370
Other developed Europe	492	3 431	714	-	591	651
Switzerland	492	3 296	618	-	3	13
North America	3 853	8 718	10 113	4 700	26 164	16 914
United States	3 573	6 385	7 207	3 928	8 837	14 401
Other developed countries	517	471	804	45	642	15 617
Australia	185	55	24	34	560	14 992
Developing economies	2 958	4 651	5 567	2 962	3 768	6 314
Latin America and the Caribbean	2 830	2 312	4 499	2 830	2 312	4 499
Argentina	121	160	2	1 026	9	270
Brazil	1 094	244	1 257	1 571	609	597
Colombia	-	554	1 188	35	64	789
Mexico	1 552	987	905	104	967	422
Asia and Oceania	128	1 917	913	132	1 311	1 815
Asia	128	1 917	913	131	1 311	1 815
Bahrain	-	798	-	-	-	-
Hong Kong, China	11	678	301	18	11	230
Singapore	-	-	356	108	1 286	1 192
South-East Europe and CIS	-	15	-	71	-	-

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

registered a sevenfold increase, to $1.5 billion, as a result of the acquisition by transnational banks of two important local banks.[75] Inflows to *Trinidad and Tobago* totalled $1 billion, while the other countries in the subregion received less than $1 billion each in 2007 (table II.14).

Figure II.19. Latin America and the Caribbean: rate of return on inward FDI[a] by subregion, 1995–2007
(Per cent)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).
[a] This is the ratio of income on FDI to the average inward FDI stock. The average inward FDI stock is the average of the inward FDI stock at the end of the year and at the end of the previous year. Data on FDI income are from the IMF's balance of payments statistics and from national authorities. The data exclude offshore financial centres.

ii. Outward FDI fell in 2007 after a significant increase in 2006

FDI outflows from LAC, excluding offshore financial centres, decreased by 43%, to $24 billion in 2007 (figure II.20).[76] This fall reflected in particular smaller outflows from Brazil ($7 billion), following the exceptionally high level ($28 billion) in 2006. Nevertheless, outflows from Brazil remained larger than in 2000–2005, when they averaged about $2.5 billion per year. Outward FDI from Mexico rose by 43% to $8.3 billion, while those from offshore financial centres increased by 37% to $28 billion (figure II.21). Overall, however, FDI data may underestimate the pace of internationalization of Latin American companies. This is because some significant cross-border acquisitions have not been registered as FDI outflows in the balance of payments.[77]

The fall in outward FDI was not caused by a slowdown in the internationalization efforts of Latin American companies; rather, it signified a return to more normal levels after the exceptional year of 2006. Latin American companies, mainly from Brazil and Mexico, are now competing for global leadership in such industries as oil and gas, metal mining, cement, steel, and food and beverages. In addition, beyond this traditional industries, new TNCs are appearing in, for example, software, petrochemicals and biofuel refining. For instance, Sonda (a Chilean software and information and communication technologies (ICT) services company) that has operations in several Latin American countries, made its largest investment abroad in 2007 when it acquired a Brazilian company for $118 million (ECLAC, 2008). Mexichem (Mexico), with investments in Colombia and the United States, made two major acquisitions in Brazil (in chemicals) and in Colombia (in petrochemicals) in 2007, for a total value of $750 million.[78] Finally, Brazil's national oil company, Petrobras, is investing in biofuels in Colombia and the Dominican Republic and in Africa, where it is sponsoring a number of biofuel projects in collaboration with China and the EU. It has recently teamed up with Eni (Italy) to explore African biofuel sources for export to Italy, and both companies are currently looking to collaborate on the construction of biodiesel plants in Angola and Mozambique as well as in Brazil.[79]

b. Sectoral trends: growth led by primary and natural-resource-based activities

In 2007, the primary sector saw the strongest increase in FDI, and most manufacturing-related FDI went to natural-

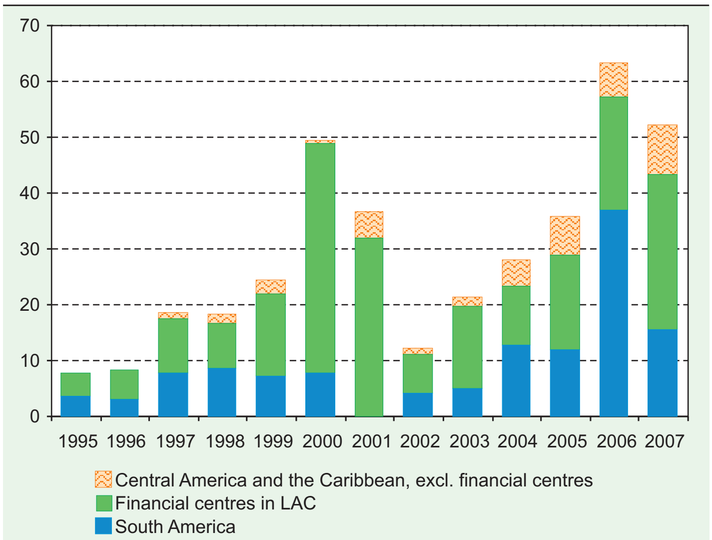
Table II.14. Latin America and the Caribbean: distribution of FDI flows among economies, by range,[a] 2007

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

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

[a] Economies are listed according to the magnitude of their FDI flows.

Figure II.20. Latin America and the Caribbean: FDI outflows, 1995–2007
(Billions of dollars)



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

resource-based activities. There is a concern, however, that this could be reinforcing a Dutch disease process[80] (Moreno Brid and Perez, 2008). Meanwhile, in the services sector, foreign investors are facing mounting competition from local firms in several industries.

i. Primary sector: more room for FDI in metal mining

The high and rising levels of commodity prices continued to have a mixed effect on FDI in the primary sector in Latin America: governments as well as the private sector were eager to capture the extremely high rents accruing from the price hike. Despite policy shifts in some resource-rich countries that helped increase the State's share in profits and/or ownership, the sustained high price levels continued to attract foreign investors to these activities. However, the picture differs between hydrocarbons and metal mining, the latter allowing more room for FDI activity due to the absence of State-owned companies in all the countries except Chile.

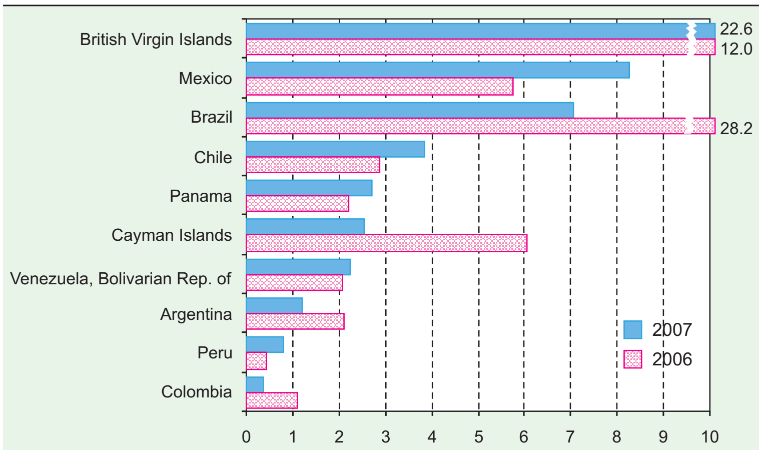
In oil and gas, the dominant position or exclusive presence of State-owned companies has reduced the volume of FDI in the most richly endowed countries (the Bolivarian Republic of Venezuela, Brazil and Mexico). Other reasons for the lower FDI are, in some cases, drastic changes in the tax regime and contractual relations with private firms as in the Bolivarian Republic of Venezuela, Bolivia and Ecuador (discussed in *WIR06*, *WIR07* and the next section).

Most of the FDI inflows in oil and gas in 2007 were concentrated in Brazil and Colombia. Inflows to Colombia increased by 90% to reach $3.4 billion, while those to Brazil remained at almost the same level as in the previous year, at around $1.3 billion. In Trinidad and Tobago, foreign companies that are exploiting offshore natural gas fields are optimistic about prospects for further oil and gas discoveries, and exploration activities are taking place in Chile, Guyana and Nicaragua.

In contrast, FDI in oil and gas in Bolivia, the Bolivarian Republic of Venezuela and Ecuador – that used to be among the most important FDI recipients in this industry in the region – were very low or negative in 2007, as a result of more restrictive FDI policies. However in Bolivia, fresh spending by oil and gas companies is now being spurred by the prospect of selling major volumes of natural gas to Argentina and Brazil, both of which are worried about security of gas supply. Petrobras, which had frozen its new investments in 2006 following the issuance of a nationalization decree in Bolivia (see *WIR06* and *WIR07*), announced plans in late 2007 to invest $750 million–$1 billion in that country, including in new areas.[81] This resumption of investments by Petrobras may encourage other major investors, including Spain's RepsolYPF, to follow suit.

A large share of FDI inflows in mining was concentrated in Brazil, Chile, Colombia, Mexico and Peru. In Chile, a large proportion of these inflows,

Figure II.21. Latin America and the Caribbean: top 10 sources of FDI outflows,[a] 2006–2007
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of 2007 flows.

estimated at $7 billion (ECLAC, 2008), are reinvested earnings as a result of large profits in the mining industry.[82] Mining FDI in Brazil increased more than fivefold in 2007, reaching $3.3 billion, while it surpassed $1 billion each in Colombia, Mexico and Peru.[83]

As in oil and gas, metal mining is attracting increasingly large volumes of investment into countries that traditionally have not been important destinations for such investment. For example, FDI in metal mining in Mexico trebled in 2007 to $1.2 billion, and BHP is investing in exploration in Guatemala and developing a bauxite project in Suriname. Also, more and more Asian firms are investing in the industry. For example, the State-owned Korea Resource company is exploiting a copper mine in Bolivia in a joint venture with Comibol (Bolivia), and Chinese investors are very active in the metal mining industry in Peru (ECLAC, 2008).

ii. Manufacturing: FDI favours resource-based industries

FDI flows in manufacturing were boosted in 2007 by the strong demand for resource-based manufacturing products both locally – as a result of sound regional economic performance – and internationally. In Brazil, metallurgy, foods and beverages, plastic and rubber products, oil and biofuel refineries, pulp, paper, metal, mineral and chemical products together attracted three times more FDI in 2007 than in 2006, and accounted for more than 90% of total inflows into manufacturing.[84] Resource-based industries attracted almost all of M&As in the manufacturing sector (table II.15). Mexico and Brazil were the main destinations for cross-border acquisitions by foreign firms in steel[85] and Brazil in biofuels.[86] Countries such as Colombia and the Dominican Republic have also hosted FDI in these two industries mainly from Brazil due to their preferential access to the United States market.[87]

Although overshadowed by resource-based manufacturing, the automotive industry remains an important FDI recipient in the region. The main automobile TNCs with operations in MERCOSUR and Mexico – such as Chrysler, Fiat, Ford, GM, PSA Peugeot-Citroën, Renault/Nissan and Volkswagen – are investing to increase production capacity, reactivate plants, develop new models and raise productivity. Firms with a smaller presence, such as Honda, Hyundai and Toyota, are also investing in new plants and in developing new models. In addition, recently carmakers from India and China initiated investments in Latin America.[88] Latin American production units offer advantages for the production of small, low-cost cars and those running with alternative fuels, the demand for which is booming worldwide due to high oil prices and increasing environmental concerns. In South America, these advantages stem from host countries' long experience with specializing in the production of small cars. This was originally in response to demands from their local middle-income markets and later from decades of experience with biofuels in Brazil, which is a leader in the development of "flex-fuel" engines. Vehicle production in MERCOSUR is mainly geared to the local market, but is increasingly targeting Mexico and other emerging markets. Carmakers in Mexico – which offers the advantages of its proximity to the United States and of FTAs with the EU and Japan – are introducing new models to meet the growing demand from developed markets for smaller, cheaper and hybrid vehicles (ECLAC, 2008).[89]

Finally, output from Central America's apparel assembly (*maquiladoras*) – an important FDI activity – has been slowing or declining in recent years, as countries in that subregion have lost market shares in the United States to Asian countries (see *WIR07*). In addition, they have to face a slowdown in the United States economy since the end of 2007.Falling export earnings have resulted in closure of firms and job losses. For example, Hanesbrands (United States) closed down several of its factories in Central America and the Caribbean in 2007, with the most jobs being lost in the Dominican Republic (2,500) and Mexico (2,200); and Fruit of the Loom (United States) shut down its operations in Honduras where it employed 800 people. Efforts have been made towards vertical integration to be able to supply

Table II.15. Latin America and the Caribbean: cross-border M&As, by sector/industry, 2005–2007
(Millions of dollars)

	Sales			Purchases		
Sector/industry	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
Total	17 905	22 561	30 696	11 458	33 820	41 923
Primary	939	1 285	1 750	927	17 928	4 066
Mining, quarrying and petroleum	939	1 144	1 470	927	17 928	4 064
Manufacturing	9 994	3 541	8 864	1 694	2 863	23 691
Food, beverages and tobacco	5 518	974	1 659	120	428	2 032
Coke, petroleum and nuclear fuel	-	631	251	377	754	-
Chemicals and chemical products	904	713	812	42	24	871
Rubber and plastic products	-	28	779	-	-	3
Non-metallic mineral products	1 025	155	374	647	271	14 803
Metals and metal products	2 429	530	4 157	424	491	5 123
Services	6 973	17 735	20 081	8 837	13 029	14 166
Electricity, gas and water	201	1 202	1 965	942	604	1 029
Hotels and restaurants	111	3 551	123	-	282	44
Trade	1 103	1 404	3 168	591	372	1 009
Transport, storage and communications	878	1 877	3 827	2 662	4 522	2 188
Finance	1 179	7 207	7 342	4 415	5 430	9 140
Business activities	2 668	1 838	2 122	108	1 279	36
Community, social and personal services	764	598	687	-	-	-

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

complete packages of higher value-added items for special niche requirements, and to offer the flexibility needed to quickly respond to seasonal changes in fashion in the clothing market. This strategy has been successful in El Salvador: companies that had moved their production operations from there to Asia are now returning (ECLAC, 2008).[90]

iii. Services: local and regional players continue to gain strength

Some important developments related to FDI took place in the services sector in 2007, notably in telecommunications, electricity and banking.

In telecommunications, Telefónica's (Spain) acquisition of a controlling stake in Telecom Italia (Italy) has raised competition issues in various countries, including Argentina and Brazil. In Argentina, the acquisition gives Telefónica indirect control over the only two existing fixed-line operators in the country, a development which is under scrutiny by the local competition authorities, Comisión Nacional de Defensa de la Competencia (CNDC).[91] In Brazil, where three foreign affiliates together control 83% of the mobile telephony market,[92] the acquisition of Telecom Italia would give Telefónica control of the two largest mobile operators with a combined market share of around 58%. This has driven the Brazilian authorities to consider introducing legal changes that would allow the Brazilian fixed-line, broadband and mobile company, Oi Participações, to pursue its $3.5 billion planned purchase of a controlling stake in its rival Brasil Telecom, the country's third-largest fixed-line operator.[93] This would result in the creation of a major local operator in the telecoms sector to face the regional giants, Spain's Telefónica and Mexico's América Móvil.

