GLOBAL INVESTMENT TRENDS

CHAPTER I

Global foreign direct investment (FDI) flows rose moderately to $1.24 trillion in 2010, but were still 15 per cent below their pre-crisis average. This is in contrast to global industrial output and trade, which were back to pre-crisis levels. UNCTAD estimates that global FDI will recover to its pre-crisis level in 2011, increasing to $1.4–1.6 trillion, approaching its 2007 peak in 2013. This positive scenario holds, barring any unexpected global economic shocks that may arise from a number of risk factors still in play.

For the first time, developing and transition economies together attracted more than half of global FDI flows. Outward FDI from those economies also reached record highs, with most of their investment directed towards other countries in the South. Furthermore, interregional FDI between developing countries and transition economies has been growing rapidly. In contrast, FDI inflows to developed countries continued to decline.

Some of the poorest regions continued to see declines in FDI flows. Flows to Africa, least developed countries, landlocked developing countries and small island developing States all fell, as did flows to South Asia. At the same time, major emerging regions, such as East and South-East Asia and Latin America, experienced strong growth in FDI inflows.

International production is expanding, with foreign sales, employment and assets of transnational corporations (TNCs) all increasing. TNCs' production worldwide generated value added of approximately $16 trillion in 2010 – about a quarter of global GDP. Foreign affiliates of TNCs accounted for more than one-tenth of global GDP and one-third of world exports.

State-owned TNCs are an important emerging source of FDI. There are some 650 State-owned TNCs, with 8,500 foreign affiliates across the globe. While they represent less than 1 per cent of TNCs worldwide, their outward investment accounted for 11 per cent of global FDI in 2010. The ownership and governance of State-owned TNCs have raised concerns in some host countries regarding, among others, the level playing field and national security, with regulatory implications for the international expansion of these companies.

A. GLOBAL TRENDS AND PROSPECTS: RECOVERY OVER THE HORIZON

1. Overall trends

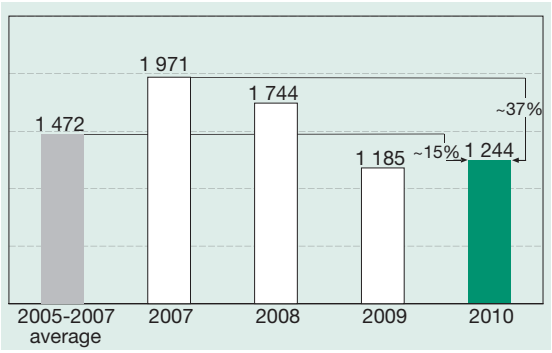
Global FDI flows rose modestly in 2010, but the share of developing and transition economies in both global inflows and outflows reached record highs.

As stimulus packages and other public fiscal policies fade, sustained economic recovery becomes more dependent on private investment. At present, transnational corporations (TNCs) have not yet taken up fully their customary lead role as private investors.

Global foreign direct investment (FDI) inflows rose modestly in 2010, following the large declines of 2008 and 2009. At $1.24 trillion in 2010, they were 5 per cent higher than a year before (figure I.1). This moderate growth was mainly the result of higher flows to developing countries, which together with transition economies – for the first time – absorbed more than half of FDI flows.

While world industrial production and trade are back to their pre-crisis levels, FDI flows in 2010 remained some 15 per cent below their pre-crisis average, and 37 per cent below their 2007 peak (figure I.1).

Figure I.1. Global FDI inflows, average 2005–2007 and 2007 to 2010
(Billions of dollars)



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

The moderate recovery of FDI flows in 2010 revealed an uneven pattern among components and modes of FDI. Cross-border mergers and acquisitions (M&As) rebounded gradually, yet greenfield projects – which still account for the majority of FDI – fell in number and value. Increased profits of foreign affiliates, especially in developing countries, boosted reinvested earnings – one of the three components of FDI flows – while uncertainties surrounding global currency markets and European sovereign debt resulted in negative intra-company loans and lower levels of equity investment – the other two components of FDI flows. While FDI by private equity firms regained momentum, that from sovereign wealth funds (SWFs) fell considerably in 2010.

FDI inward stock rose by 7 per cent in 2010, reaching $19 trillion, on the back of improved performance of global capital markets, higher profitability, and healthy economic growth in developing countries.

UNCTAD predicts FDI flows will continue their recovery to reach $1.4 –1.6 trillion, or the pre-crisis level, in 2011. In the first quarter of 2011, FDI inflows rose compared to the same period of 2010, although this level was lower than the last quarter of 2010 (figure I.2). They are expected to rise further to $1.7 trillion in 2012 and reach $1.9 trillion in 2013, the peak achieved in 2007. The record cash holdings of TNCs, ongoing corporate and industrial restructuring, rising stock market valuations and gradual exits by States from financial and non-financial firms' shareholdings built up as supporting measures during the crisis, are creating new investment opportunities for companies across the globe.

However, the volatility of the business environment, particularly in developed countries, means that TNCs have remained relatively cautious regarding their investment plans. In addition, risk factors such as unpredictability of global economic governance, a possible widespread sovereign debt crisis and fiscal and financial sector imbalances in some developed countries, rising inflation and apparent signs of overheating in major emerging market economies, among others, might derail FDI recovery.

Figure I.2. UNCTAD's Global FDI Quarterly Index,[a] 2007 Q1–2011 Q1
(Base 100: quarterly average of 2005)

Source: UNCTAD.
[a] The Global FDI Quarterly Index is based on quarterly data of FDI inflows for 87 countries, which together account for roughly 90 per cent of global flows. The index has been calibrated such that the average of quarterly flows in 2005 is equivalent to 100.

a. Current trends

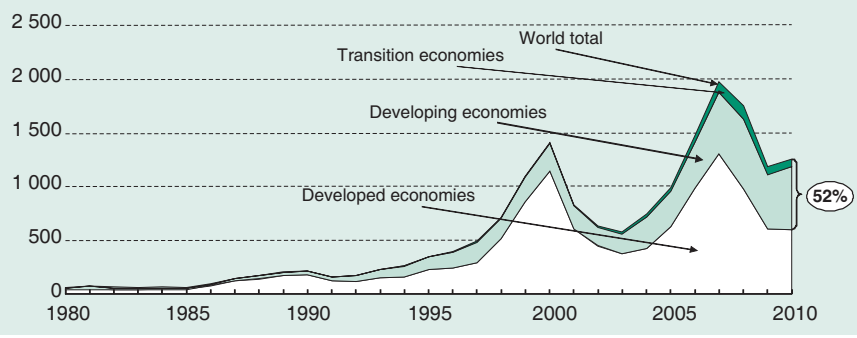
The shift of FDI inflows to developing and transition economies accelerated in 2010: for the first time, they absorbed more than half of global FDI flows.

Global FDI inflows in 2010 reached an estimated $1,244 billion (figure I.1) – a small increase from 2009's level of $1,185 billion. However, there was an uneven pattern between regions and also between subregions. FDI inflows to developed countries and transition economies contracted further in 2010. In contrast, those to developing economies recovered strongly, and together with transition economies – for the first time – surpassed the 50 per cent mark of global FDI flows (figure I.3).

FDI flows to developing economies rose by 12 per cent (to $574 billion) in 2010, thanks to their relatively fast economic recovery, the strength of domestic demand, and burgeoning South–South flows. The value of cross-border M&As into developing economies doubled due to attractive valuations of company assets, strong earnings growth and robust economic fundamentals (such as market growth).

As more international production moves to developing and transition economies, TNCs are increasingly investing in those countries to maintain cost-effectiveness and to remain competitive in the global production networks. This is now mirrored

Figure I.3. FDI inflows, global and by group of economies, 1980–2010
(Billions of dollars)



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

by a shift in international consumption, in the wake of which market-seeking FDI is also gaining ground.

This changing pattern of FDI inflows is confirmed also in the global ranking of the largest FDI recipients: in 2010, half of the top 20 host economies were from developing and transition economies, compared to seven in 2009 (figure I.4). In addition, three developing economies ranked among the five largest FDI recipients in the world. While the United States and China maintained their top position, some European countries moved down in the ranking. Indonesia entered the top 20 for the first time.

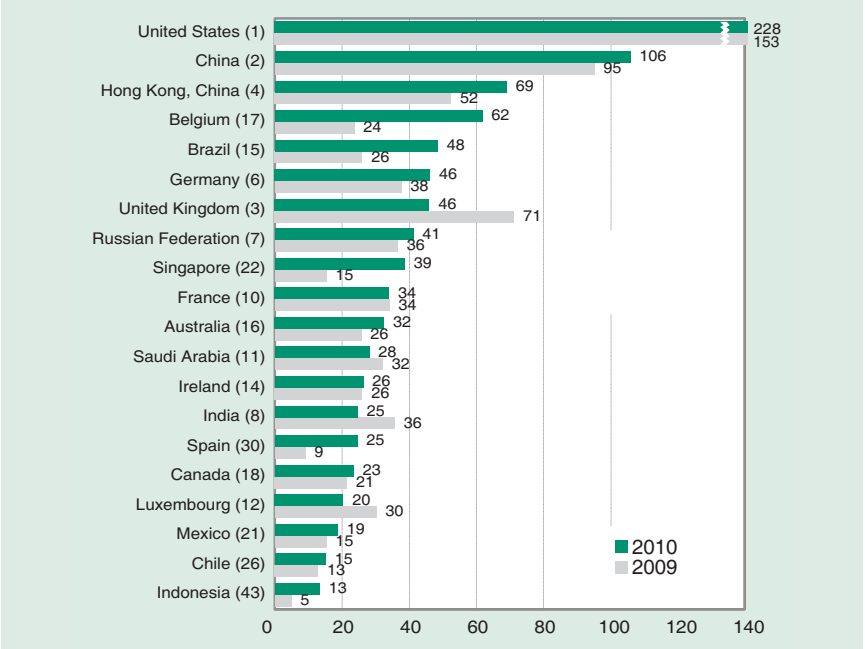
The shift towards developing and transition economies in total FDI inflows was also reflected in a change in the ranking of host countries by UNCTAD's *Inward FDI Performance Index*, which measures the amount of FDI that countries receive relative to the size of their economy (GDP). The index for developed countries as a group is below unity (the point where the country's share in global FDI flows and the country's share in global GDP are equal), and their ranking has fallen in the after-crisis period compared to the pre-crisis period of 2005–2007. In contrast, developing countries increased their performance index in the period 2005–2010, and they all have indices above unity (figure I.5).

Slow growth of FDI flows globally masks diverging trends between and within regions. Some of the poorest regions continued to see declines.

The rise of FDI to developing countries hides significant regional differences. Some of the poorest regions continued to see declines in FDI flows. In addition to least developed countries (LDCs), landlocked developing countries (LLDCs) and small island developing States (SIDS) (chapter II), flows to Africa continued to fall, as did those to South Asia. In contrast, major emerging regions, such as East and South-East Asia and Latin America experienced strong growth in FDI inflows (figure I.6).

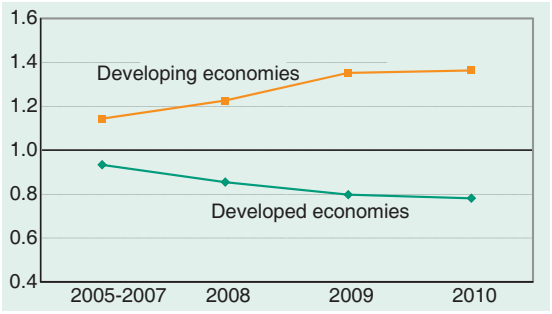
FDI flows to South, East and South-East Asia picked

Figure I.4. Global FDI inflows, top 20 host economies, 2009 and 2010 [a]
(Billions of dollars)



Source: UNCTAD, based on annex table I.1 and the FDI/TNC database (www.unctad.org/fdistatistics).
[a] Ranked on the basis of the magnitude of 2010 FDI inflows.
Note: The number in bracket after the name of the country refers to the ranking in 2009. British Virgin Islands, which ranked 12th in 2010, is excluded from the list.

Figure I.5. Inward FDI Performance Index,[a] developed and developing economies, average of 2005–2007 and 2008–2010



Source: UNCTAD, based on data from FDI/TNC database (www/unctad.org/fdistatistics).

[a] The Inward FDI Performance Index is the ratio of a country/region's share in global FDI inflows to its share in global GDP. A value greater than 1 indicates that the country/region receives more FDI than its relative economic size, a value below 1 that it receives less.

Note: A full list of countries ranked by the index is available at www.unctad.org/wir.

up markedly, outperforming other developing regions. Inflows to the region rose by about 24 per cent in 2010, reaching $300 billion, rising especially in South-East Asia and East Asia. Similarly, strong economic growth, spurred by robust domestic and external demand, good macroeconomic fundamentals and higher commodity prices, drove FDI flows to Latin America and the Caribbean to $159 billion. Cross-border M&As in the region rose to $29 billion in 2010, after negative values in 2009. Nearly all the big recipient countries saw inward flows increase, with Brazil the largest destination.

In contrast, inflows to Africa, which peaked in 2008 driven by the resource boom, continued the downward trend which started in 2009. Inflows to South Africa declined to little more than a quarter of those for 2009. North Africa saw its FDI flows fall slightly (by 8 per cent) in 2010; the uprisings which broke out in early 2011 impeded FDI flows in the first quarter of 2011 (see box II.1).

FDI flows to West Asia, at $58 billion decreased, despite the steady economic recovery registered by the economies of the region. Sizeable increases in government spending by oil-rich countries helped bolster their economies, but business conditions in the private sector remained fragile in certain countries.

The transition economies of South-East Europe and the Commonwealth of Independent States (CIS) registered a marginal decrease in FDI inflows in 2010, of roughly 5 per cent, to $68 billion, having fallen by 41 per cent in 2009. FDI flows to South-East Europe continued to decline sharply due to sluggish investment from EU countries – traditionally the dominant source of FDI in the subregion. The CIS economies saw their flows increase by less than 1 per cent despite stronger commodity prices, a faster economic recovery and improving stock markets.

FDI inflows to developed countries contracted moderately in 2010, falling by less than 1 per cent to $602 billion. Europe stood out as the subregion where flows fell most sharply, reflecting uncertainties about the worsening sovereign debt crisis. However,

Figure I.6. FDI inflows to developing and transition economies, by region, average of 2005–2007 and 2008 to 2010
(Billions of dollars)

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

while Italy and the United Kingdom suffered, FDI in some of the region's other major economies fell only slightly (e.g. France) or increased (e.g. Germany). Declining FDI flows were also registered in Japan, where there were a number of large divestments. In contrast, FDI flows to the United States surged by almost 50 per cent largely thanks to a significant recovery in the reinvested earnings of foreign affiliates. However, FDI flows were still at about 75 per of their peak level of 2008.

Outward FDI from developing and transition economies reached a record high, with most of their investment directed towards other economies within these regions.

At $1,323 billion, global FDI outflows in 2010, while increasing over the previous year, are still some 11 per cent below the pre-crisis average, and 39 per cent below the 2007 peak (see box I.1 for differences between FDI inflows and outflows). As in the case of inflows, there was an uneven pattern among regions. FDI flows from developing and transition economies picked up strongly, reflecting the strength of their economies, the dynamism of their TNCs and their growing aspiration to compete in new markets. The downward trend in FDI from developed countries reversed, with an 10 per cent increase over 2009. However, it remained at half the level of its 2007 peak.