In the electricity industry, divestment of assets by foreign firms – a trend initiated in 2003–2004 – continued in 2007, and concerned mainly firms from the United States as well as the French firm EDF. Assets sold by these firms were either acquired by local companies or other TNCs (see table II.16), attracted by their lower price and by long-term prospects of higher profits in markets with growing demand. Cross-border M&A deals in the electricity industry in Latin America and the Caribbean totalled $8 billion in 2007, of which only 13% constituted sales of domestic companies to foreign firms, representing net FDI inflows, while 62% involved changes in ownership between foreign companies, and 25% were acquisitions by nationals of local assets owned by foreigners (net negative FDI inflows).[94]

Finally, in the financial services industry, foreign entities acquired a number of local financial institutions in 2007. The largest deals were in Chile and El Salvador.[95] Among the deals that involved a change of ownership between foreign investors the most important was the acquisition in Brazil of Banco Real – ABN AMRO's (the Netherlands) affiliate in Brazil – by Santander (Spain), as a result of the latter's acquisition of the parent bank (ABN AMRO).[96] With this acquisition, Santander became the country's second-largest private bank in terms of assets, bringing an end to the traditional domination of the Brazilian banking sector by private domestic institutions such as Banco Bradesco and Banco Itaú (see *WIR06*).

c. Policy developments

As in 2005–2006 (see *WIR06* and *WIR07*), in 2007 some countries in Latin America adopted a number of policy measures related to FDI, which continued to reverse the trend towards liberalizing regulations and promoting FDI that had been dominant since the early 1990s. Such changes, which involved reducing incentives, increasing taxes and restricting or prohibiting foreign investment, while still concentrated in the extractive industries, have been progressively extended in some countries to other activities considered strategic, such as infrastructure and food. On the other hand, a number of initiatives aimed at promoting FDI have also been adopted in some countries.

The Bolivarian Republic of Venezuela continued its policy of extending State control

Table II.16. Latin America and the Caribbean: 10 largest cross-border M&A deals in electricity, 2007

			Acquiring company		Acquired company		
Value ($ billion)	Shares acquired (%)	Host economy	Company name	Home economy	Company name	Home economy	Type of deals (effect on FDI flows)
1 451	100	Mexico	Gas Natural SDG	Spain	EDF - 5 Power Plants	France	Change of foreign ownership (no net FDI)
1 082	80	Jamaica	Marubeni Corp	Japan	Jamaica Public Service Co Ltd	United States	Change of foreign ownership (no net FDI)
837	93	Venezuela, Bolivarian Rep. of	PDVSA	Venezuela, Bolivarian Rep. of	CA La Electricidad de Caracas SACA	United States	Change from foreign to domestic ownership (negative FDI)
685	50	Chile	AEI	United States	Chilquinta Energia SA	United States	Change of foreign ownership (no net FDI)
660	95	Chile	CGE	Chile	Empresas Emel SA	United States	Change from foreign to domestic ownership (negative FDI)
615	100	Mexico	AES Corp	United States	Termoelectrica del Golfo S de RL de CV	United States	Change of foreign ownership (no net FDI)
390	100	Peru	SN Power Invest SA	Norway	Electroandes SA	United States	Change of foreign ownership (no net FDI)
340	16	Brazil	Interconexion Electrica SA	Colombia	CTEEP	Brazil	Change from domestic to foreign ownership (positive FDI)
211	100	Brazil	CPFL Energia SA	Brazil	CMS Energy Brasil SA	United States	Change from foreign to domestic ownership (negative FDI)
180	86	El Salvador	AEI	United States	Distribuidora de Electricidad del Sur SA	United States	Change of foreign ownership (no net FDI)

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

over industries considered strategic. Following its modification of contracts with foreign oil companies to give the State a majority stake in oil operations, and the takeover of the largest telecommunications and electricity companies in 2007 (see *WIR07*), the Government nationalized two locally owned food-related companies (amid higher food prices and shortages of some basic foodstuffs) in 2008.[97] It also took a 60% controlling share in three wholly foreign owned cement makers, affiliates of Cemex (Mexico), Lafarge (France) and Holcim (Switzerland), and announced plans to re-nationalize the steel company Sidor, controlled by Techint of Argentina, which had been privatized in 1997. In addition, the Government agreed in March 2008 to pay $700 million in compensation to the Italian oil company Eni for its takeover in 2007 of Eni's stake in the Dación heavy oil field. This will leave ExxonMobil (United States) as the only company still pursuing a legal suit for compensation.[98] Finally, in April 2008 the Venezuelan Parliament approved a new tax on windfall oil profits.[99]

In Ecuador, a presidential decree raised the Government's share of excess oil profits (those arising from oil prices above the contractual benchmark) from 50% to 99%, and the Government began to renegotiate contracts in January 2008 with five foreign oil companies: Andes Petroleum (China), City Oriente (United States), Perenco (France), Petróleo Brasileiro (Petrobras, Brazil) and Repsol (Spain). The purpose was to switch from production-sharing contracts to service contracts. This coincides with the rewriting of Ecuador's constitution that is being drafted by a constituent assembly, which will review the Investment Promotion and Guarantee Act (1997), among others. The new constitution is expected to give the State substantial additional control over revenues from natural resources. In April 2008, the constituent assembly suspended all mining exploration and revoked 80% of unexploited mining concessions. These suspensions are to remain in effect until a new mining law is enacted, scheduled for October 2008.

In Bolivia, the Government nationalized the country's largest telephone company, Entel, in May 2008, and is negotiating an accord with Telecom Italia (Italy) on compensation for its takeover of the Italian firm's 50% share of the company.[100] The Government also announced its decision to take a majority stake or total control of some foreign energy companies.[101]

In Argentina, regulators removed tax exemptions for mining companies that will be required to pay export duties ranging from 5% to 10%. At least five mining companies have taken legal action against the Government for breaching a 1993 law guaranteeing no tax regime changes for 30 years.[102] In addition, the Government increased the export tax on oil and gas, grains and oilseeds to help secure greater domestic supplies and curb inflation.

In the Dominican Republic, the Government has announced its intention to purchase Shell International's 50% stake in Refidomsa, the country's only oil refinery, to make it wholly State-owned.[103]

In an opposite trend, Colombia and Trinidad and Tobago introduced policy changes in the oil and gas industry aimed at promoting greater foreign participation. In Colombia, the Government announced a plan to sell 20% of the shares of the State oil company, Ecopetrol. In Trinidad and Tobago, the Government is considering changes in the tax and incentives scheme relating to the energy sector in order to increase investment in exploration and production, both of which have lagged in recent years. There will also be a review of the tax regime for downstream energy projects. In Peru, Congress approved a new law in 2008 to stimulate tourism-related investment around several of the country's most famous archaeological sites, but amended it later amid strong opposition and protests from local communities in Cusco.[104]

Brazil and El Salvador took measures to promote investment in specific activities. In Brazil, the Government announced measures to boost exports of manufactured goods and reduce the country's dependence on commodity exports. The scheme will offer companies tax cuts and loans to finance the purchase of capital equipment and develop industrial infrastructure. In El Salvador, the Government passed the International Services Act that provides tax exemptions for some activities.[105]

Colombia and Jamaica also took measures to improve their business environment. Some of the measures introduced by Colombia included electronic tax declarations, gradual reduction of income tax and simplification of the rules of accounting (ECLAC, 2008). In Jamaica, the Government has been awarded a $90 million loan by the Inter-American Development Bank to improve the business environment by reducing the costs of doing business.[106]

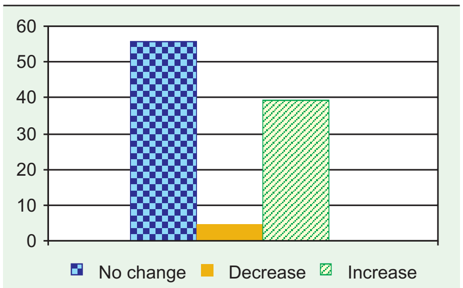
Regarding international investment agreements, Latin American countries concluded only four new BITs in 2007. This development mirrors efforts exerted by some countries in the region to narrow the scope of existing commitments to international investor-State arbitration. In this respect, some countries have denounced or withdrawn from the Convention of the International Centre for Settlement of Investment Disputes (ICSID) and are denouncing or renegotiating existing BITs. Ecuador, for example, suspended negotiation of new BITs until the enacting of a new constitution, notified 9 countries[107] of its decision to denounce such treaties, and will propose renegotiations to another 13 countries.[108] These renegotiations will aim at rebalancing investors' rights with the public interest, restricting access of private foreign investment to certain strategic sectors and limiting future commitments on liberalization and national treatment. Another goal of these renegotiations is to include performance requirements and the definition of expropriation and dispute settlement clauses.[109] In terms of international arbitration, Bolivia withdrew from ICSID with effect from 3 November 2007,[110] and on 4 December 2007 Ecuador notified ICSID that it would no longer consent to that body's jurisdiction in investment disputes related to exploitation of natural resources, such as oil, gas, minerals and others. Furthermore, the Bolivarian Republic of Venezuela and Nicaragua have made public that they are considering denouncing the ICSID Convention (Gaillard, 2008).

Meanwhile, other Latin American countries have continued to expand their network of FTAs that include investment provisions. After Colombia, Panama and Peru concluded FTAs with the United States in 2006, Uruguay and the United States signed a Trade and Investment Framework Agreement that establishes an institutional framework to follow up and monitor investment relations and opportunities. Chile signed an agreement with Japan for a Strategic Economic Partnership that includes a full chapter on investment protection and liberalization. Costa Rica signed an FTA with Panama and ratified the Dominican Republic–Central American Free Trade Agreement (DR-CAFTA).

d. Prospects: growth of inflows and outflows

In UNCTAD's *World Investment Prospects Survey, 2008-2010,* only 5% of the companies surveyed expected a decrease in FDI inflows to Latin America and the Caribbean, while 39% expected an increase and 56% anticipated no change (figure II.22). In JBIC's annual survey of FDI by Japanese manufacturing companies, Brazil and Mexico are ranked 7th and 12th respectively among the promising destinations for business expansion over the medium and long term. In Brazil, the growth potential of its local market is by far the most important reason for attracting FDI, as indicated by 77% of respondent companies (JBIC, 2008).

Figure II.22. FDI prospects in Latin America and the Caribbean, 2008–2010
(Percentage of respondents to the UNCTAD survey)



Source: UNCTAD, 2008b.

FDI inflows to Latin America and the Caribbean are expected to increase in 2008, mainly driven by South America, where high commodity prices and strong economic growth of the subregion will continue to sustain TNCs' profits. Within South America, FDI inflows to Brazil and Chile are expected to reach new record highs, mainly boosted by metal-mineral extractive industries in Chile and resource-based manufacturing industries and extractive industries in Brazil. The other resource-rich countries of the subregion, such as Bolivia, Colombia and Peru are also expected to attract increasing FDI inflows to their extractive activities. Central America and the Caribbean, excluding offshore financial centres, will face an uncertain year for FDI inflows due to the slowdown of the United States economy, which is expected to affect investments in export-oriented manufacturing activities.

FDI outflows from Latin America and the Caribbean, excluding offshore financial centres, are expected to increase in 2008. Companies based in Brazil and Mexico have already announced ambitious investment plans for 2008 in manufacturing,[111] oil and gas production[112] and telecommunications.[113]

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

1. Geographical trends[114]

In 2007, FDI inflows to South-East Europe and the Commonwealth of Independent States (CIS) maintained their upward trend to reach a new record level. While various economies in the CIS experienced strong inward-FDI growth, with foreign investors eager to access their fast growing consumer markets and natural resources, privatization-linked projects remained the main drivers of FDI flows to South-East Europe. EU countries accounted for the bulk of both greenfield projects and cross-border M&As, though there was an increase in greenfield investments from North America. The drive to acquire strategic assets worldwide and control global markets segments spurred outward FDI from the CIS to record levels. Besides investing in the "traditional" locations of other transition economies, TNCs from the region are expanding their activities not only to Western Europe and North America but also to Africa. Governments in the CIS liberalized their policies with respect to FDI in industries deemed non-strategic, but strengthened their control over natural resources. In South-East Europe, some countries adopted flat-rate tax systems that could improve their FDI prospects. Having experienced only a limited impact from the recent financial and credit crises, the CIS continues to enjoy growth in FDI, as foreign investors are encouraged by the potential growth of local markets and accession (or prospective accession) of these States to the WTO in 2008 and beyond.

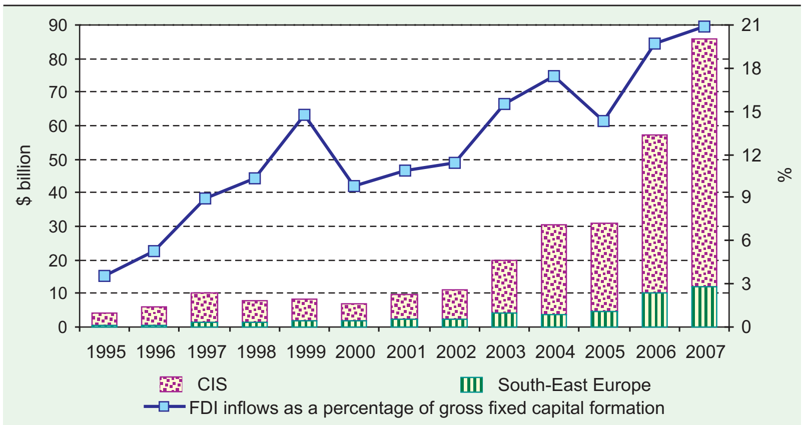
a. Inward FDI: growing market-seeking FDI

Inward FDI flows into South-East Europe and the CIS recorded their seventh consecutive year of growth, reaching an all-time high of $86 billion (figure II.23). As domestic investment grew at a similar pace to FDI, the ratio of inward FDI to gross fixed capital formation increased only marginally, from 20% in 2006 to 21% in 2007. Inflows remained concentrated in a few economies, with the top five destinations accounting for 94% of the flows to the region (figure II.24).

In 2007, FDI inflows to *the Russian Federation* grew by 62%, reaching $52 billion (figure II.24). Foreign investors responded positively to the fast growing local consumer market there and the ongoing liberalization of selected industries, in particular electricity generation. Driven by high expected returns, foreign TNCs also increased their investments in energy and natural-resource-related projects. Examples in 2007 include the framework agreements of the oil and gas TNCs StatoilHydro (Norway) and Total (France) with State-controlled firm Gazprom on the development of the large Shtokman field – the world's largest untapped natural gas deposit.