Outward FDI from developing and transition economies reached $388 billion in 2010, a 21 per cent increase over 2009 (figure I.7; annex table I.1). Their share in global outflows of 29 per cent was up from 16 per cent in 2007, the year prior to the financial crisis. Behind this general increase there lie significant differences between countries.

Investors from South, East and South-East Asia and Latin America were the major drivers for the

Box I.1. Why are data on global FDI inflows and outflows different?

The discrepancy between reported global inward and outward FDI flows has been significant (box figure I.1.1). This is a major problem for policymakers worldwide, as sound policy analysis and informed policymaking on this issue require reliable, accurate, timely and comparable data (Fujita, 2008).

Box figure I.1.1. The difference between global FDI inflows and outflows, 1999–2010

(Billions of dollars)

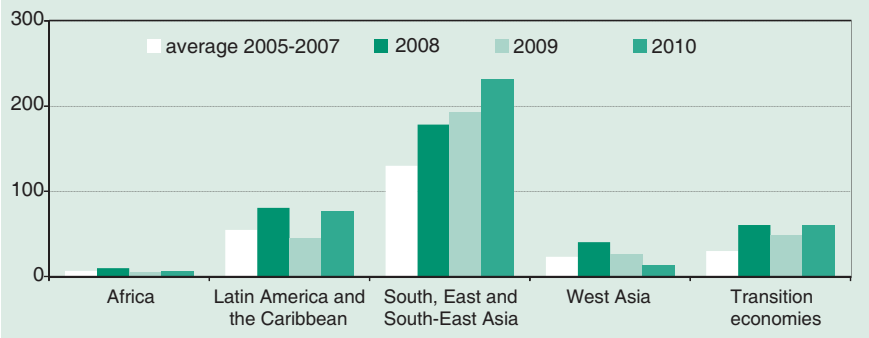
Source: UNCTAD.
Note: Positive value means inflows are higher than outflows, and vice versa.

The discrepancy is due to several reasons. First, there are inconsistencies in the data collection and reporting methods of different countries. Examples include different methods used by host and home countries recording the same transactions, uneven coverage of FDI flows between countries (e.g. treatment of reinvested earnings), and different exchange rates used for recording FDI transactions. Second, the changing nature (e.g. investment through exchange of shares between investors and acquired firms, investment from indirect sources) and the increasing sophistication of FDI-related transactions (that involve not only funds from parent firms, but also government loans and development assistance in the same package) often make it difficult to attribute exact values to FDI. Third, the distinction between FDI transactions with "portfolio-like behaviour" and portfolio investment, including hot money, is blurred. Finally, the accuracy of FDI reporting may itself be a victim of the global crisis, which caused increasing volatility in exchange rates, making an exact correspondence between home- and host-country reporting more uncertain (as differences in the timing of records may coincide with major exchange-rate differences).

This situation calls for a continuous improvement of both FDI-related definitions and data collection, especially in developing countries. As considerable efforts by UNCTAD and other international organizations are underway to harmonize definitions and data collection, it can be expected that the discrepancy between reports on inflows and outflows will narrow over time.

Source: UNCTAD.

Figure I.7. FDI outflows from developing and transition economies, by region, average of 2005–2007 and 2008 to 2010
(Billions of dollars)



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

strong growth in FDI outflows. Outflows from the largest FDI sources – Hong Kong (China) and China – increased by more than $10 billion each, reaching historical highs of $76 billion and $68 billion, respectively. Chinese companies continued their buying spree, actively acquiring overseas assets in a wide range of industries and countries, and overtaking Japanese companies in total outward FDI.

All of the big outward investor countries from Latin America – Brazil, Chile, Colombia and Mexico – bolstered by strong economic growth at home, increased their acquisitions abroad, particularly in developed countries where investment opportunities have arisen in the aftermath of the crisis.

In contrast, outflows from major investors in West Asia fell significantly, due to large-scale divestments and redirection of outward FDI from government-controlled entities to support their home economies weakened by the global financial crisis.

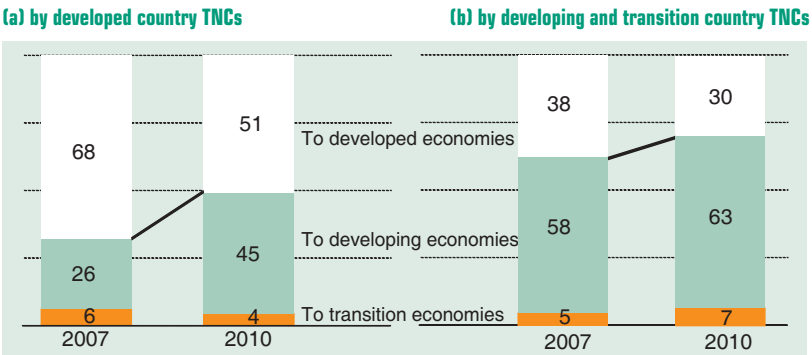
FDI outflows from transition economies grew by 24 per cent, reaching a record $61 billion. Most of the outward FDI projects, as in previous years, were carried out by Russian TNCs, followed by TNCs from Kazakhstan. The quick recovery of natural resource-based companies in transition economies was boosted by strong support by the State,[1] and by recovering commodity prices and higher stock market valuations, easing the cash flow problems these firms had faced in 2009.

Developed countries as a group saw only a limited recovery of their outward FDI. Reflecting their diverging economic situations, trends in FDI outflows differed markedly between countries and regions: outflows from Europe and the United States were up (9.6 and 16 per cent, respectively), while Japanese outward FDI flows dropped further in 2010 (down 25 per cent). The lingering effects of the crisis and subdued prospects in developed countries forced many of their TNCs to invest in emerging markets in an effort to keep their markets and profits: in 2010 almost half of total investment (cross-border M&A and greenfield FDI projects) from developed countries took place in developing and transition economies, compared to only 32 per cent in 2007 (figure I.8).[2]

In 2010, six developing and transition economies were among the top 20 investors (figure I.9). UNCTAD's *World Investment Prospects Survey 2011–2013* (WIPS) confirms that developing and transition economies are becoming important investors, and that this trend is likely to continue in the near future (UNCTAD, forthcoming a).

Many TNCs in developing and transition economies are investing in other emerging markets, where recovery is strong and the economic outlook better. Indeed, in 2010, 70 per cent of FDI projects (cross-border M&A and greenfield FDI projects) from these economies were invested within the same regions (figure I.8). TNCs, especially large State-owned enterprises, from the BRIC countries – Brazil, the

Figure I.8. Distribution of FDI projects,[a] by host region, 2007 and 2010
(Per cent)



Source: UNCTAD, based on UNCTAD cross-border M&A database and information from the *Financial Times* Ltd, fDi Markets (www.fDimarkets.com).
[a] Including both cross-border M&As and greenfield FDI projects.

Russian Federation, India and China – have gained ground as important investors in recent years as the result of rapid economic growth in their home countries, abundant financial resources and strong motivations to acquire resources and strategic assets abroad (section C).

In 2010 there were seven mega-deals (over $3 billion) involving developing and transition economies (or 12 per cent of the total) (annex table I.7), compared to only two (or 3 per cent of the total) in 2009. Firms from developing Asia expanded their acquisitions in 2010 beyond their own regions. For example China's outward FDI showed substantial increases in Latin America (chapter II; ECLAC, 2011). Transition-economy firms also increased their purchases in other transition economies in 2010.

b. FDI by sector and industry

In the aftermath of the crisis, FDI in manufacturing bounced back while services sector FDI is still in decline.