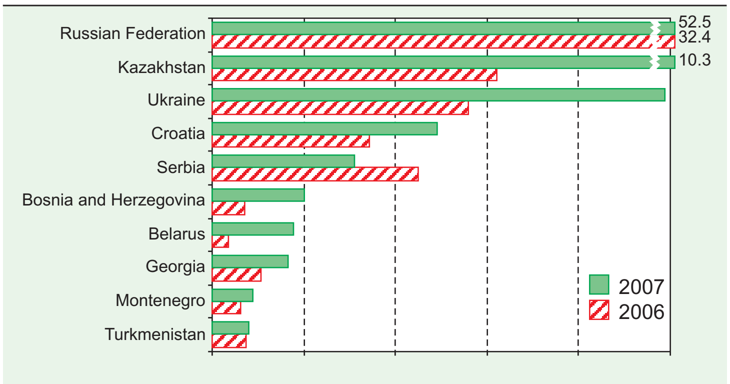
Even with the recent upsurge, the FDI potential of the Russian Federation remains higher than its performance, as shown by UNCTAD's Inward FDI Performance and Potential indices for 2006 (figure

Figure II.23. South-East Europe and CIS: FDI inflows in value and as a percentage of gross fixed capital formation, 1995–2007



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,[a] 2006–2007
(Billions of dollars)



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

[a] Ranked by magnitude of 2007 flows.

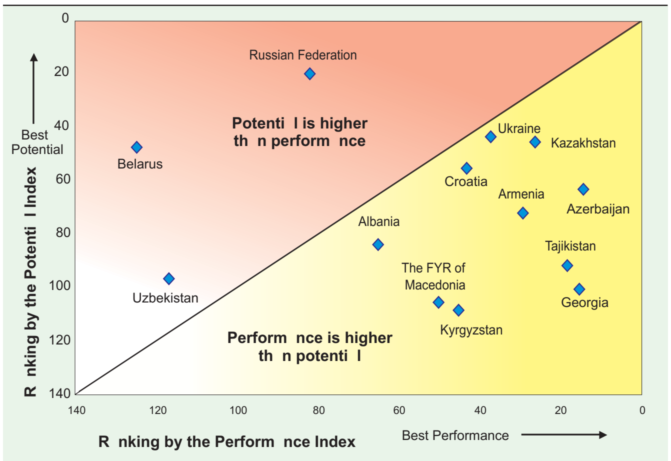
II.25),[115] suggesting that FDI inflows could continue growing further.

Kazakhstan, owing to the development of three main hydrocarbon projects, namely Kashagan, Tengiz and Karachaganak, was the second largest recipient of FDI inflows. The relaxation of foreign ownership restrictions in the financial services industry also accelerated the entry of foreign investors into Kazakhstan's banking. Indeed, the acquisition of ATF Bank from Unicredit (Italy) for $2.1 billion was one of the biggest non-oil FDI projects in the country. Despite uncertainties caused by domestic politics during 2007, *Ukraine* attracted FDI inflows that reached a new high of almost $10 billion, as its banking industry opened up to FDI as a result of the country's accession to the WTO, and large projects were initiated in real estate and in construction. In *Croatia*, the financial services industry was the largest recipient (60%) of record FDI inflows in 2007, while in *Montenegro,* inflows reached almost $1 billion, making that small economy the top recipient of FDI per capita in the region.

In 2007, the number of countries in the region that attracted FDI inflows of less than $1 billion fell to 10, compared to 12 in 2006 (table II.17). Developed countries, mainly EU members, remained the largest sources of inward FDI in the region. The share of the United States in the total number of greenfield projects increased from 11% in 2006 to 13% in 2007, while that of intraregional FDI in such projects declined from 11% to 9%. In addition, companies from developing countries invested in large greenfield projects in the CIS.[116]

With regard to cross-border M&As, developed countries, particularly members of the EU, increased their share of transactions in the region (in terms of total value) from 46% in 2006 to 85% in 2007 (table II.18) (and from 57% to 58% in the number of deals). For example, with the acquisition by the Italian energy firms Eni and Enel of the assets of the bankrupt Russian oil firm Yukos, and the participation of Enel in the liberalized electricity industry, Italy became the leading source of cross-border M&As in the Russian Federation in 2007. It was followed by Germany, reflecting purchases by the electricity TNC E.ON of various assets in the Russian power-generating industry. The share of TNCs from developing countries as buyers in cross-border M&As of enterprises in South-East Europe and the CIS remained at 4% in 2007, the same as in 2006 (in terms of the number of deals).

Figure II.25. Inward FDI Performance and Potential indices rankings of selected countries, 2006



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table A.I.10.

Table II.17. South-East Europe and CIS: distribution of FDI flows among economies, by range,[a] 2007

Range	Inflows	Outflows
Over $5.0 bn	Russian Federation, Kazakhstan and Ukraine	Russian Federation
$1.0 bn to $4.9 bn	Croatia, Serbia, Bosnia and Herzegovina, Belarus and Georgia	Kazakhstan
$0.1 bn to $0.9 bn	Montenegro, Turkmenistan, Armenia, Albania, Republic of Moldova, Tajikistan, The FYR of Macedonia, Uzbekistan and Kyrgyzstan	Serbia, Ukraine, Azerbaijan, Croatia and Montenegro
Less than $0.1 bn	Azerbaijan	Georgia, Albania, Republic of Moldova, Bosnia and Herzegovina, Belarus, Kyrgyzstan, The FYR of Macedonia and Armenia

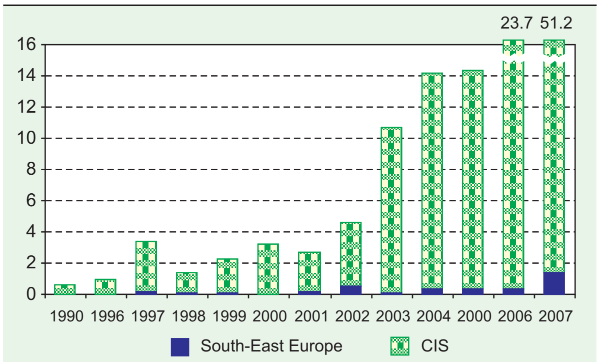
Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Economies are listed according to the magnitude of their FDI flows.

b. Outward FDI: Russian TNCs expanding abroad

In 2007, outward FDI from the region more than doubled, reaching $51 billion (figure II.26). Most of the outward FDI projects, as in the past years, were carried out by Russian TNCs, followed by those from Kazakhstan. The value of cross-border M&A purchases by TNCs from the region almost doubled from 2006, with 72% of the activity taking place in developed economies (table II.18). On the other hand, almost two thirds of greenfield operations by investors from South-East Europe and CIS were undertaken in developing and transition economies.

Figure II.26. South-East Europe and CIS: FDI outflows, 1995–2007
(Billions of dollars)



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

Outward FDI from the Russian Federation reached a new high in 2007 ($46 billion) strengthening its position as a leading investor from developing and transition economies. Russian TNCs increasingly look for strategic assets in the mature markets of developed countries, including downstream activities in the energy industry and value-added production activities in metallurgy. Most of the outward FDI from the Russian Federation has been undertaken by a relatively few big TNCs with large export revenues that have played a key role in supporting and financing the growth of their overseas business activities (Vahtra, 2007). In 2007, Russian steel companies acquired assets in North America (for example Evraz Group bought Oregon Steel Mills Inc (United States) for $2.1 billion). In mining, the purchase of LionOre Mining (Canada) by Norilsk Nickel for $6.3 billion was the largest ever foreign acquisition by a Russian company. In the oil and gas industry, Gazprom's expansion into European downstream markets slowed down, but it sustained the pace of its acquisitions of national gas distributors in other transition economies.[117]

Russian companies continued to expand into Africa in 2007, enhancing their raw material supplies and moving into new segments of strategic commodities. They entered the African market either directly (e.g. the purchase of Samancor Chrome in South Africa by a Russian investor group, and Gazprom's production-sharing agreement in the Libyan Arab Jamahiriya), or through acquisitions of parent firms in developed countries (e.g. the above-mentioned purchase of LionOre Mining (Canada), which allowed Norilsk Nickel to gain control over two major nickel mines, one in South Africa and the other in Botswana), or through asset-swap agreements with companies from developed countries that have concession rights in Africa (e.g. in the Libyan Arab Jamahiriya, Gazprom acquired a 49.9% stake in two oil concessions from Germany's BASF).

In 2007, outward FDI from Kazakhstan grew significantly, reaching $3.2 billion. The country's State-owned oil and gas company, KazMunaiGaz, expanded abroad in order to secure markets for its oil exports as well as locations for overseas refineries. The company is expanding its operations in Romania and in the CIS, with an investment in an oil refinery on Georgia's Black Sea coast. Another State-owned company, the nuclear fuel and power generator Kazatomprom, aiming to access uranium-processing

Table II.18. South-East Europe and CIS: cross-border M&As, by region/economy, 2005–2007
(Millions of dollars)

	Sales of South-East European and CIS firms			Purchases by South-East European and CIS firms		
Region/economy	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
World	12 781	17 113	30 081	22 802	10 833	18 394
Developed economies	11 040	12 961	27 503	19 552	6 702	13 228
Europe	9 193	9 831	26 044	17 124	5 420	2 957
European Union	9 193	7 870	25 460	17 124	5 224	2 942
Austria	1 119	901	403	61	-	1 637
France	60	661	2 085	-	-	18
Germany	337	1 209	6 829	-	10	-
Italy	472	343	9 438	579	700	-
Luxembourg	4 803	-	1 065	-	805	45
United Kingdom	235	428	1 863	15 898	2 926	714
Other developed Europe	-	1 960	584	-	197	15
Norway	-	1 956	6	-	-	-
Switzerland	-	-	337	-	197	-
North America	1 652	2 743	1 367	1 967	1 282	9 720
Canada	29	167	42	-	4	7 876
United States	1 622	2 577	1 325	1 967	1 278	1 844
Developing economies	92	823	364	1 602	1 079	2 951
Africa	22	81	165	-	-	250
Asia and Oceania	-	742	199	1 602	1 064	2 701
Turkey	-	661	161	1 602	22	612
China	-	-	-	-	1 000	1 979
South-East Europe and the CIS	1 648	3 052	2 214	1 648	3 052	2 214
South-East Europe	6	14	864	65	14	1 020
Serbia and Montenegro	6	5	860	59	-	-
Commonwealth of Independent States (CIS)	1 642	3 038	1 350	1 583	3 038	1 194
Russian Federation	1 292	2 936	941	868	2 844	356

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

technology, purchased a 10% stake in the nuclear engineering group Westinghouse Electric (United States) from Toshiba (Japan) for $540 million.[118]

2. Sectoral trends: services dominate

Judging from the data on cross-border M&As sales, the primary and services sectors of South-East Europe and CIS received significantly higher inflows in 2007 than in the previous year, while flows to manufacturing declined (table II.19).

Primary sector

In 2007, FDI to the primary sector increased, mainly in the petroleum and gas industry. Despite stricter conditions on entry, foreign companies continued to seek natural resources in the CIS. Two developments played a role in that respect. First, through asset swap deals, oil and gas firms of transition economies were allowed to enter downstream markets in developed countries in exchange for letting TNCs from the latter take minority participations in their own domestic exploration and extraction projects. For instance, in 2007, Winterstall (Germany) acquired a stake in the Yuzhno-Russkoye gas field in Siberia and Eni (Italy) gained access to exploration and production facilities in the Russian Federation (including former Yukos assets). In return, Gazprom could acquire parts of their European assets in hydrocarbons transportation, storage and distribution. Second, in some oil and gas projects requiring cutting-edge technology, such as the development of the Shtokman field, involvement of developed-country TNCs such as StatoilHydro (Norway) and Total (France) was needed because of their technology and expertise.

In 2007, companies from developing countries became more active through partnerships in the primary sector with major firms in the CIS. For example, CNPC (China) formed a joint venture with Rosneft to develop oil projects in the Russian Federation and downstream operations in China, while the same Chinese company formed another joint venture with Kazakhstan's State-owned nuclear energy company, Kazatomprom, to invest in uranium production in Kazakhstan.

Manufacturing

Cross-border M&A sales of firms in the manufacturing sector in South-East Europe and the CIS declined in 2007 compared to 2006. However there was increased TNC activity in the automotive industry as illustrated by the number of greenfield projects in that industry. This was fuelled by foreign manufacturers' search for low-cost, highly skilled labour and access to a growing market. Largely due to an industrial assembly policy that allows zero

Table II.19. South-East Europe and CIS: cross-border M&As, by sector/industry, 2005–2007
(Millions of dollars)

	Sales			Purchases		
Sector/industry	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
Total	12 781	17 113	30 081	22 802	10 833	18 394
Primary	2 504	3 335	9 683	16 093	3 555	3 536
Mining, quarrying and petroleum	2 504	3 331	9 281	16 093	3 555	3 536
Manufacturing	6 300	6 496	1 709	2 163	2 093	7 501
Food, beverages and tobacco	730	447	571	2	3	-
Wood and wood products	6	20	620	6	-	18
Coke, petroleum and nuclear fuel	-	2 353	157	-	-	22
Chemicals and chemical products	315	3 308	193	564	3	-
Metals and metal products	5 120	163	57	1 590	1 629	7 408
Services	3 977	7 282	18 689	4 546	5 185	7 357
Electricity, gas and water	49	567	7 353	52	2 358	-
Construction	-	6	30	-	-	1 644
Transport, storage and communications	1 210	2 772	1 320	876	857	2 010
Finance	2 420	3 508	9 082	3 599	1 947	2 749
Business activities	37	344	635	19	8	409

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

Table II.20 Production of cars by foreign manufacturers in the Russian Federation, actual and announced, 2007

Manufacturer	Brand	Time of launching	City/region	Investments as of 2007 ($ million)	Output in 2007 (annual)	Output by 2010 (annual forecast)
Operating in 2007						
GM-AvtoVAZ	Chevrolet	2002	Togliatti	534	45 000	75 000
Avtoframos	Renault	2005	Moscow	333	80 000	160 000
IzhAvto	KIA	2005	Izhevsk	70	62 000	100 000
Taganrog Automobile Plant (TagAZ)	Hyundai	1998	Taganrog	320	70 000	100 000
Avtotor	BMW, Chevrolet	1999	Kaliningrad	200	95 000	100 000
Ford Motor Company	Ford	2002	Vsevolozhsk	330	72 000	125 000
Severstal Auto	Fiat	2006	Tatarstan	18	15 000	40 000
Severstal Auto	SsangYong	2005	Tatarstan	70	10 000	10 000
Total:				1 875	450 000	710 000
Projects announced in 2007						
				Planned Investments ($ million)		
Severstal Auto	Fiat	2008	Tatarstan	120	-	75 000
GAZ Group	Chrysler	2008	Nizhny Novgorod	150	-	40 000
Toyota	Toyota	2007	St. Petersburg	150	-	20 000
Volkswagen	Volkswagen	2007	Kaluga	552	-	115 000
General Motors	Opel	2008	St. Petersburg	300	-	70 000
Nissan	Nissan	2009	St. Petersburg	200	-	50 000
Hyundai	Hyundai	2010	St. Petersburg	390	-	20 000
Mitsubishi	Mitsubishi	2010	St. Petersburg	180	-	30 000
PSA Peugeot Citroen	Peugeot, Citroen	2010	Nizhny Novgorod	448	-	80 000
Suzuki	Suzuki	2009	St. Petersburg	120	-	30 000
Chery	Chery	2010	Kaliningrad	250	-	25 000
Total:				2 860		390 000
Total as of end 2010:						**1 100 000**

Source: "Volkswagen to become part of Russian auto industry" *Ria Novosti*, 28 November 2007.

customs duties on a long list of auto parts, many key players in international car manufacturing have opened production facilities in the Russian Federation (table II.20).[119] The food and beverages industry also benefited from a high growth of FDI in 2007.[120]

Services

The widespread shift of FDI towards services continued, driven in particular by investments in financial services, electricity generation and telecommunications. As the retail financial services market is far from saturated in the region, and liberalization of the banking industry is in progress under WTO commitments, there were a number of cross-border M&As in this industry in 2007.[121] As part of ongoing plans to liberalize the power generation market in the Russian Federation, the State-controlled monopoly UES began to sell its power generating and distributing assets. In this process, foreign TNCs such as E.ON (Germany) and Enel (Italy) were active acquirers. Intraregional M&As in the telecommunications industry also continued in 2007, with the largest transactions carried out by Vimpelcom (Russian Federation).[122]

3. Policy developments

The rapid growth of FDI flows to South-East Europe and CIS countries partly reflects steps taken by countries in the region to open up their economies to foreign investment. At the same time, increased restrictions on inward FDI in certain sectors and countries may have a dampening effect on future flows. In 2007, UNCTAD's annual survey of changes in national laws and regulations identified eight policy measures that were introduced in the CIS and seven in South-East Europe.

Whereas most of the national policy changes observed in 2007 were in the direction of greater openness to FDI, only two of those changes made the environment for foreign investment less favourable. Some CIS countries introduced (or continued to implement) more restrictive policies in particular with regard to FDI in the extractive industries and other "strategic sectors". This trend mirrors developments in other parts of the world (chapter I; *WIR07*).

In Kazakhstan, a new natural-resource law was approved, which allows the Government to change existing contracts unilaterally if they adversely affect the country's economic interests in the oil, metals and minerals industries. The best-known case of a related contract revision was that of the Kashagan oilfield, where KazMunaiGaz, the State-owned oil and gas TNC, increased its share in the project from 8% to 17% (figure II.27). Furthermore, in early 2008, the Government announced that it would no longer negotiate production sharing agreements, and that it would impose more stringent conditions on foreign investors. In the same vein, a new tax code was expected to be approved in 2008.

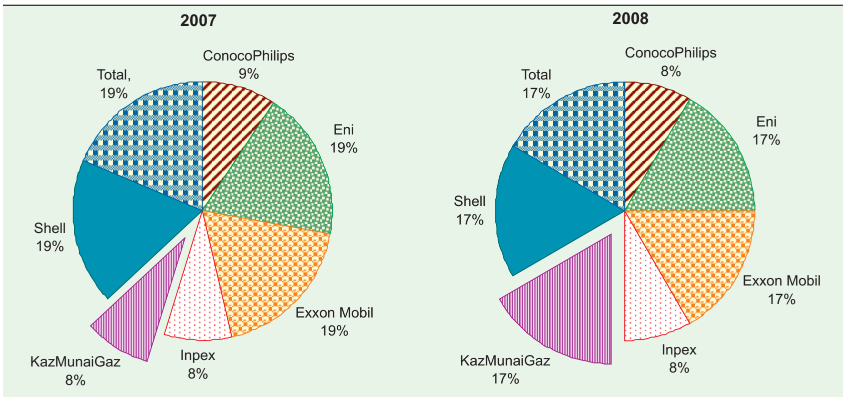
In the Russian Federation, the long-discussed Strategic Sector Law was approved in May 2008. It is intended to clarify rules on foreign investment in strategic industries, including procedures and foreign ownership limitations (box II.7 and annex table A.II.1).

Ukraine's accession to the WTO in 2008 is expected to stimulate inward FDI in certain industries such as in banking and steel.

In South-East Europe, policy changes observed for 2007 were part of broader market-oriented reform processes, often associated with EU (and sometimes NATO) accession. One feature of the changing policies is the effort to speed up privatization of the remaining SOEs.[123] In Croatia, a "one-stop shop" was set up to consolidate procedures for starting new companies. In the former Yugoslav Republic of Macedonia, tax payment procedures were simplified, and Georgia took steps to strengthen investor protection through amendments to its securities law. All three countries ranked among the top 10 "reform countries" in the World Bank's *Doing Business Survey* for 2008. Moreover, several countries introduced new, low corporate tax regimes. For example, Albania and the former Yugoslav Republic of Macedonia introduced a flat tax rate, with the aim of improving the investment climate and reducing the underground economy and the rate of tax evasion.

At the international level, countries in the region concluded 11 new BITs involving 9 countries in 2007. Azerbaijan and the Russian Federation concluded

Figure II.27. Distribution of shares among energy companies involved in the Kashagan project, Kazakhstan, 2007 and 2008



Source: United States, Energy Information Administration, 2008.

Box II.7. The Strategic Industry Law of the Russian Federation

In May 2008, the President of the Russian Federation signed the long-awaited law on strategic industries, *On the Order of Foreign Investment in Companies with Strategic Impact on the National Security of the Russian Federation*. The law provides a detailed framework for regulating foreign investment in companies operating in industries deemed to be of national or strategic importance (strategic companies). By requiring government approval for foreign investments in particular strategic companies, it enables the Government to regulate such investments on a case-by-case basis.

The list of industries deemed to be of national or strategic importance includes among others: nuclear and radioactive materials, military-related activities, large-scale radio and television broadcasting, the exploration for and extraction of natural resources on subsoil plots of federal importance,[a] extraction of biological resources from waters and large-scale printing and publishing activities (see annex table A.II.1 for the full list).

According to the law, private foreign investors need the consent of a government commission before they can acquire direct or indirect control over any strategic company.[b] While foreign State-owned firms or international organizations are not allowed to own majority shares in a strategic company, they may acquire up to 25% of the equity shares. A foreign investor does not need permission (a) if, at the time of the investment, it already controls more than 50% of a strategic company (non-subsoil); or (b) if it acquires up to 50% of the shares in a subsoil company in which the Russian Federation owns or controls more than 50%. However, permission is *always* required if the foreign investor is a State-owned firm. The procedure for obtaining the approval to invest in a strategic company will consist of several steps and involve a number of different agencies.

Source: UNCTAD based on Liuhto, 2008; and Allen & Overy LLP, 2008.

[a] The definition of control means acquisition by private foreign companies of more than 50% of the shares, 50% participation in the charter capital or more than 50% representation on the board of directors of a strategic company. The threshold is 10% for a subsoil company.

[b] Participation by foreign State-owned firms or international organizations of more than 25% equity share in a strategic company, other than a subsoil company, and of more than 5% in a subsoil company, needs approval by the government commission.

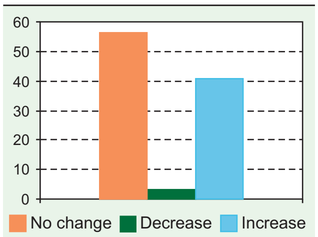
two new BITs each. In addition, 24 new DTTs were concluded involving 13 countries. Moldova concluded 4 new DTTs, followed by Azerbaijan, Belarus and Georgia with 3 new treaties each.

4. Prospects: natural resources will continue to attract FDI

In the UNCTAD's *World Investment Prospects Survey*, 41% of the companies surveyed expected an increase in FDI in the period 2008–2010 (figure II.28). Among the natural-resource-rich economies, while FDI prospects for Kazakhstan could be affected by the Government's less favourable policies for foreign investors, in the Russian Federation, foreign investors, accustomed to operating in a more restrictive business environment, seem ready to participate with their advanced technologies as minor partners in large oil and gas projects.

Rapid economic growth in South-East Europe and the CIS is expected to continue in 2008 (World Bank, 2007b; EBRD, 2007). FDI is likely to remain high in the region as whole, due to market opportunities, especially in consumer goods and services, as well as to increasing openness and transparency, competitive wage levels and an improving economic and institutional framework. Beyond natural resources, FDI could increase in other activities such as electricity generation (e.g. in the Russian Federation), retail trade (as illustrated by the entry of Ikea of Sweden in 2008 into Kazakhstan) and banking (in Ukraine). In the automotive industry, the Russian Federation appeals to investors for its potential to become Europe's largest car market. Foreign manufacturers such as Volkswagen and Skoda have also started moving some production capacity to Ukraine, another relatively large potential market. A planned $1 trillion multi-year programme of investment in infrastructure in the Russian Federation, with some foreign participation, could further increase FDI in the country (Deutsche Bank, 2007).

Figure II.28. FDI prospects in South-East Europe and CIS, 2008–2010
(Percentage of respondents to the UNCTAD survey)



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

Privatization plans in a few countries of the region are expected to boost FDI. In Uzbekistan, the Government announced the privatization of 1,400 companies including 49% of the State-owned oil and gas company, Uzbekneftegas, and 49% of the country's main telecoms operator Uzbtelecom. In Ukraine, Odesa Port Plant, the largest trans-shipment facility in the CIS, will be privatized, while in Albania the privatization of large State-owned companies in oil and gas, insurance and electricity is planned in 2008.

According to a survey by PricewaterhouseCoopers (2008a), consolidation of the banking industry in the CIS,[124] as well the current global credit crunch could accelerate FDI in financial services, particularly in retail banking and insurance in the subregion. According to the A.T. Kearney's *FDI Confidence Index* (2008a), the Russian Federation was among the top 10 FDI destinations in the world, while Ukraine is the seventh most attractive investment destination for European investors. The annual survey of Japanese manufacturing TNCs by JBIC (2008) reported that the CIS region's attractiveness for Japanese investors was rising due to future market potential.

Outward FDI from the Russian Federation is expected to grow rapidly in the near future, not only to other transition economies and developed countries but also to developing countries, especially in Africa. State-owned TNCs such as Gazprom and Evraz can play a major role in that expansion. The role of Government in outward FDI is expected to be further strengthened with the establishment of the country's first sovereign wealth fund for investment purposes. In February 2008, the Russian Federation established a government investment company to manage a $32 billion fund drawn from the Oil Stabilization Fund. This follows the same proactive approach to petrodollars as that adopted by West Asian governments (chapter I).

C. Developed countries

1. Geographical trends[125]

In 2007, FDI inflows to developed countries rose by 33% to $1,248 billion. As in previous years, cross-border M&As were mainly responsible for this continued rise. The high profitability of foreign affiliates of TNCs led to strong reinvested earnings that also contributed to increased FDI. FDI flows were particularly strong in manufacturing. In addition to flows from developed countries that are dominant, FDI by new investors from developing countries has also been on the rise. FDI outflows from developed countries amounted to $1,692 billion, representing an increase of 56%.

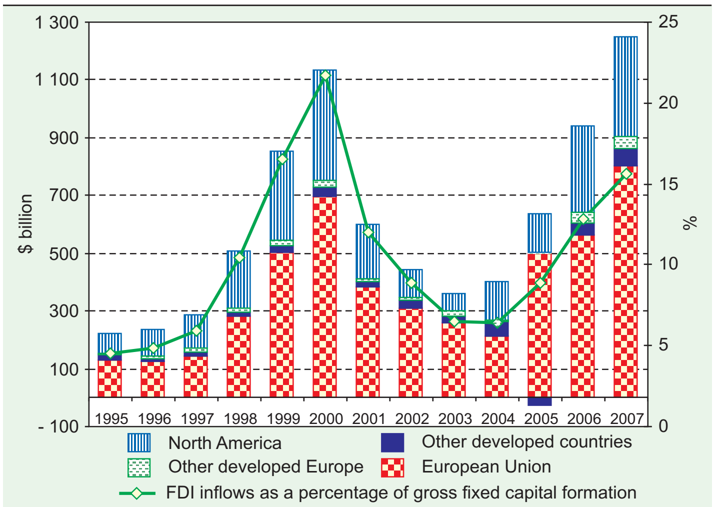
The financial-market crisis that began in 2007, combined with weaker economic growth, especially in the developed economies, has been dampening FDI flows to and from developed countries in 2008. Cross-border M&As in developed countries declined considerably in the first half of 2008 compared to the second half of 2007, partly because private equity funds and hedge funds reduced their investment activities as their access to bank loans for large buyout transactions has been reduced. A renewed rise in FDI depends crucially on improved growth prospects in the world economy and financial market conditions. However, in 2009, economic growth in developed countries is expected to be low and financial market conditions could remain difficult (IMF, 2008c), which would curb FDI activity (OECD, 2008b). The results of UNCTAD's *World Investment Prospects Survey* point in the same direction.

a. Inward FDI: more vibrant in the EU

FDI inflows to developed countries increased for the fourth consecutive year in 2007, to reach $1,248 billion (figure II.29). They rose considerably in the major developed-country subregions of North America and Europe, and in 20 out of 38 developed countries (annex table B.1). The United States retained its position as the largest single host country for FDI (table II.21 and figure II.30). Three EU countries (the United Kingdom, France and the Netherlands, in that order) received record FDI inflows. Japan's FDI inflows grew strongly for the first time since the end of the 1990s.

Inward FDI flows in *North America* grew by 14%, to $341 billion (figure II.29) in 2007. Flows to the *United States* amounted to $233 billion, down from $237 billion in 2006 (figure II.30). Reinvested earnings of foreign affiliates in the United States remained strong ($64 billion) and equity capital inflows increased further: at $147 billion, they were 25% higher than in 2006. A series of high-value cross-border acquisitions of United States firms raised the equity capital stock of foreign TNCs in that country. There were 19 cross-border M&As valued at more than $5 billion (annex table A.I.3), compared with 6

Figure II.29. Developed countries: FDI inflows in value and as a percentage of gross fixed capital formation, 1995–2007



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

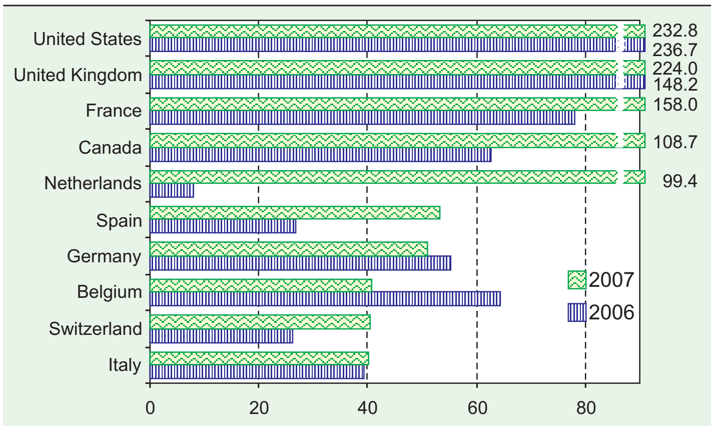
Table II. 21. Developed countries: distribution of FDI flows among economies, by range,[a] 2007

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

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

[a] Economies are listed according to the magnitude of their FDI flows.