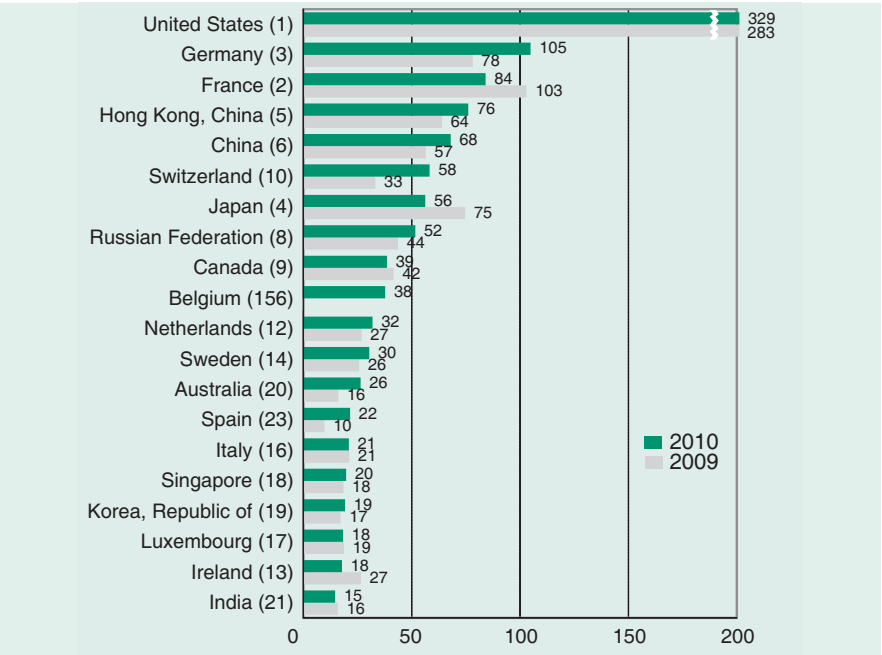
The unchanged level of overall FDI in 2010 also obscures some major sectoral differences. Data on FDI projects (both cross-border M&As and greenfield investment) indicate that the value and share of manufacturing rose, accounting for almost half of the total. The value and share of the primary and services sector declined (figure I.10). Compared with the pre-crisis level (2005–2007), the picture is quite different. While the primary sector has recovered, services are still less than half, and manufacturing is 10 per cent below their pre-crisis levels (annex table I.5).

The value of FDI projects in manufacturing rose by 23 per cent in 2010 compared to 2009, reaching $554 billion. The financial crisis hit a range of manufacturing industries hard, but the shock could eventually prove to be a boon to the sector, as many companies were forced to restructure into more productive and profitable activities – with attendant effects on FDI. In the United States, for example, FDI in manufacturing rose by 62 per cent in 2010, accompanied by a substantial rise in productivity (Bureau of Labor Statistics, 2011).

Within manufacturing, business-cycle sensitive industries such as metal and metal products, electrical and electronics equipment and wood and wood products were hit by the crisis, in terms of sales and profits (annex table I.5). As a result, investment fell in these industries, which suffered from serious overcapacity and wished to use cash to restore their balance sheet. In addition, their prospects for higher demand and market growth remained gloomy, especially in developed countries.

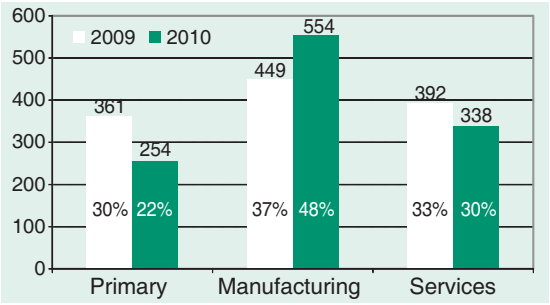
Some manufacturing industries such as chemicals (including pharmaceuticals) remained more resilient to the crisis; while other industries, such as food, beverages and tobacco, textile and garments, and

Figure I.9. Global FDI outflows, top 20 home economies, 2009 and 2010[a]
(Billions of dollars)



Source: UNCTAD, based on annex table I.1 and the FDI/TNC database (www.unctad.org/fdistatistics).
[a] Ranked on the basis of the magnitude of 2010 FDI outflows.
Note: The number in bracket after the name of the country refers to the ranking in 2009. British Virgin Islands, which ranked 16th in 2010, is excluded from the list.

Figure I.10. Sectoral distribution of FDI projects,[a] 2009–2010
(Billions of dollars and per cent)



Source: UNCTAD.
[a] Comprises cross-border M&As and greenfield investments. The latter refers to the estimated amounts of capital investment.

automobiles, recovered in 2010. The pharmaceutical industry, for example, remained attractive to foreign investment, thanks to the dynamism of its final markets – especially in emerging economies. This rests, first, on the necessity of setting up or acquiring production facilities, as the patent protection for a number of major drugs marketed by global pharmaceutical firms is about to expire, and secondly on the ageing demography of most developed countries. Restructuring continued in 2010, as witnessed by two large deals that took place in the industry.[3] Opportunities for business deals exist due to rapid growth in the number of scientists and pharmaceutical firms in emerging economies, most notably in China and India.

In food, beverages and tobacco the recovery was due to the sustained demand for basic items, especially in developing countries. For many large TNCs in this industry, profits soared in 2010, and a number of large acquisitions were made.[4] In the case of textiles and clothing, the recovery is prompted by a growth in consumer spending, particularly in some emerging countries. Garment production is fairly cost-sensitive, which may prompt accelerated

relocation to countries where there is cheap labour.

FDI in the primary sector decreased in 2010 despite growing demand for raw materials and energy resources, and high commodity prices. FDI projects (including cross-border M&A and greenfield investments) amounted to $254 billion in 2010, raising the share of the primary sector to 22 per cent, up from 14 per cent in the pre-crisis period. Natural resource-based companies with sound financial positions, mainly from developing and transition economies, made some large acquisitions in the primary sector. Examples include the purchase of Repsol (Brazil) by China's Sinopec Group for $7 billion, and the purchase of the Carabobo block in the Bolivarian Republic of Venezuela by a group of investors from India for $4.8 billion (annex table I.7).

The value of FDI projects in the services sector continued to decline sharply in 2010, with respect to both 2009 and the pre-crisis level of activity. All main service industries (business services, finance, transport and communications and utilities) fell, although at different speeds. Business services declined by 8 per cent compared to the pre-crisis level, as TNCs are outsourcing a growing share of their business support functions to external providers, seeking to cut internal costs by externalizing non-core business activities (chapter IV). Transportation and telecommunication services suffered equally in 2010 as the industry's restructuring is more or less completed after the round of large M&A deals before the crisis, particularly in developed countries.

FDI in the financial industry – the epicentre of the current crisis – experienced the sharpest decline, and is expected to remain sluggish in the medium term. Over the past decade, its expansion was instrumental in integrating emerging economies into the global financial system, and it has brought substantial benefits to host countries' financial systems in terms of efficiency and stability. However, it also produced a bubble of unsustainable lending, which had to burst. In the period of post-bubble correction, issues relating to the management of country risk and the assessment of conditions in host-country financial systems play a major role in supporting expansion abroad.