Figure II.30. Developed countries: top 10 recipients of FDI inflows,[a] 2006–2007
(Billions of dollars)



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

[a] Ranked by magnitude of 2007 FDI flows.

in 2006 (*WIR07*). The largest FDI recipient industries were chemicals, wholesale trade, machinery, and computers and electronic products (Bach, 2008). The leading source countries of FDI in the United States were Luxembourg (accounting for 18% of the total), Canada (16%), and Japan (12%), followed by the Netherlands, France and Spain. European companies took advantage of the low value of the United States dollar vis-à-vis the euro, which made investments in the United States relatively cheap (chapter I). Despite a slowdown in economic growth following the outbreak of the crisis in the United States housing market and the financial turmoil affecting the banking industry, investors continued to be strongly attracted by the size of the United States economy, the high income levels and access to cutting-edge technology and research.

After doubling in 2006, FDI inflows into *Canada* again grew strongly, by 73%, to reach a new historic record of $109 billion. Canada therefore ranked fourth among the top developed-country recipients of FDI. The wave of cross-border investments in the Canadian mining and natural resource industries continued. Alcan Inc, a Canadian aluminium producer, was acquired by Rio Tinto (United Kingdom/Australia) for $37.6 billion in the second largest cross-border M&A deal in 2007. In the crude petroleum and natural gas industry three high-value acquisitions of Canadian companies by TNCs from the United States and the Netherlands totalled $21 billion.[126] Natural resources and metallic minerals attracted the largest FDI flows among Canadian industries, while finance and insurance attracted the second largest ($22 billion). As in previous years, strong economic growth and favourable business conditions in the Canadian economy were factors that stimulated FDI inflows to Canada in 2007 (*WIR07*: 36).

FDI flows into the *27 EU* countries rose by 43% in 2007, to a total of $804 billion. The restructuring and concentration process in the enlarged common market of the EU countries continued unabated and led to a renewed wave of cross-border acquisitions. Six of the ten largest M&As worldwide in 2007 took place in the EU (annex table A.I.3) while 7 intra-EU cross-border M&As were valued at more than $10 billion. Cross-border M&As grew strongly in both value and number in a broad range of services and manufacturing industries. In addition, FDI inflows were driven by increased reinvested earnings as corporate profits of European firms remained strong.

Inward FDI flows to the 13 countries of the *European Monetary Union* (EMU) (or Euro zone) grew by 50%, to $485 billion. A large part of the inflows was intra-EMU FDI spurred by favourable economic growth. European firms in the common currency area continued to consolidate their activities (Ricci, 2006). Seven of the 13 countries recorded a significant increase in FDI inflows. Inward FDI in the *Netherlands*, for instance, grew considerably, from $8 billion in 2006 to a record $99 billion in 2007 due to a single large acquisition, that of ABN AMRO by a consortium of three European banks for $98 billion – the largest ever cross-border acquisition in the financial services industry worldwide (annex table A.I.3). FDI inflows to *France* doubled, to $158 billion – a new record – raising the country's inward FDI stock to more than $1 trillion. FDI inflows into France were spread over different sectors. Intra-company loans of foreign investors to their French affiliates contributed the most to the high level of FDI inflows (66% of total FDI inflows in 2007). Equity capital inflows increased only slightly, as there were only a few larger cross-border acquisitions of French companies.[127] As in the Netherlands and France, FDI inflows into *Austria* also reached a record high in 2007. They increased to $31 billion – more than the amount of inflows in the previous five years combined. The bulk of FDI was in the banking industry. Intra-company loans of foreign TNCs to their Austrian affiliates played a major role, as a number of European firms use Austrian affiliates as a gateway to invest in Eastern European countries.

Several other EMU-13 countries, including Spain, Ireland, Italy and Finland, also recorded an increase in FDI inflows. Inward FDI in *Spain* increased to $53 billion in 2007, reaching a new record high. It was largely driven by some large cross-border acquisitions, such as the $33 billion acquisition of the Spanish energy supplier, Endesa, by a consortium comprising Italy's Enel and Spain's Acciona, though it was heavily disputed. *Italy* recorded a marginal increase in inflows to $40 billion. The country's inward FDI remained well above its average annual value of the past ten years. In *Ireland,* after three consecutive years of negative inflows due to large loan repayments of Irish affiliates to their parent firms, inward FDI flows increased to $31 billion in 2007.

In five EMU-13 countries (Belgium, Germany, Greece, Luxembourg and Portugal) inward FDI flows declined in 2007. Inflows into *Germany* remained high, even though they fell slightly, from $55 to $51 billion. Relatively strong economic growth and an improved business climate may have contributed to the country's sustained high inflows.[128] Most of these inflows came from EMU partner economies, and were spread across different sectors. In contrast, FDI inflows to Luxembourg were negative (-$36 billion) partly due to transactions related to the merger between Arcelor and Mittal Steel which were completed in two phases over the period 2006–2007.

Inward FDI inflows into three EU-15 countries that do not participate in the EMU were uneven in 2007 (table II.21). The *United Kingdom* retained its position as the largest FDI recipient in Europe in 2007 with inflows increasing by 51% (to $224 billion). Three of the 10 largest cross-border M&As worldwide were recorded in that country (annex table A.I.3). Cross-border acquisitions of United Kingdom companies were spread across different sectors and industries, but were particularly prominent in electricity, gas and water supply, consumer goods, trade and construction.[129] Reinvested earnings of foreign affiliates grew strongly, contributing to the rise in FDI flows.

FDI inflows to the 12 new EU member countries remained at the same level in 2007 as in 2006, at $65 billion. Inflows were unevenly distributed, with the top recipients Poland, Romania, Czech Republic and Bulgaria in that order, alone accounting for more than two third of the group's total. *Poland*'s rapidly expanding domestic market, its flexible and skilled labour force and solid banking system prompted a steady and sizeable flow of FDI, which amounted to $18 billion in 2007 – close to the record FDI inflows of 2006. Investment by European companies dominated FDI in the 12 new EU members, but the United States was the largest single investor in the subregion due to some large acquisitions in the telecommunications industry.[130] Large State-owned companies from the CIS were also active acquirers of firms in the new EU-member countries (e.g. the acquisition of Rompetrol (Romania) by State-owned KazMunaiGaz of Kazakhstan[131]).

FDI inflows to *Japan*, the second largest economy in the world after the United States, increased considerably in 2007 to $23 billion. After several years of low flows (with negative inflows in 2006) Japan received the highest annual inward FDI ever. A rise in equity capital inflows, essentially driven by the single largest acquisition ever in financial services in Japan (the $8 billion acquisition of Nikko Cordial by Citigroup (United States)), as well as an increase in intra-company loans of foreign TNCs to their Japanese affiliates, contributed to the increase. Foreign investments in distressed assets in the services sector (e.g. hotels and restaurants, real estate), in small and medium-sized enterprises (SMEs) and in other firms facing difficulties in the manufacturing sector continued. However, a recent tightening of regulations empowering the Government to screen all FDI cases in strategic industries is raising concerns among foreign investors (see section C.3 on policy developments). At the same time, the use by Japanese companies of measures (e.g. poison pills) against takeovers by foreign firms, including private equity funds, may adversely affect the current FDI recovery.

Inward FDI flows to *Switzerland* increased considerably by 54%, to $40 billion in 2007. Several high-value acquisitions of Swiss pharmaceutical and financial services firms as well as investments in holding companies[132] contributed to the increased flows.

In 2007, the value of cross-border M&As sales of developed-country firms rose by 50% to $1,454 billion (table II.22). The number of M&A deals grew by 10%, to more than 7,800. The renewed strong increase was driven by continued economic growth and favourable economic prospects, which lasted until mid-2007. Since then, the financial crisis and the weakening of the United States economy have dampened the positive outlook, but they did not have strong negative effects on cross-border M&As in late 2007 (chapter I). TNCs from developed countries – well endowed with financial resources stemming from high corporate profits – contributed to a growing number of mega M&A deals (i.e. those over $1 billion; see annex table A.I.3 for those with

Table II.22. Developed countries: cross-border M&As, by region/economy, 2005–2007
(Millions of dollars)

Region/economy	Sales of developed country firms 2005	2006	2007	Purchases by developed country firms 2005	2006	2007
World	820 358	969 116	1 454 084	777 609	930 101	1 410 802
Developed economies	708 877	841 587	1 281 706	708 877	841 587	1 281 706
Europe	473 463	496 680	749 713	521 482	542 417	788 535
European Union	444 390	436 476	707 845	501 596	501 675	748 648
France	83 678	70 352	102 035	52 127	42 811	61 732
Germany	40 178	50 944	101 719	85 549	73 802	98 422
Italy	30 140	18 468	62 021	29 288	31 954	31 091
Netherlands	87 414	23 245	25 790	102 773	33 905	208 183
Spain	29 690	85 781	45 053	27 290	20 389	64 562
Sweden	19 808	10 537	36 440	16 083	21 855	11 943
United Kingdom	113 310	87 178	276 434	131 298	184 227	208 356
Other developed Europe	29 073	60 204	41 868	19 886	40 742	39 887
Switzerland	15 943	45 693	25 600	10 290	35 489	31 894
North America	180 275	262 260	436 669	157 001	257 060	398 710
Canada	29 639	46 040	72 743	32 911	39 179	108 561
United States	150 636	216 220	363 927	124 090	217 880	290 149
Other developed countries	55 139	82 647	95 324	30 394	42 111	94 461
Australia	38 724	39 395	50 296	13 150	20 543	28 861
Bermuda	1 612	1 310	1 076	2 392	3 080	44 021
Japan	11 748	30 570	31 080	9 291	4 657	18 246
Developing economies	65 587	101 914	137 070	57 692	75 544	101 594
Africa	15 795	16 934	3 897	9 561	9 505	7 160
Egypt	12 825	5 129	868	1 410	2 336	-
South Africa	2 870	11 803	3 013	6 030	5 384	6 322
Latin America and the Caribbean	8 425	30 052	35 610	14 824	17 572	25 046
Brazil	1 591	22 356	10 404	1 515	5 533	7 828
Mexico	2 136	3 313	17 321	3 406	1 127	5 581
Asia and Oceania	41 366	54 928	97 563	33 306	48 467	69 388
Saudi Arabia	53	4 451	12 707	-	21	-
Turkey	243	202	1 026	4 541	15 320	13 593
United Arab Emirates	4 727	16 351	14 631	192	49	4 266
China	6 223	8 962	2 408	5 920	7 868	4 568
Hong Kong, China	6 277	5 312	2 633	3 700	5 930	21 633
India	4 215	5 542	27 083	2 981	2 467	3 638
Singapore	3 672	2 644	18 184	2 303	4 414	3 417
South-East Europe and CIS	19 552	6 702	13 228	11 040	12 961	27 503
Russian Federation	19 031	4 526	12 479	1 960	6 239	22 949

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

over $3 billion). Around 90% of cross-border M&As in developed countries were concluded by firms from other developed countries. But developing-country TNCs were also increasingly active in tapping developed-country markets for corporate assets. These TNCs were involved in 28 mega M&A deals that amounted to a total of around $100 billion and accounted for 7% of the total cross-border M&A sales of developed-country firms. TNCs from India, Singapore, Mexico and the United Arab Emirates played a major role. Among economies in transition, the Russian Federation accounted for over $12 billion of cross-border M&A sales of developed-country firms.

In contrast to cross-border M&As, the number of greenfield projects in developed countries fell slightly in 2007 to a total of 6,037 compared to 6,198 in 2006 (annex table A.I.1). The EU was the only subgroup of developed economies where greenfield projects decreased in 2007, while the United States remained the single country with the largest number of projects (800). Developing-country firms had virtually the same share of greenfield projects as in 2006 (7%), and the number of projects by Chinese firms increased to 75 in 2007, compared to 50 in 2006.

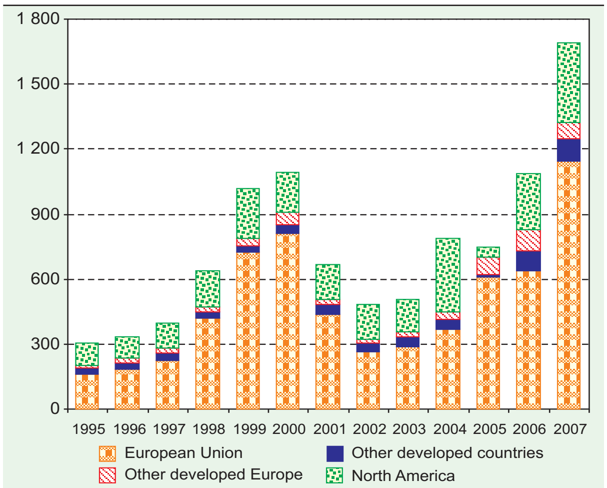
b. Outward FDI: strong net outward investments

FDI outflows from developed countries increased by 56% to $1,692 billion (figure II.31). With FDI outflows exceeding inflows by $445 billion, developed countries maintained their position as large net outward investors. The growth of outward FDI was broad-based and concerned 28 out of the 38 developed countries in 2007.

Five countries recorded FDI outflows of more than $100 billion. The largest sources of FDI were the United States, the United Kingdom, France, Germany, Spain, Italy and Japan, in that order (figure II.32). Outward FDI from these seven countries together amounted to $1,256 billion, or 74% of the total FDI outflows of the group. Strong reinvested earnings (31% larger than in 2006) and large intra-company loans (almost nine times higher than in 2006) also contributed to the increase in FDI outflows.

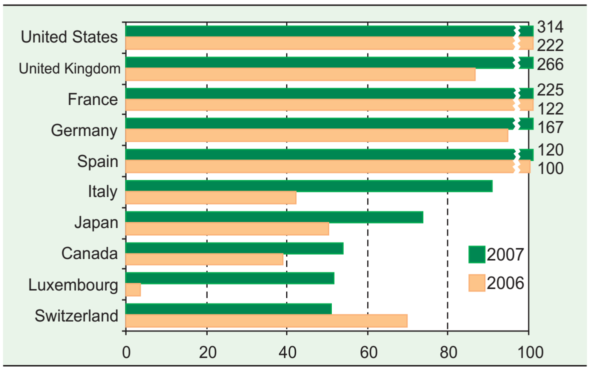
The *United States* maintained its position as the largest outward investor in 2007 with $314 billion (a 42% increase over 2006). United States TNCs concentrated their investments in the EU ($175 billion) but there was also a

Figure II.31. Developed countries: FDI outflows, 2006–2007
(Billions of dollars)



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

Figure II.32. Developed countries: top 10 sources of FDI outflows,[a] 2006–2007
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of 2007 FDI flows.

considerable increase in FDI outflows to Asia and the Pacific as well as Latin America and the Caribbean, and Canada. The increase in FDI outflows was driven mainly by investments in the services sector (56% more than in 2006), especially holding companies (Bach, 2008).