Utilities were also strongly affected by the crisis, as some investors were forced to reduce investment or even divest due to lower demand and accumulated losses.

c. FDI by modes of entry

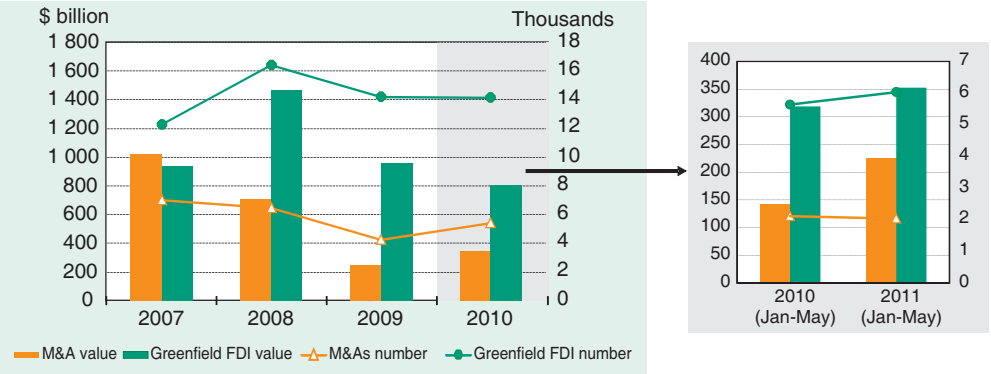
Greenfield investment has become much larger than cross-border M&As. Recovery of FDI flows in 2011 relies on the rise of both greenfield investments and cross-border M&As.

There are diverging trends between the two main modes of FDI entry: M&As and greenfield (new) investment. The value of cross-border M&A deals increased by 36 per cent in 2010, to $339 billion, though it was still roughly one-third of the previous peak in 2007 (figure I.11). Higher stock prices increased the purchasing power of investors to invest abroad, as higher values of corporate assets in 2010 raised the leverage of investors in undertaking M&As by using shares in part-payment. At the same time, the ongoing corporate and industrial restructuring is creating new acquisition opportunities, in particular for cash-rich TNCs, including those from emerging markets. On the other hand, greenfield investment – the other mode of FDI – declined in 2010. Differing trends between cross-border M&As and greenfield FDI are not surprising, as to some extent companies tend to consider the two modes of market entry as alternative options. However, the total project value of greenfield investments has been much higher than that of cross-border M&As since the crisis.

Developing and transition economies tend to host greenfield investment rather than cross-border M&As. More than two-thirds of the total value of greenfield investment is directed to these economies, while only 25 per cent of cross-border M&As are undertaken there. At the same time, investors from these economies are becoming increasingly important players in cross-border M&A markets, which previously were dominated by developed country players.

During the first five months of 2011, both greenfield investments and cross-border M&As registered a significant rise in value (figure I.11; annex tables I.3–6 and I.8). Cross-border M&As rose by 58 per cent, though from a low level, compared with the corresponding period of 2010.

Figure I.11. Value and number of cross-border M&As and greenfield FDI projects, 2007–May 2011



Source: UNCTAD, based on UNCTAD cross-border M&A database and information from the *Financial Times* Ltd, fDi Markets (www.fDimarkets.com).

Note: Data for value of greenfield FDI projects refer to estimated amounts of capital investment.

d. FDI by components

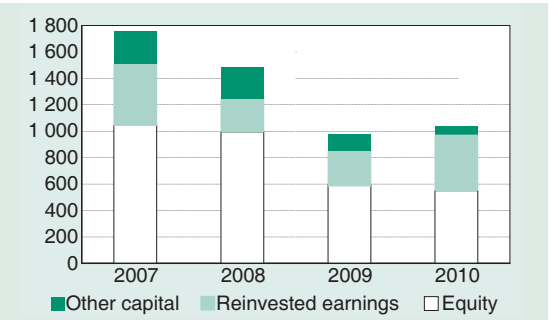
In 2010, reinvested earnings grew fast, while equity capital investment and intra-company loans declined. Cash reserves of foreign affiliates grew substantially.

Stagnant global flows in 2010 were accompanied by diverging trends in the components of FDI inflows (figure I.12). Improved economic performance in many parts of the world, and increased profits of foreign affiliates, lifted reinvested earnings to nearly double their 2009 level (figure I.13). This reflects the general increase in profits globally. For example, the profits to sales ratio of the United States' S&P 500 firms in 2010 improved further, while profits of Japanese firms also rose in 2010. Also in developing countries, operating profits of companies from China and the Republic of Korea rose significantly in 2010.

However, not all reinvested earnings are actually reinvested in productive capacity. They may be put aside to await better investment opportunities in the future, or to finance other activities (box I.2), including those that are speculative (box I.5). About 40 per cent of FDI income was retained as reinvested earnings in host countries in 2010 (figure I.13).

The increase in reinvested earnings compensated for the decline in equity capital flows, which were down slightly despite an up-tick in cross-border M&As. The continuing depressed level of equity investments was still the key factor keeping FDI

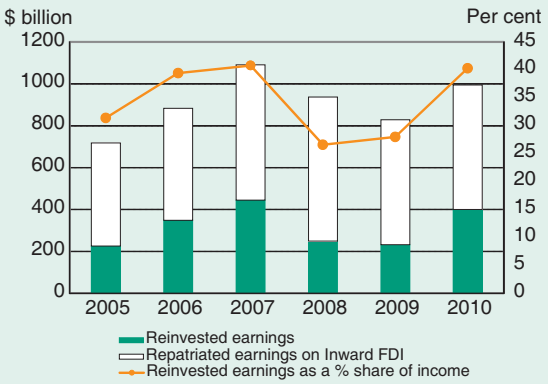
Figure I.12. FDI inflows by component, 2007–2010[a]
(Billions of dollars)



Source: UNCTAD, based on data from FDI/TNC database (www/unctad.org/fdistatistics).

[a] Based on 106 countries that account for 85 per cent of total FDI inflows during the period 2007-2010.

Figure I.13. FDI income, 2005–2010[a]
(Billions of dollars and per cent)



Source: UNCTAD.

[a] Based on 104 countries that account for 81 per cent of total FDI inflows during the period 2005-2010.

Box I.2. FDI flows and the use of funds for investment

FDI is traditionally broken down into three components: equity capital, intra-company loans, and reinvested earnings of foreign affiliates. These component parts can be considered as sources of funds for investment, additional to funds raised on local and international capital markets. However, the decision by a TNC to finance an investment in productive assets in a host country through an increase in equity capital, a loan, or by using income earned in the host country is driven by a wide range of factors, most of which are beyond the reach of host-country policymakers to influence.

From a policymaker's perspective, it may be more relevant to see how FDI flows are used (use of funds). TNCs can employ FDI (1) for the creation, expansion or improvement of productive assets, generating additional productive capacity, (2) to finance changes in ownership of assets (M&As), or (3) to add to the financial reserves of foreign affiliates. The latter may be motivated by decisions on the level of financial leverage of the firm, by the need to retain cash for planned future investments, by fiscal considerations (e.g. to defer tax liabilities upon repatriation of profits), or by other factors, including opportunistic behaviour on the part of TNCs to profit from changes in exchange rates or local asset-price rises.

The traditional method of analysing FDI by sources of funds tends to overlook the significance of such "parked funds" held in foreign affiliates of TNCs. "Reinvested earnings" consist of income earned by foreign affiliates that is not repatriated to the home country of the parent firm; firms do not necessarily reinvest this income in additional productive capacity. The difference between FDI flows and actual capital expenditures by foreign affiliates represents FDI not immediately employed for the creation of additional productive capacity and, as such, it is a good proxy for the increase in cash reserves in foreign affiliates.

Box figure I.2.1. Estimated value of the "non-used" part of FDI by United States TNCs, 2001–2010

(Billions of dollars)

Source: UNCTAD based on FDI database and Bureau of Economic Analysis.

This proxy indicator for overseas cash reserves of United States firms over the last 10 years shows a peak in 2004, a steep drop in 2005 and an ascent to new heights in 2008 – with estimates for 2009 and 2010 equally high (box figure I.2.1). The 2004 peak and the 2005 trough can be explained by the Homeland Investment Act which provided a tax break on repatriated profits in 2005. Anticipating the tax break, firms hoarded cash in their overseas affiliates in 2004 and brought back several years' worth of retained earnings in 2005 (some $360 billion). For the last three years, levels have been similar to the anomalous 2004 peak, leading to the conclusion that cash reserve levels in foreign affiliates may well exceed what is required for normal operations.

The sensitivity of overseas cash reserves to the tax rate on fund repatriation can also be observed in Japan. A 2009 tax change on the repatriation of foreign earnings is estimated to bring back an additional $40 billion in overseas funds annually (chapter II; *WIR10*).

The implications are significant. Under-employed cash reserves of TNCs represent untapped funds that could be gainfully employed to stimulate the global economy, create jobs and finance development.

Source: UNCTAD.

flows relatively low. It is a source of concern, as among the components of FDI, equity investment compared with reinvested earnings and intra-company loans is the one that is related most directly to TNCs' long-term international investment strategies. Intra-company loans declined also, as parent firms withdrew or were paid back loans from their affiliates, in particular those in developed host countries, in order to strengthen their balance sheets. This was especially true of European TNCs which, facing fears of a sovereign debt crisis spreading in many parts of the euro zone, significantly reduced loans to their affiliates in the United Kingdom and the United States.

Given the fact that foreign affiliates hold a significant amount of retained earnings on their balance sheets (box I.2), unless they are repatriated to their parent firms in home countries, reinvested earnings continue to play an important role in determining the level of investment flows.

e. FDI by special funds: private equity and sovereign wealth funds

Private equity funds

Private equity-sponsored FDI has regained momentum, although it fell short of its pre-crisis level. It is directed more towards developing and transition economies, secondary buyouts and smaller acquisitions.

In 2010, the value of private equity-sponsored cross-border M&As increased by 14 per cent to $122 billion, compared to $107 billion in 2009 after two years of consecutive decline (table I.1).[5] At the same time, the corresponding number of cross-border M&As reached a record high, with 2,050 deals completed.

The factors behind the increase in FDI by private equity funds are largely related to the stabilization of macroeconomic conditions. Also, investors were looking for yields, in a declining interest rate environment. Positive trends were supported by stronger private equity activity in emerging markets (Emerging Markets Private Equity Association, 2011). Thus 31 per cent of FDI by private equity firms, amounting to $38 billion, was directed to developing and transition economies in 2010 (figure I.14), up from 26 per cent in 2009. This rise reflects the increasing interest of private equity firms in developing country firms and venture capital business, which provide better business opportunities than before.

Despite stronger private equity-sponsored cross-border M&As in 2010, their value is still more than 70 per cent lower than the peak level in 2007. The relative contribution of private equity to global FDI continues to decline. The volume share of private equity in total cross-border M&As fell from 19 per cent in 2009 to 17 per cent in 2010 (table I.1). The relative contribution of private equity funds to total FDI contracted by nearly 40 per cent from 2004, its peak year, to 2010.

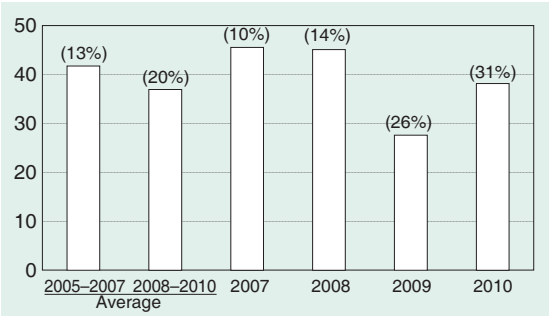
A more benign global economic environment should see fundraising and investment picking up in 2011, also bolstering a more positive outlook for private equity-sponsored FDI. Private equity investors were estimated to have held nearly a trillion dollars of uninvested capital at the beginning of 2010, including reserves for future use, that could result

Table I.1. Cross-border M&As by private equity firms, 1996–May 2011
(Number of deals and value)

Year	Number of deals		Value	
	Number	Share in total (%)	$ billion	Share in total (%)
1996	932	16	42	16
1997	925	14	54	15
1998	1 089	14	79	11
1999	1 285	14	89	10
2000	1 340	13	92	7
2001	1 248	15	88	12
2002	1 248	19	85	18
2003	1 488	22	109	27
2004	1 622	22	157	28
2005	1 736	20	207	22
2006	1 698	18	271	24
2007	1 917	18	457	27
2008	1 785	18	322	25
2009	1 993	25	107	19
2010	2 050	22	122	17
2011	591	17	91	20

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics).
Note: Value is on a gross basis, which is different from other M&A tables based on a net value. The table includes M&As by hedge funds. Private equity firms and hedge funds refer to acquirers as "investors not elsewhere classified". This classification is based on the Thomson Finance database on M&As.

Figure I.14. Cross-border M&As by private equity funds directed to developing and transition economies, 2005–2010
(Billions of dollars and per cent)



Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics).
Note: Figures in parenthesis refer to the percentage share in total private equity. Data for 2005–2007 and 2008–2010 are annual averages.

in a surge in volume of cross-border M&As in 2011 (Bain & Co., 2011).

On the supply side, there are now more opportunities. There are two factors. First, companies owned by private equity firms are becoming targets for other private equity firms. The relative performance of these secondary buyouts (i.e. buyouts of private equity invested firms) is only slightly lower than that of primary buyouts: this is because the former can be executed faster than the latter in issuing IPOs (initial public offerings), and because secondary buyouts entail a lower risk profile.[6] Second, private equity firms are now seeking smaller firms, and are engaged in smaller-scale buyouts. This is an area to which private equity firms have not paid much attention in the past, yet one where many attractive firms are to be found.

However, private equity funds continue to face regulations in response to the global financial crisis, partly due to the G-20's commitment to subject all significant financial market actors to appropriate regulation and supervision. For example, the EU Alternative Investment Funds Managers Directive[7] and the United States' Dodd-Frank Wall Street Reform and Consumer Protection Act[8] will affect directly and indirectly the operations of private equity funds and their fund-raising ability, and in consequence their contribution to FDI.

Sovereign wealth funds

SWF-sponsored FDI declined substantially because of severely reduced investment from the Gulf region. However, its long-term potential as a source of investment remains.

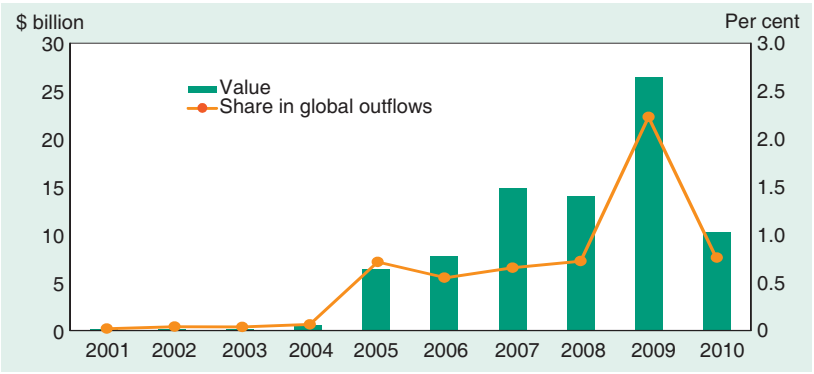
Sovereign wealth funds (SWFs) are special-purpose investment funds or arrangements that are owned by government.[9] At the end of 2009, more than 80 SWFs, with an estimated total of $5.9 trillion in assets, could be identified.[10] In 2010 alone, nearly 20 governments, mostly from emerging economies, considered or decided to establish an SWF.

While funds that invest mainly in debt instruments (e.g. government bonds) were largely unaffected by the global financial crisis, SWFs with considerable equity exposure suffered a dramatic erosion of the value of their investments. By the end of 2009, however, with the recovery of stock markets worldwide, almost all SWFs had been able to recoup their losses from 2008.