In 2007, outward FDI from the *EU countries* nearly doubled, to $1,142 billion. The new dynamic of FDI outflows from the EU subregion – after stagnation in 2006 – reflects the financial strength of many European TNCs that undertook several very large foreign acquisitions. Six of the top 10 source countries for FDI in 2007 were EU countries. FDI outflows from the United Kingdom increased more than threefold compared to 2006, to $266 billion. All components of FDI (equity capital, intra-company loans and reinvested earnings) contributed to the rise. Non-financial corporations from the United Kingdom recorded the highest levels of new investments abroad, while investment by financial and insurance service companies was lower than in 2006 (United Kingdom, National Statistics, 2008). Several large-scale M&As drove the outward FDI of the United Kingdom.[133] *France* was the third largest source of FDI with $225 billion, followed by Germany and Spain. FDI outflows from Germany attained their highest level ever, and more 80% went to developed countries.

Compared to other developed countries, the FDI outflows of the *12* new EU members remained modest at $14 billion in 2007. However, a few companies from this group of countries are becoming important players within the EU. For example CEZ, the largest electricity producer in the Czech Republic, is among the 25 largest energy TNCs in Europe in terms of foreign assets.[134]

FDI outflows from Japan continued to grow strongly ($74 billion). Driven by a doubling of net equity capital outflows and continued strong reinvested earnings, they reached a new record level.

2. Sectoral trends: significant increase in manufacturing

Judging from information on cross-border M&As, inflow FDI in manufacturing and services rose while that in the primary sector lagged behind somewhat (table II.23).

In the *primary sector*, firms from developed countries, while reducing their cross-border M&A sales by 13%, increased their cross-border M&A purchases by 83%. The continuing boom in prices of primary commodities and the consolidation process in the mining and quarrying industries (*WIR07*) led to several large deals by developed country firms. Developed-country TNCs also invested heavily in the primary sectors of developing and transition economies.

In the *manufacturing sector*, cross-border M&A sales of developed countries rose by 93%, while cross-border purchases by developed-country TNCs rose by 35%. Nearly all industries in the sector benefited from increasing investments, with cross-

Table II. 23. Developed countries: cross-border M&As, by sector/industry, 2005–2007
(Millions of dollars)

	Sales			Purchases		
Sector/industry	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
Total	820 358	969 116	1 454 084	777 609	930 101	1 410 802
Primary	150 945	97 769	85 404	107 896	62 696	114 767
Mining, quarrying and petroleum	143 026	95 112	84 287	106 573	59 682	114 150
Manufacturing	222 446	275 544	530 466	168 952	221 775	299 299
Food, beverages and tobacco	36 203	28 351	59 894	26 881	20 780	43 089
Wood and wood products	7 394	7 867	16 726	3 652	5 527	11 006
Publishing and printing	15 338	25 028	25 020	8 991	10 138	12 953
Chemicals and chemical products	60 643	55 634	127 943	32 949	38 568	101 182
Non-metallic mineral products	12 784	9 214	41 903	18 629	10 229	5 910
Metals and metal products	24 732	48 522	114 246	18 808	45 741	34 801
Machinery and equipment	7 308	16 207	22 575	8 988	20 223	7 145
Electrical and electronic equipment	17 257	39 274	25 251	14 286	36 540	37 608
Motor vehicles and other transport equipment	11 265	16 449	29 637	10 249	9 238	12 927
Precision instruments	16 164	11 341	39 487	8 970	12 879	19 827
Services	446 966	595 802	838 215	500 724	645 521	996 020
Electricity, gas and water	73 390	60 700	119 860	43 921	23 369	71 786
Construction	8 316	11 612	10 059	7 113	7 041	5 622
Hotels and restaurants	11 335	39 115	26 971	3 394	12 696	2 847
Trade	33 307	28 904	70 411	14 587	15 403	22 681
Transport, storage and communications	87 579	131 703	86 974	51 852	93 677	63 365
Finance	82 226	131 152	303 544	309 537	430 634	734 010
Business activities	114 262	141 630	163 271	53 496	45 837	72 813
Community, social and personal services	24 757	28 435	38 670	10 201	10 433	13 143

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

border M&A sales the highest in chemicals, metals and food, beverages and tobacco – in that order.

Services continued to be the sector with the largest FDI activity in developed countries, judging from cross-border M&A data. They accounted for 58% of cross-border M&A sales in 2007. Competitive pressure and further deregulation in the electricity, gas and water industries led to several large cross-border acquisitions in Europe. Cross-border M&A activity was also very intense in financial services due to ongoing deregulation and restructuring and the financing needs of several banks following the crisis in financial markets (chapter I). Several mega deals, such as the above-mentioned acquisition of ABN AMRO by a consortium of three banks, contributed to the strong increase in the value of cross-border M&A sales in developed countries, which amounted to $838 billion in 2007. *New EU member* countries continue to be hot spots for FDI in international business services such as IT support, shared services and customer support services.[135]

3. Policy developments

In the past few years, the policy environment for FDI in a number of developed countries has been influenced by public debates on possible negative effects of cross-border investments by SWFs as well as private equity and hedge funds (chapter I). Moreover, in several new EU member States, public sentiment against further privatization of State-owned companies has provoked policy debates. At the same time, the G-8 countries and the EU have reiterated their commitment to openness to investment and to the free movement of capital.[136] Those declarations were supported by several national policy changes in 2007. Of the 36 changes in their regulatory frameworks affecting FDI, 27 sought to facilitate greater FDI inflows, while 9 changes may directly or indirectly hinder cross-border investments.

Privatization and liberalization. Several developed countries continued to privatize and liberalize their economies in 2007. Poland and Latvia privatized their State-owned aerospace and telecommunications companies.[137] The Government of Portugal sold a further stake in Rede Eléctrica National (REN), which operates the country's power grid. By contrast, other countries stopped further privatizations. For example, in Slovakia the Government halted all large-scale privatization plans and announced the re-nationalization of several "strategic" industries.[138] A similar policy was followed in Estonia, where Estonian Railways was re-nationalized in early 2007. In Lithuania and Poland, the Governments prevented the privatization of firms that were deemed to be of national strategic importance.

Tax policy and other incentives. The tax policy of several developed countries was made more favourable to foreign investment. In Denmark, the Netherlands, Hungary, Malta and Poland, various corporate tax rates were cut or tax incentives introduced. In Switzerland, Hungary and the United States[139], measures to reduce bureaucracy, shorten time limits for processing applications, and other initiatives were initiated to encourage foreign investment.

Laws and policies to regulate foreign investment. Several developed countries introduced new laws or amended existing laws with the aim of protecting sensitive industries for national security or strategic reasons. In particular, the energy sector and utility networks were subject to such measures in Germany, Hungary, Japan and the United States. In the United States, the Foreign Investment and National Security Act (FINSA) that became law in 2007 amends the so-called Exon-Florio Act. FINSA provides for an investigation if a cross-border acquisition endangers critical infrastructure, energy-supply safety or technologies that are important for national defence (United States, GAO, 2008: 31). The Japanese Foreign Exchange and Foreign Trade Act was strengthened to require a foreign investor to notify the Government in advance for a planned investment in sensitive or strategic industries. The Government applied this regulation to the investment by the Children's Investment Fund (United Kingdom) in J. Power, an electric power company, because of security concerns.[140]

In Hungary, the Government strengthened rules on hostile takeovers in order to prevent ÖMV (Austria) from acquiring the Hungarian Oil Company MOL. After a debate in 2007, the Government of Germany announced modifications of the German Foreign Trade and Payments Act, which regulates FDI. According to the newly announced law, all foreign investments above a 25% threshold of voting rights are subject to this Act, regardless of the sector and the size of the firms (Germany, Bundesministerium für Wirtschaft und Technologie, 2008: 8). The concern of several EU member countries about the rising importance of SWFs has induced the European Commission to propose a common European approach (Commission of the European Communities, 2008). Its proposal is expected to contribute to the efforts of the IMF and the OECD to set up guidelines for these funds (Chapter I)

At the international level, developed countries concluded 25 new BITs involving 14 countries. The Netherlands concluded five new treaties, followed by Germany, Finland and Spain with three new treaties each. Developed countries concluded 51 new DTTs in 2007, of which 7 new ones were concluded by Belgium and 5 by the United States.

4. Prospects: FDI growth likely to decline in the short term

The short-term prospects for FDI flows to and from developed countries have deteriorated as a result of financial turbulence and weaker economic growth. Economic growth in developed countries – one of the key drivers of FDI flows in past years – has slowed markedly since the fourth quarter of 2007. Economic expansion of the United States economy in 2008 is expected to fall below 2%. A similar slowdown is projected for Western Europe and Japan (IMF, 2008b). Deteriorating profits of TNCs in the wake of the economic slowdown will make the cash financing of FDI more difficult. In addition, the strong tightening of credit standards and the rise in risk premiums, especially for buyouts by collective investment funds (e.g. private equity and hedge funds), are likely to subdue cross-border M&As. High and volatile commodity prices (especially oil prices), inflationary pressures in several developed countries and sharp exchange-rate fluctuations further contribute to uncertainty in long-term investment decisions. In the first half of 2008 cross-border M&As were considerably lower than their peak in the second half of 2007, though they were slightly higher than in the first half of 2007.

In the medium-term, FDI growth prospects are uncertain due to continued slow growth and difficult market conditions in developed countries. UNCTAD's *World Investment Prospects Survey* supports this view: 39% of TNCs surveyed anticipated an increase in FDI inflows into developed countries compared to more than 50% of the TNCs in last year's survey (*WIR07*: 73*)*. TNCs continue to express greater optimism for FDI inflows to the new EU-12 members, while they are less certain about other EU countries and other developed countries (Japan, Australia and New Zealand) (figure II.33).

Different surveys provide different messages. According to an Ernst & Young survey (2008b), Western Europe and North America fall back to third and fifth place, respectively, as the most attractive global investment regions compared to first and third place in 2006. In contrast, according to 11th Annual Global CEO Survey (PricewaterhouseCoopers, 2008a), Western Europe remains the most popular destinations for cross-border M&As while, for the first time, the 12 new EU members are considered more attractive than North America.

Notes

1 For a number of commodities, several African countries offer profitability prospects that exceed the profitability of other export products by as much as 20% or 30%. This is the case for commodities such as copper, diamonds, gold, oil and platinum, the prices of which rose by more than 200% between 2000 and 2008 (Bloomberg.com, Commodity futures, at: www.bloomberg.com/ markets/commodities.cfutures.html).

2 Data on international reserves are from the IMF, *International Financial Statistics.*

3 The data for 2007 are based on 39 African countries.

4 The subregion comprises Algeria, Egypt, the Libyan Arab Jamahiriya, Morocco, Sudan and Tunisia.

5 *Source:* "Libya industry: Oilinvest sells 65% stake in Tamoil to Colony Capital", *EIUViewswire*, 29 June 2007.

6 For example, the national shipping company, Comanav, was sold to France's CMA CGM for $256 million *Source:* "Morocco industry: France's CMA CGM buys shipping company Comanav", *EIUViewswire*, 16 May 2007.

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

8 In Nigeria, a consortium of Royal Netherlands Shell (Netherlands), Chevron (United States) and the BG Group (United Kingdom) started construction at the OK-LNG plant in Olokola Free Trade Zone. CNOOC Ltd (China) also made payments for a 45% stake in an offshore oil field in Nigeria for $2.27 billion.

9 In Burkina Faso, FDI inflows reached $0.6 billion in 2007. Etruscan Resources (Canada) began drilling on the country's Youga Gold deposit, a project estimated at $44 million, and AIM Resources (Australia) also began its Perkoa zinc project, worth about $215 million, along with other smaller companies. Maroc Télécom (Morocco) paid the Government of Burkina Faso $290 million to buy a 51% stake in Onatel ("Burkina Faso industry: Telecoms utility is privatised", *EIUViewswire,* 16 March 2007).

10 FDI inflows mainly in petroleum exploitation and refining have skyrocketed, reaching $427 million in 2007, up from $319 million in 2006 ("Côte d'Ivoire industry: US$1.4bn crude oil facility to be built in Abidjan", *EIU Viewswire*, 31 October 2007).

11 In Mali, Sonatrach International Petroleum & Production (Sipex) (Algeria) launched a $11-million oil exploration project in collaboration with that country's Government.

12 Economies in the subregion are: Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Mauritius, Mayotte, Reunion, Seychelles, Somalia, Uganda and the United Republic of Tanzania.

13 "Madagascar industry: Korean banks put up US$650m for Ambatovy nickel project", *EIUViewswire*, 5 March 2008.

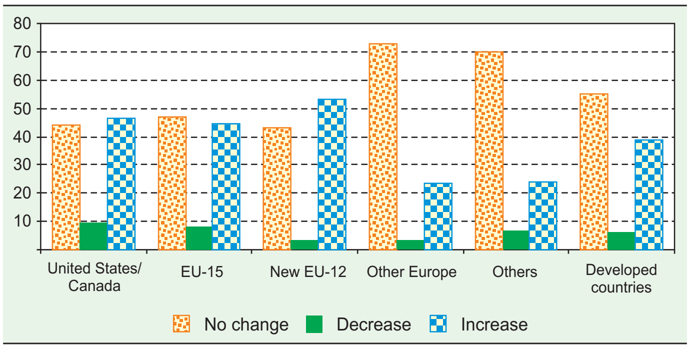
14 Countries in the subregion are: Burundi, Cameroon, the Central African Republic, Chad, Congo, the Democratic Republic of the Congo, Equatorial Guinea, Gabon, Rwanda and Sao Tome and Principe.

15 Countries in the subregion are: Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Zambia and Zimbabwe.

16 "Chinese megabank buys R37bn Standard stake", *BusinessDay*, 18 June 2007 (http://www.businessday.co.za/articles/dailymailer.aspx?ID=BD4A597073).

17 For example, China's Luanshya Copper Mines (LCM) planned to invest $354 million in the development of the Mulyashi copper mine in Zambia. "Zambia industry: LCM boosts Mulyashi mine investment to US$354m", *EIUViewswire*, 5 March 2008.

Figure II.33. FDI prospects in developed countries, 2008–2010
(Per cent of respondents to the UNCTAD survey)



Source: UNCTAD, 2008b.

18 At around $100 a month, typical salaries in Lesotho are at least five times higher than those in Bangladesh, and two to three times higher than those in China ("Africa industry: Looming difficulties for textiles", *EIUViewswire*, 20 July 2007).

19 The auto trade pact, for instance, stipulates that motor components manufactured in South Africa are once again allowed tariff-free entry into the EU (reversing a decision made in 2006). To qualify for the exemption, the vehicles and components must have no less than 60% of local content (including labour costs and company margins). South Africa, in turn, will lower or scrap duties on certain EU vehicle-related products. The pact improves access to the EU market and could encourage automobile manufacturers to invest in South Africa for use as an export base to Europe, given the fact that a number of automobile producers such as Daimler-Chrysler (Germany/United States), SAAB (United States/Sweden), Toyota (Japan) and others are already producing in the country ("South Africa/EU industry: Auto pact", *EIUViewswire,* 16 March 2007).