In 2010 the positive outlook for most SWFs held firm, supported by the overall recovery in equity markets. However, total SWF-sponsored FDI in 2010 amounted to only $10.0 billion, a significant drop from 2009's $26.5 billion (figure I.15). The largest SWF-sponsored deals included investments in infrastructure, retail, transportation, natural resources and utilities in Australia, Canada, the United Kingdom and the United States (table I.2).

The fall in SWF-sponsored FDI in 2010 is a considerable deviation from the trend of SWFs becoming more active foreign direct investors, that started in 2005. There are two reasons for this slump. First, unlike in earlier years, in 2010 FDI by SWFs based in the Gulf region (e.g. United Arab Emirates) was almost absent (table I.2). Asian and Canadian SWFs were the main investors in 2010. Second, while SWF-sponsored FDI is not necessarily pro-cyclical, the low appetite for direct investments in 2010 can be traced back to the exceptionally uncertain global financial environment of previous years. Because of that uncertainly, in 2010 SWFs directed about one-third of their FDI to acquire shares of, or inject capital into, private equity funds and other funds,[11] rather than investing in acquiring shares issued by industry

Figure I.15. Cross-border M&As by SWFs, 2001–2010
(Million dollars and per cent)



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

Table I.2. Selected large FDI deals by SWFs in 2010

Value ($ million)	Acquiring company	Acquiring nation	Target company	Target nation	Industry of the acquired company
3 090	Canada Pension Plan Investment Board	Canada	Intoll Group	Australia	Finance
2 227	Qatar Holding LLC	Qatar	Harrods	United Kingdom	Retail
1 581	China Investment Corp	China	AES Corp	United States	Electricity, gas and water
881	Canada Pension Plan Investment Board	Canada	407 ETR Concession Co	Canada	Transport, storage and communications
800	China Investment Corp	China	Penn West Energy Trust	Canada	Mining, quarrying and petroleum
576	Ontario Teachers Pension Plan	Canada	Camelot Group PLC	United Kingdom	Community, social and personal service activities
400	Temasek Holdings(Pte)Ltd	Singapore	Odebrecht Oleo & Gas SA	Brazil	Mining, quarrying and petroleum
259	Caisse de Depot & Placement du Quebec	Canada	HDF(UK)Holdings Ltd	United Kingdom	Finance
194	GIC Real Estate Pte Ltd	Singapore	Salta Properties-Industrial Property Portfolio	Australia	Business services
100	Temasek Holdings(Pte)Ltd	Singapore	Platmin Ltd	South Africa	Mining, quarrying and petroleum
91	Canada Pension Plan Investment Board	Canada	Vornado Realty Trust	United States	Business services
43	Oman Investment Fund	Oman	Petrovietnam Insurance Joint Stock Corp	Viet Nam	Finance

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

(e.g. the Canadian Pension Plan Investment Board's investment in Intoll Group, an infrastructure fund, for $3 billion – table I.2).

While expenditure on FDI has declined, the fundamental drivers for stronger SWF-sponsored FDI activity remain robust. Strong commodity prices in 2010 in particular have created a positive funding environment for SWFs, including those that have been actively involved in FDI in previous years. The foreign assets of the Qatar Investment Authority, an active strategic investor, were estimated to grow from $65 billion in 2009 to $90 billion in 2010, and $120 billion in 2011.[12] It has been suggested that the China Investment Corporation, established in 2007 with a mandate to diversify China's foreign exchange holdings, and an active investor in energy, natural resources, and infrastructure-related assets, received $100–200 billion in new funds in 2010.[13]

Other SWFs have seen strong returns in 2010, supporting policy decisions to become more

proactive sponsors of FDI. Since 2009, for example, the Norwegian Government Pension Fund Global, with more than $400 billion under management and owning roughly 1 per cent of the world's equity, is now allowed to own up to 10 per cent of a listed company – the threshold to be considered FDI – making the fund a considerable potential source of FDI.[14] Greater availability of funds, as well as policies that give SWFs more leeway to acquire larger stakes in attractive assets, together with improved in-house fund management capacity, will result in SWFs becoming more visible sources of FDI.

2. Prospects

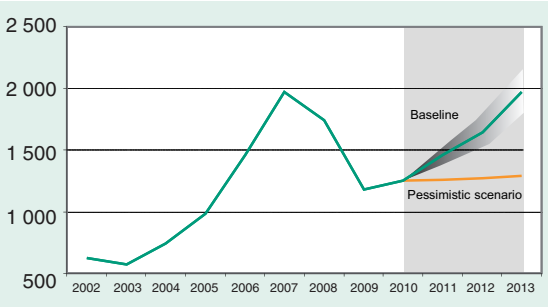
Recovery is underway, but risks and uncertainties remain.

Judging from the data on FDI flows, cross-border M&As and greenfield investment for the first few months of 2011, the recovery of FDI is relatively strong. This trend may well continue into the remaining period of 2011. New investment opportunities await for cash-rich companies in developed and developing countries. Emerging economies, particularly Brazil, China, India and the Russian Federation, have gained ground as sources of FDI in recent years. A recovery in FDI is on the horizon.

However, the business environment remains volatile, and TNCs are likely to remain relatively cautious regarding their investment plans. Consequently, medium-term prospects for FDI flows – which have not really picked up yet after the sharp slump in 2008 and 2009, and which had only a moderate recovery in 2010 – may vary substantially, depending on whether or not the potential risks in the global economy materialize or not.

To illustrate these uncertainties, UNCTAD proposes baseline and pessimistic scenarios for future FDI growth (figure I.16). The former scenario is based on the results of various leading indicators, including UNCTAD's World Investment Prospects Survey 2011—2013 (WIPS) (UNCTAD, forthcoming a), an econometric model of forecasting FDI inflows (box I.3), and data for the first four to five months of 2011 for cross-border M&As and greenfield investment values. Taking these various indicators together, FDI flows could range from $1.4–1.6 trillion in 2011 (with a baseline scenario of $1.52 trillion) — the pre-crisis average of

Figure I.16. Global FDI flows, 2002–2010, and projection for 2011–2013
(Billions of dollars)



Source: UNCTAD.

2005–2007. They are expected to rise further to $1.7 trillion in 2012 and reach $1.9 trillion in 2013, the peak achieved in 2007.

However, there is also a possibility of stagnant FDI flows (pessimistic scenario) if the above–mentioned risks such as the unpredictability of global economic governance, worsening sovereign debt crisis, and fiscal and financial imbalances were to materialize.

After the sharp recession at the end of 2008 and beginning of 2009, the economic environment has improved significantly over the past two years. The recovery in world output growth rests on a number of factors, including stabilization of the financial system, the resilient growth of emerging markets, the stimulus package programmes implemented in various major economies in the world, and the pick-up in final demand in developed countries, following a return to confidence for both households and companies. Recent forecasts suggest that global GDP will grow by 3 per cent in 2011. Moreover, domestic investment, is expected to pick up strongly not only in developing countries but also in advanced economies (table I.3). Take for example the Republic of Korea, where investment expenditure in 2011 is expected to rise by nearly 10 per cent, to a record high.[15]

The improvement in the global macroeconomic outlook has had a direct positive effect on the capacity of TNCs to invest. After two years of slump, profits of TNCs picked up significantly in 2010 (figure I.17), and have continued to rise in 2011: in the first quarter the S&P 500 United States

Box I.3. Forecasting global and regional flows of FDI

Part of UNCTAD's forecast for FDI flows is based on an econometric model, by which not only global but also regional estimations are made possible for 2011–2013. As FDI decisions are a strategic choice by firms choosing among alternative locations, the single country/region model cannot demonstrate how a TNC chooses a particular location over others. Existing studies typically portray FDI as reacting to individual host country/region factors, but fail to capture the impact of factors elsewhere on the other regions that may attract investment to, or divert investment from, the country in question. Consequently, in order to explain and forecast global and regional FDI, factors in all regions must be taken into consideration simultaneously.