20 In South Africa, for example, FDI in the textile industry suffered from increasing input costs, due to higher oil prices, as well as a weaker rand. "Embattled textile sector seeks state survival aid", *Business Day*, 23 February 2008 (www.businessday.co.za/articles/dailymailer.aspx?ID=BD4A714292).

21 Several projects and activities are under way, including preparation of Invest in COMESA: A Practical Guide; creation of a COMESA Business Intelligence System (a computerized information system); Compilation of a compendium of investment opportunities; organizing a one-stop-shop best practices workshop; and Invest in COMESA: Practical Guide Conference.

22 The Government of China adopted its Investment Policy on Africa in 2006, which aims to encourage and support Chinese investment in the continent through various measures. The policy identifies four major areas of involvement. First, it provides for preferential loans and buyer credits to its investors. Recently it has granted its firms preferential loans and buyers' credits amounting to $5 billion for their transactions in Africa. Also, it has established a China-Africa Development Fund to support the activities of Chinese firms in Africa. Second, the policy encourages exploring new ways for promoting investment cooperation with African countries, formulating and improving relevant policies for this purpose, and providing guidance and services to its investors. Third it encourages the signing of investment agreements with African countries. Fourth, it offers protection of investors' legitimate rights and interests. China's policy emphasis appears to be on infrastructure development, including transportation, communications, water conservation, electricity and other infrastructure (China, Ministry of Foreign Affairs, 2006).

23 The Agreements set up respective Joint Councils on Trade and Investment, which were responsible for (i) monitoring investment relations between the two parties, (ii) identifying opportunities for expanding investment, (iii) identifying issues relevant to investment that may be appropriate for negotiation in an appropriate forum, (iv) holding consultations on specific investment matters of interest to the Parties and (v) identifying and working toward the removal of impediments to investment (Office of the United States Trade Representative: www.ustr.gov/Trade_Agreements/Section_Index.html).

24 SACU comprises: Botswana, Lesotho, Namibia, Swaziland and South Africa.

25 It consists of Iceland, Liechtenstein, Norway and Switzerland.

26 "Congo (Dem Rep)/China industry: China to invest $5bn in DRC", *EIUViewswire*, 27 September 2007.

27 A consortium of Energy Allied International, WCW International and Ivorian State-owned oil company Petroci is to build, own and operate a crude oil refining and storage facility in Abidjan for $1.4 billion.

28 The economy of the region (including Central Asia) is estimated to have grown by 8.7%, but some subregions grew at a much faster rate in 2007 (Asian Development Bank, 2008). For instance, China is estimated to have grown by 11.4% in 2007, India by 8.7% and the ASEAN region as a whole by 6.5%.

29 Data are based on ultimate parent transactions.

30 *Source:* UNCTAD, based on data obtained from Shanghai Foreign Investment Commission and Invest Beijing.

31 Significant FDI by TNCs such as by Philip Morris and Standard Chartered also contributed to higher inflows. In addition, there were a number of acquisitions: Singapore Telecommunications acquired a 30% stake in Warid Telecom for $758 million, Orascom Telecom acquired an 11% stake in Pakistan Mobile Communications for $290 million, and China Mobile Communications acquired an 89% interest in Paktel for $284 million.

32 "Pakistan expects record $6.5 billion FDI this year", *Business in Asia Today,* 9 May 2007 (www.antara.co.id/en/arc/2007/5/9/pakistan-expects-record-us65-bln-fdi-this-year/).

33 www.dialog.lk/en/corporate/press/releases/pressRelease.jsp?id=182.

34 See "MIGA supports critical telecommunications investment in Afghanistan", 3 July 2007 (www.miga.org/index.cfm?aid=709). MTN (South Africa) also invested in Afghanistan. "Afghanistan seeks Malaysian investments in soft drinks sector", *Bernama,* 6 June 2007 (http://www.bernama.com.my/bernama/v3/news_business.php?id=265976). In mining, a large investment contract for an estimated $3 billion copper mining project won by China Metallurgical Group in November 2007 was particularly important ("China wins major Afghan project", *BBC News*, 20 November 2007 (news.bbc.co.uk/2/hi/south_asia/7104103.stm).

35 In 2007, reinvested earnings accounted for 41% of total FDI inflows in Indonesia, 56% in Malaysia, 19% in the Philippines, 53% in Singapore and 43% in Thailand.

36 Think London, an investment promotion agency, is making efforts to attract more Indian, Chinese and other Asian investments to London to help retain the capital's competitiveness as a leading global business centre ("Indian investment flows to London", *Financial Times*, 27 April 2007). In 2007, the Chicago-China Development Corporation was established in Shanghai to attract Chinese investment and assist Chicago companies in China ("Mayor Daley to chair Chicago office in Shanghai", *World Business Chicago*, volume 28, February 2007).

37 *Fortune*, 21 July 2008. In 2006, there were 44 such firms.

38 "India plans sovereign wealth fund for energy assets abroad", *The Economic Times*, 20 February 2008.

39 According to Dealogic. For example, Doosan Infracore (Republic of Korea) acquired Bobcat (United States) for $4.9 billion in one of the largest deals undertaken by a Korean firm.

40 For example, Minmetals continues to acquire in mineral resources overseas and has already established 44 foreign affiliates. Having acquired Peru Copper for $793 million in 2007, Chinalco is expected to invest $2.8 billion in a bauxite mine in Queensland, Australia. ("Chinalco to start constructing Australian project next year", *China Mining*, at: www.chinamining.org, 13 June 2008).

41 In 2007, Viet Nam approved 64 outward FDI projects with a registered investment of $391 million, a 92% increase over the value approved in 2006; the projects included a rubber plantation in the Lao People's Democratic Republic by Dau Tieng Viet-Lao Rubber Joint-Stock Corporation, and oil and gas exploration by Vietnamese firms in Madagascar ("Outward investment of Viet Nam's enterprises"; Foreign Investment Agency, Ministry of Planning and Investment, Viet Nam, at: http://fia.mpi.gov.vn/Default.aspx?ctl=Article&TabID=0&aID=530). In 2008, Kova Paint Group of Viet Nam opened its first manufacturing plant in Cambodia.

42 For instance, Carlyle Group (United States) acquired a 25% stake in Ta Chong Bank (Taiwan Province of China) in 2007.

43 Calculations are based on data provided by MOFCOM, China.

44 In Guangdong, for instance, more than 1,000 small footwear manufacturers (about 10% of the total) and related suppliers were closed in 2007. The main manufacturing hubs such as the Pearl River Delta in China have also been affected, and it is estimated that about 10% of the 60,000 to 70,000 factories owned by investors from Hong Kong (China) may be closed in 2008. (Mei Fong and Sky Canaves, "Many factories in China's South sound last whistle", *Wall Street Journal*, 25 February 2008).

45 "India lifts FDI caps in key sectors", *The Financial Express*, 30 January 2008 (www.financialexpress.com/news/India-lifts-FDI-caps-in-key-sectors/267054/) and "India eases rules to attract more overseas investment", *Bloomberg*, accessed 22 April 2008 (www.bloomberg.com/apps/news?pid=20601091&sid=aAmSp60DunNE&refer=india).

46 Viet Nam also announced a list of 163 national projects seeking foreign investment for the period 2006–2010, of which 70 were in infrastructure industries. "Call for foreign investment focuses on infrastructure", *Met Vuong*, 30 October 2007 (http://en.metvuong.com/thongtin/148_Call-for-foreign-investment-focuses-on-infrastructure.html); and "Viet Nam calls for over

US$61 billion capital in five years", *VietnamNet Bridge*, 19 October 2007 (english.vietnamnet.vn/reports/2007/10/750250/).

47 "Infrastructure development in Viet Nam – a new BOT decree", *Freshfields Bruckhaus Deringer,* July 2007 (http://www.mekongresearch.com/doc/).

48 Indonesia's new investment law of 29 March 2007 provided for greater equality of treatment between foreign and local firms, and investment disputes, if any, between the State and investor can now be arbitrated using international laws. ("Indonesia regulations: investment law - key points", *EIU Viewswire*, 29 March 2007.

49 Information paper "Korea's investment review system in relation to national security" submitted to the OECD Investment Committee by the Ministry of Knowledge and Economy, Republic of Korea, 26 March 2008.

50 The Government of Thailand has undertaken a number of measures to increase the country's competitiveness for investment in 2007. These were introduced in conjunction with the launch of "Thailand Investment Year: 2008-2009", notably to promote investment in automotive and electronics industries and alternative and renewable energy ("BOI debuts incentives for biotech industry: maximum incentives offered to grow the industry", BOI Thailand, *Press Release*, 6 February 2007; "BOI increases incentives to shipbuilding and shipyard operators: more expansion expected in Zone 2 and Zone 3", BOI Thailand, *Press Release*, 9 February 2007; "BOI new policy to stage Thailand a leading production base for export of passenger cars and big-bike motorcycles", BOI Thailand, *Press Release*, 1 October 2007).

51 The Catalogue was jointly promulgated by the National Development and Reform Commission and the Ministry of Commerce, which became effective since 1 December 2007. Electricity transmission is opened to equity participation by foreign investors but Chinese investors should have majority ownership (www.ndrc.gov.cn/zcfb/zcfbl/2007lingt20071107_171058.htm).

52 Foreign investments in real estate in China were tightened and investment in residential housing was removed from the encouraged list (*Source*: "China: Policy and Business Outlook", *EIU*, Country Forecast - Main Report, 4 April 2007 (www.EIU.com).

53 For instance, public broadcasting service of radio and television, and provider and operator of terminal in transportation are added to the list of business activities closed to foreign investment (*Sources*: "Indonesia blacklists FDI", *Asia Times*, 10 July 2007; "Presidential Regulation of the Republic of Indonesia, Number 77 of 2007, Concerning List of Lines of Business Closed and Open with Conditions to Investment" (www.bkpm.go.id/node/1875); "Negative investment list criticism is "premature", *Jakarta Post*, 2 July 2007 (http://old.thejakartapost.com/yesterdaydetail.asp?fileid=20070702.A05)).

54 See "Myanmar and Viet Nam sign pact on petroleum cooperation", *The Earth Times,* 15 August 2007 (www.earthtimes.org/articles/show/93757.html).

55 An overseas investment promotion policy was approved to encourage overseas investment as part of Thai national policy ("BOI boosts Thai overseas investment, aims to strengthen competitiveness of Thai industries", BOI Thailand, *Press Release*, 10 April 2007). The Reserve Bank of India has increased the overseas investment limit on Indian companies from 300% of the net worth to 400% for wholly-owned Indian subsidiaries abroad ("Overseas direct investment – liberalisation", Reserve Bank of India, *A.P. (DIR Series) Circular No. 11*, 26 September 2007). In 2007, the Government of the Republic of Korea announced measures to encourage outward FDI, including measures to streamline and simplify outward FDI procedures as well as providing investment insurance ("Plans to encourage outward FDI", Ministry of Finance and Economy, *Press Release*, 16 January 2007, and "Strategy for SOE's investment abroad", *Decision by Outward Foreign Investment Committee*, 27 December 2007).

56 "China approves China-Africa Development Fund", *People's Daily Online*, 14 May 2007 (http://english.people.com.cn/200705/14/eng20070514_374190.html).

57 In China, FDI inflows to the non-financial sector increased by 46% to $52 billion in the first half of 2008, although part of such flows are considered to be "hot money" (i.e. speculative capital driven by the expectation of further appreciation of the yuan) (Song, 2008).

58 Examples include Chinalco's (China) acquisition of a 12% stake in Rio Tinto (United Kingdom/Australia) for $14 billion in cooperation with Alcoa (United States); Petronas (Malaysia) announced plans to buy a 40% interest in Santos Ltd. (Australia) for $2.5 billion; China Huaneng Group acquired Tuas Power (Singapore) for $3.1 billion; and Tata Motors (India) entered into an agreement in March 2008 with Ford to purchase Jaguar Land Rover for about $2.3 billion. Acquisitions by Indian firms in the telecommunications sector are also rising in 2008 (PricewaterhouseCoopers, 2008b).

59 West Asia comprises Bahrain, Iraq, Jordan, Kuwait, Lebanon, Oman, the Palestinian territories, Qatar, Saudi Arabia, the Syrian Arab Republic, Turkey, the United Arab Emirates and Yemen. From this *WIR* onwards, the Islamic Republic of Iran is excluded from this subregion, as it is now classified under South Asia in the United Nations general geographical classification of countries.

60 The sharp increase in FDI inflows in the recent period was due mainly to foreign acquisitions of large Turkish companies, particularly in banking and telecommunications, through privatization and private sector M&A deals. Privatizations accounted for around 40% of the total cross-border M&A volume in 2005–2007 (Deloitte Turkey, 2008; Ernst & Young, 2008a). In 2007 alone, there were 162 M&A deals totalling $21 billion, of which 77% was attributable to foreign investors.

61 M&A deals in Turkey by firms from the Netherlands amounted to $11.1 billion in 2005–2007, which represents nearly one quarter of total FDI inflows to Turkey. The biggest investment by Netherlands investors was in financial services: ING Group NV acquired Oyak Bank for $2.7 billion (Raymond James, 2008).

62 Information from the OCO monitor web site (www.ocomonitor.com).

63 For example, Bahrain-based Arcapita Bank, a leading Islamic private equity investment firm, acquired a Texas power plant for $695 million (*CEEMarketWatch*, 29 January 2008), and also PODS (Portable On Demand Storage) for $452 million in the United States (*CEEMarketWatch*, 26 February 2008). Saudi Basic Industries Corporation agreed to buy the plastics unit of General Electric for $11.6 billion ("As oil hits high, Mideast buyers go on a spree", *Wall Street Journal*, 21 September 2007).

64 Turkish official statistics indicate that Turkey's outward FDI stock is over $12 billion, but this an underestimate as official statistics do not fully cover reinvested earnings.

65 The company will have a 40% stake in the project (Zawya.com, "ADNOC sour gas fields development: Shah Field" (www.zawya.com/projects/project.cfm?pid=0201070610329, accessed in April 2008).

66 For example, Hikma, Jordan's largest private pharmaceutical manufacturer took over the German company Ribosepharm for $45 million and Egypt's Alcan Pharma for $61 million to expand its operations mainly in North Africa and the Asia-Pacific region (*CEEMarketWatch*, 8 October 2008).

67 Excluding $905 million in property leasing services.

68 For example, AsiaCell, a consortium comprising Qatar Telecom (40% share), Kuwait's MTC and Iraq's Korek took three 15-year mobile operating licences in Iraq for $3.75 billion in August 2007 (*CEE MarketWatch*, 17 August 2007). Another example is a joint venture between Qatar Telecom (Qtel) and AA Turki Corporation for Trading and Contracting of Saudi Arabia (ATCO), which acquired a 75% equity in Burraq Telecom of Pakistan. This acquisition is an example of Qtel's strategy for regional and Asian expansion. Qtel recently acquired a 25% stake in Hong Kong, China's Asia Telecom for $635 million and a 51% stake in Kuwait's Wataniya for $3.7 billion and it made a bid for 67% of India's Hutchison Essar (*CEEMarketWatch,* 22 May 2007).

69 "Saudis plan to grow crops overseas", *Financial Times*, 13 June 2008.

70 The establishment of the Syrian Investment Agency is part of broader economic reforms, as laid down in the 10th five-year plan (2006–2010), and the Government's recent steps towards building a regulatory framework to govern the new market economy. Areas that receive special attention are banking, insurance and capital markets, and housing and real estate (*EIU Country Report*, April 2007, at: http://www.eiu.com).

71 "Company law in six month", *UAE Interact*, 31 March 2008.

72 In the period 1995–2000, such acquisitions accounted for 45% of total FDI inflows. This share fell to 21% in 2001–2006, and was 25% in 2007 (UNCTAD, cross-border M&As database). Although these ratios must be interpreted with caution because data on FDI and M&As are not directly comparable (see *WIR00*),

they are a good indication of the relative importance of M&As as a mode of FDI.

73 Based on data from national authorities.

74 Growing demand within Latin America and the Caribbean, trade agreements with the Southern Common Market (MERCOSUR), Japan and the EU, and the appreciation of the euro, are among the most important factors that helped Mexico diversify its exports.

75 These are Grupo Cuscatlan acquired by Citigroup (United States) and Banagricola acquired by Bancolombia (Colombia).

76 Including financial centres, FDI outflows fell by 17% to $52 billion.

77 Examples include the $14.2 billion acquisition in 2007 by Cemex (Mexico) of Rinker (Australia) (annex table A.I.3), a transaction which would not have been reflected in Mexican outward FDI data because it was financed through Cemex's foreign affiliates, and the $2.2 billion acquisition by the steel company Tenaris (Argentina) of Hydril Co LP (United States) which would not figure as Argentinean outward FDI because the company is headquartered in Italy.

78 In Brazil, it bought Grupo Amanco (Chile) for $500 million, and in Colombia it bought Petroquimica Colombiana for $250 million.

79 "Africa is a New Frontier for Biofuels… Good or Bad??", *Africa Journal*, 28 July 2007, Washington DC (http://craigeisele.wordpress.com/2007/09/02/africa-is-a-new-frontier-for-biofuels-good-or-bad/).

80 The Dutch disease is explained in *WIR07*: 95.

81 Petrobras, *Press release*, 17 December 2007.

82 Chile is the only country in the region that maintains a State-owned company that is competing with several foreign companies (*WIR07*).

83 Banco Central do Brasil (www.bcb.gov.br), Banco Central de la República de Colombia (www.banrep.gov.co), Ministerio de Economía de México (www..economia.gob.mx) and Banco Central de la República del Perú (2008).

84 Banco Central do Brasil (www.bcb.gov.br).

85 In Brazil, minority shareholders of Arcelor Brazil, an affiliate of Arcelor Mittal, received about $5 billion from the sale of their shares to the parent company, and in Mexico, three Mexican steelmakers –Grupo Imsa, Sicartsa and Grupo Industrial Feld – were acquired for a total of $3.4 billion by Ternium (Italy/Argentina), Arcelor Mittal (Luxembourg) and Gerdau (Brazil) respectively (UNCTAD, cross-border M&As database).

86 Acquisitions of Brazilian sugar refineries by companies from Spain, France and Japan amounted to $1.2 billion (UNCTAD, cross-border M&As database).

87 Petrobras (Brazil) is investing in biofuels in these two countries (ECLAC, 2008), while Grupo Votorantim (Brazil) paid $489 for the acquisition of a Colombian steel company (Acerias Paz del Rio) and Gerdau (Brazil) acquired a Dominican steel company for $42 million (UNCTAD, cross-border M&As database).

88 Tata (India) signed a joint production agreement with Fiat to reactivate Fiat's plant in Córdoba (Argentina), and the Chinese firms, Chery and ZX, are investing in Uruguay and Mexico, respectively, for exports to MERCOSUR (in the case of Chery) and to the United States and other markets (in the case of ZX).

89 General Motors, for example, announced a $500 million investment in Mexico to produce hybrid (petrol/electric) vehicles that will be destined for the United States.

90 Examples include Lacoste, Benetton, Adidas, Reebok, Under Armour, Land's End and LL Bean.

91 *The Inquirer Net*, "Telefonica's dream of hegemony faces hurdles", 17 October 2007 (www.theinquirer.net/gb/inquirer/news/2007/10/17/telefonica-dreams-hegemony).

92 These three companies are: 1) Vivo, a joint venture between Telefónica (Spain) and Portugal Telecom, that has a 33% market share; 2) Claro, owned by Mexico's América Móvil, which has a 25% market share; and 3) TIM Brasil, previously owned by Telecom Italia, which has a 25% market share.

93 This deal will enable Oi Participações to gain control over some 70% of Brazil's fixed-line market, around 40% of its broadband Internet services and 18.5% of its mobile telephony market. Its closure depends on a change in telecommunications law that prohibits one company from holding two separate telecoms concessions.

94 UNCTAD, cross-border M&As database.

95 In El Salvador, these were the $1.5 billion acquisition by Citigroup (United States) of Grupo Cuscatlan (a Salvadorian Bank headquartered in Panamá) and the $791 million purchase by Bancolombia (Colombia) of an 89.15% stake in Banagrícola (El Salvador). In Chile, Scotiabank (Canada) bought a 78.9% stake in Banco del Desarrollo (Chile) for $829 million.

96 This was part of the larger acquisition of ABN AMRO (the Netherlands) by a consortium comprising Santander, Royal Bank of Scotland (United Kingdom) and Fortis (the Netherlands/Belgium).

97 These companies are Lácteos Los Andes, a dairy producer responsible for around 30% of national milk production, and Centro de Almacenes Congelados (Cealco), the country's largest cold storage and distribution company. These companies are to be incorporated into Productora y Distribuidora de Alimentos (PDVAL), a food distributor and affiliate of State oil company Petróleos de Venezuela (PDVSA).

98 There were no legal battles over nationalized telephone and electricity companies because compensation was satisfactorily agreed upon.

99 The new tax will work as follows: whenever the average monthly price of Brent North Sea crude exceeds $70 a barrel, 50% of the additional revenue will go to the State, and the other 50% to the company extracting and selling the oil. But when the reference price climbs above $100 a barrel, the State's share of the windfall profits will go up to 60%. The tax will not be applied if the price is lower than $70 (www.tradingmarkets.com/.site/news/Stock%20News/1360980/).

100 These 50% shares will be added to the 47% already owned by the State (www.entel.bo).

101 The Government increased its existing shares to gain majority control in two foreign energy companies: Andina (affiliate of the Spanish Repsol) and Chaco (affiliate of BP). It also took full control of the following two pipeline companies: Transredes (50% of which was owned by Ashmore (United Kingdom) and Shell (United Kingdom/Netherlands)); and Compañia Logística de Hidrocarburos Boliviana (Germany/Peru), a company involved in hydrocarbon storage and other logistical installations (*Business Latin America*, 12 May 2008 and 9 June 2008, London: EIU).

102 www.mineweb.com/mineweb/view/mineweb/en/page67?oid=44175&sn=Detail.

103 The move follows the publication of an audit report in December 2007 alleging irregularities in oil purchases from Shell-affiliated companies that have acted to push up fuel prices (*Business Latin America*, 28 January 2008, London: EIU).

104 The amendment leaves the decision on tourism concessions with Cusco's regional government. The Cusco Region is home to the city of Cusco (which was the capital of the Inca Empire) and to the country's most famous tourist site, Machu Picchu, which attracts around 800,000 visitors each year (*Business Latin America*, 10 March 2008, London: EIU).

105 These include distribution and logistics, business process outsourcing centres, contact centres, software development, R&D, and the repair and maintenance of cruise ships, cargo vessels and aircraft carriers. The exemptions apply to income tax, import taxes on capital goods, some municipal taxes and value added tax (VAT) on purchases of inputs and services required to carry out operations (ECLAC, 2008).

106 See *Business Latin America,* 8 April 2008, London: EIU.

107 These are Cuba, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, Romania and Uruguay.

108 These are Argentina, the Bolivarian Republic of Venezuela, Canada, China, the United States and eight European countries (Finland, France, Germany, Italy, the Netherlands, Spain, Switzerland and the United Kingdom).

109 Based on a communication from the Permanent Mission of Ecuador in Geneva.

110 Article 71 of the ICSID Convention states that denunciation shall take effect six months after the receipt by the World Bank of a notice to withdraw. Such notice was delivered on 2 May 2007.

111 For instance, Brazil's JBS, the world's biggest beef producer, plans to acquire two beef businesses in the United States, which will make it the largest beef producer in that country, and one in Australia, for a total of $1.3 billion.

112 Petrobras plans to increase oil and gas production abroad by 1.8 times by 2012, which will involve investments of $15 billion

during the period 2008–2012 (Agência Petrobras de Notícias, “Petrobras announces its international strategies”, 19 October 2007, at: www.agenciapetrobrasdenoticias.com.br/en_materia.asp?id_editoria=8&id_noticia=3597).

113 In the telecommunications industry, Mexico´s mobile telephony provider, América Móvil, has announced a $4 billion investment plan for network expansion in 2008 to meet growing demand for data, video and calling services and to deploy third-generation (3G) mobile networks.

114 Beginning with this report, Bulgaria and Romania are reclassified as part of the EU and the developed-country group.

115 As the inward FDI potential index for 2007 is not yet available at the time of writing this report, the data for 2006 are used.

116 For example, in 2007, the largest announced project in the region was that of the Abu Dhabi-based Allied Business Consultants in the city of Sochi (Russian Federation), related to the Winter Olympic Games in 2014, amounting to $6.2 billion.

117 In 2007, Gazprom purchased half of the pipeline operator Beltransgas (Belarus) for $2.5 billion to be paid in four tranches till 2010 (though the deal is not recorded in cross-border M&A data as the transaction was not completed in that year), while in early 2008 Gazprom purchased a 51% stake in Serbia’s State-owned oil and gas monopoly, NIS.

118 “Toshiba agrees metals deal with Kazatomprom”, *Financial Times*, 23 June 2008.

119 In 2007, apart from a preliminary agreement for the acquisition of a 25% stake in the leading local carmaker AvtoVAZ for $900 million by Renault (France), the German firm Volkswagen started to build an assembly plant in Kaluga and Japan’s Toyota started to build a plant near St. Petersburg. An important automotive project was also launched in Uzbekistan, where General Motors (United States) signed a joint-venture agreement with the State-owned holding, UzAvtosanoat, to assemble Chevrolet models.

120 For example, Pepsi (United States) acquired 100% of Ukraine’s biggest juice producer Sandora, and in early 2008 it reached an agreement to purchase a 75% stake of Lebedyansky, the Russian Federation’s largest juice producer, for $1.4 billion – so far the largest foreign acquisition by this company. “PepsiCo pays $1.4B for majority stake in Russian juice maker to expand business overseas”, *International Herald Tribune*, 20 March, 2008.

121 For instance, UniCredit (Italy) acquired Ukrsotsbank in Ukraine for $2.1 billion; Société Generale Group (France) bought 20% of Rosbank, one of the largest Russian banks for $1.7 billion; and KBC bank (Belgium) acquired Absolut Bank (Russian Federation) for $1 billion.

122 Vimpelcom acquired 90% of the Armenian fixed-line and mobile operator Armentel for over $400 million, and also invested $260 million in the acquisition of the second and fourth largest mobile operators in Uzbekistan, Unitel and Buztel.

123 For example, large FDI inflows to Bosnia Herzegovina were the result of several large privatizations of government shares in SOEs (Central Bank of Bosnia Herzegovina).

124 For instance, in Ukraine the banking sector remains fragmented with over 170 banks, and none of them holds more than 11% of the sector’s assets (*Business Monitor International*, 2007).

125 Beginning with this year’s *WIR* Bulgaria and Romania are included in the group of developed countries as a result of their accession to the EU in January 2007.

126 Royal Dutch (Netherlands) acquired Shell Canada for $7.6 billion, ConocoPhillips (United States) bought EnCana Corp for $7.5 billion and Marathon Oil Corp (United States) acquired Western Oil Sands Inc for $6.2 billion.

127 Only three of the largest 50 cross-border M&As in 2007 targeted firms in France. The German Allianz AG acquired AGF (life insurance) for $11.1 billion, Group Danone was bought for $7.2 billion by Kraft Foods (United States) and the British TDF SPL bought the French TDF SA for $6.4 billion.

128 The German economy continues to demonstrate strong export performance and increasing international competitiveness (i.e. very low inflation, moderate wage increases, high productivity and declining unit labour costs) (Moody’s Investor Services, 2007).

129 For example, Iberdrola (Spain) acquired Scottish Power for $22.2 billion and two other foreign investor groups bought Alliance Boots for $19.6 billion and Hanson OLC for $15.6 billion (annex table A.I.3).

130 For example, AIG Global Investment (United States) acquired Bulgarian Telecommunications for $1.5 billion.

131 The deal will be recorded as an inflow to the Netherlands since the company is registered in that country.

132 For example Merck (Germany) acquired the pharmaceutical company Serono for $9 billion, Societé Commerciale de Réassurance (France) bought the insurance company Converium Holding AG for $2.4 billion, and investors from New Zealand purchased Schweizerische Industrie Gesellschaft Holding AG for $2.3 billion.

133 In addition to the above-mentioned acquisition of Alcan by Rio Tinto, AstraZeneca acquired Medimmune (United States) for $15 billion (annex table A.I.3).

134 In December 2007, CEZ and MOL (Hungary) created a strategic alliance focusing on gas-fired power generation, and signed a joint-venture agreement which would enable CEZ to become a significant player in the Hungarian and Slovak markets.

135 In August 2007, HSBC bank announced its intention to establish a customer support centre in Brno (Czech Republic) while in mid-2007 Texas Instruments opened a new customer support centre in Prague.

136 See G8-Summit, 2007, and Commission of the European Communities, 2008.

137 The Government of Latvia sold major stakes in the fixed-line telephone monopoly, Lattelecom and the leading mobile operator Latvijas Mobilais Telefons (LMT), to foreign investors. Poland sold a former State-owned airline manufacturer, PZL Mielec, to Sikorksy Aircraft (United States).

138 EIU, Country Forecast, Main report: Policy and business outlook – Policy towards foreign investment, 13 April 2007 (www.eiu.com).

139 In the United States, the Invest in America initiative to attract foreign investment was the first initiative of this kind since the 1980s (*WIR07*: 78).

140 The private equity fund submitted a plan to increase its existing 9.9% equity share to 20%. The Japanese Government requested the firm to revise or review the investment plan partly because this investment involves acquisition of a nuclear facility planned to be built by the Japanese company.