UNCTAD's econometric model for FDI uses panel data for the period 1995–2010 from 93 countries, which account for more than 90 per cent of FDI in their own respective regions (Africa, West Asia, South, East and South-East Asia, Latin America and the Caribbean, EU and other developed countries).[a] The variables employed in the model include: market growth of G-20 countries as main home and host countries of global FDI (G-20 growth rate), market size (one year lagged GDP of each individual country), the one-year lagged price of oil to capture natural-resource FDI projects, trade openness (the share of exports plus imports over GDP), and the lagged dependent variable of FDI to capture the effects of FDI in the previous periods (autocorrelation). The regression results are summarized in box table I.3.1.

Based on this model, FDI flows are projected to pick up in 2011 reaching the pre-crisis level mainly due to dynamism in the economic growth of G-20 countries. FDI inflows are expected to reach the peak level of 2007 in 2013 (box table I.3.2).

However, the results of the model are based mainly on economic fundamentals and do not take into account the various risk factors mentioned in the Report. This is due to difficulties in quantifying them.

Source: UNCTAD.

[a] The only exception is Latin America and the Caribbean, where the countries included represent around 70 per cent of FDI inflows. Lower coverage is due to the absence of macroeconomic data for the Caribbean.

Box table I.3.1. Regression results of FDI forecasting model, fixed effects panel regression[a]

Explanatory variable	Coefficients
G20 growth	0.37 (3.87)***
GDP (-1)	0.01 (3.32)***
Openness	0.01 (3.48)***
Oil price (-1)	0.02 (3.9)***
FDI(-1)	0.50 (7.2)***
Constant	-0.63 (-0.58)
R^2	0.81
Observations	1395

Source: UNCTAD estimates, based on UNCTAD (for FDI inflows), IMF (G20 growth, GDP and openness), United Nations (oil price) from the Link project.

[a] The following model $FDI_{jt}=\alpha_0+\alpha_1*G20_t+\alpha_2*GDP_{jt-1}+\alpha_3*Openess_{jt}+\alpha_4*Oil\_price_{jt-1}+\alpha_5*FDI_{jt-1}+\varepsilon_{jt}$ is estimated with fixed effect panel regression using estimated generalized least squares with cross-sections weights. Coefficients computed by using white heteroscedasticity consistent standard errors. Statistical significance at the 1 per cent (***) and 5 per cent (**) levels.

Box table I.3.2. Summary of econometric medium-term baseline scenarios of FDI flows, by groupings
(Billions of dollars)

	Averages				Projections		
	2005-2007	2008-2010	2009	2010	2011	2012	2013
Global FDI flows	1 471 799	1 390 934	1 185 030	1 243 671	1 523 598	1 685 792	1 874 620
Developed countries	967 947	723 284	602 835	601 906	790 183	887 729	1 026 109
Developing countries	444 945	580 716	510 578	573 568	655 800	713 946	749 531
Transition economies	58 907	86 934	71 618	68 197	77 615	84 117	98 980

Source: UNCTAD.

firms increased their profits by 12 per cent over the corresponding period of 2010. For Japan, despite a negative economic growth rate due to the natural disaster, listed firms still achieved profits,[16] and even in the aftermath of the disaster, Japanese firms are vigorously investing abroad (box I.4). Firms now

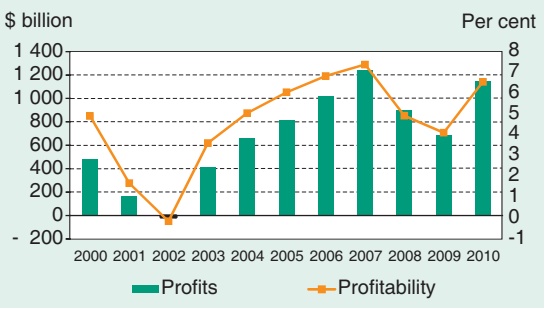
Table I.3. Real growth rates of GDP and gross fixed capital formation (GFCF), 2010–2012
(Per cent)

Variable	Region	2010	2011	2012
GDP growth rate	World	3.6	3.1	3.5
	Developed economies	1.6	1.3	1.7
	Developing economies	7.1	6.0	6.1
	Transition economies	3.8	4.0	4.2
GFCF growth rate	World	5.9	6.5	7.2
	Advanced economies[a]	2.5	4.2	6.2
	Emerging and developing economies[a]	9.6	8.9	8.2

Source: UNCTAD, based on United Nations, 2011 for GDP and IMF, 2011a for GFCF.

[a] IMF's classifications of advanced, emerging and developing economies are not the same as the United Nations' classifications of developed and developing economies.

Figure I.17. Profitability [a] and profit levels of TNCs, 1997–2010
(Billions of dollars and per cent)



Source: UNCTAD, based on data from Thomson One Banker.

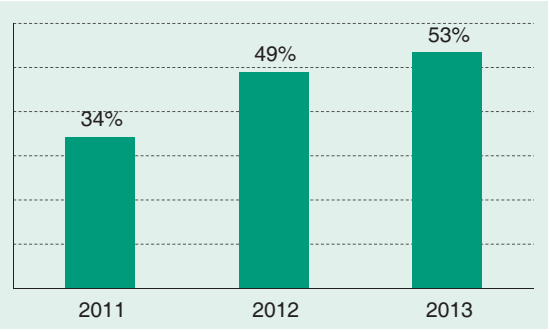
[a] Profitability is calculated as the ratio of net income to total sales.

Note: The number of TNCs covered in this calculation is 2,498.

have record levels of cash holdings. TNCs' sales have also increased significantly as compared to 2009, both globally and for their foreign affiliates (section C).

These improvements at both the macroeconomic and microeconomic levels are reflected in TNCs' opinions about the global investment climate. According to 2011's *World Investment Prospects Survey* (WIPS),[17] TNCs exhibit a growing optimism going towards 2013 (figure I.18). Some 34 per cent of respondents expressed "optimistic" or "very optimistic" views for the global investment environment in 2011, compared to more than half

Figure I.18. Level of optimism of TNCs regarding the investment environment, 2011–2013
(Percentage of responses by TNCs surveyed)



Source: UNCTAD, forthcoming a.

(53 per cent) in 2013. Perhaps more strikingly, the share of TNCs responding that they were "pessimistic" or "very pessimistic" for 2013 fell to 1 per cent.

Responses to the WIPS also suggest strongly the continuing importance of developing and transition economies as destinations for FDI (figure I.19). While the composition of the top five destinations has not changed much in recent years – for example, in 2005 the top five were China, India, United States, Russian Federation, and Brazil – the mix of the second tier of host economies has shifted over time. Reflecting the spread of FDI in developing Asia beyond the top destinations, the rankings of economies such as Indonesia, Viet Nam, and Taiwan Province of China have risen markedly compared to previous surveys. Peru and Chile have likewise improved their position as Latin American destinations, thanks largely to their stable investment climates and strong macroeconomic factors. African countries are conspicuous by their absence from the list of top potential host economies for TNCs.

While improving macro- and microeconomic fundamentals, coupled with rising investor optimism and the strong pull of booming emerging markets, should signal a strong rebound in global FDI flows, risks and uncertainties continue to hamper the realization of new investment opportunities. Such factors include the unpredictability of global governance (financial system, investment regimes,

Box I.4 Effects of the natural disaster on Japanese TNCs and outward FDI

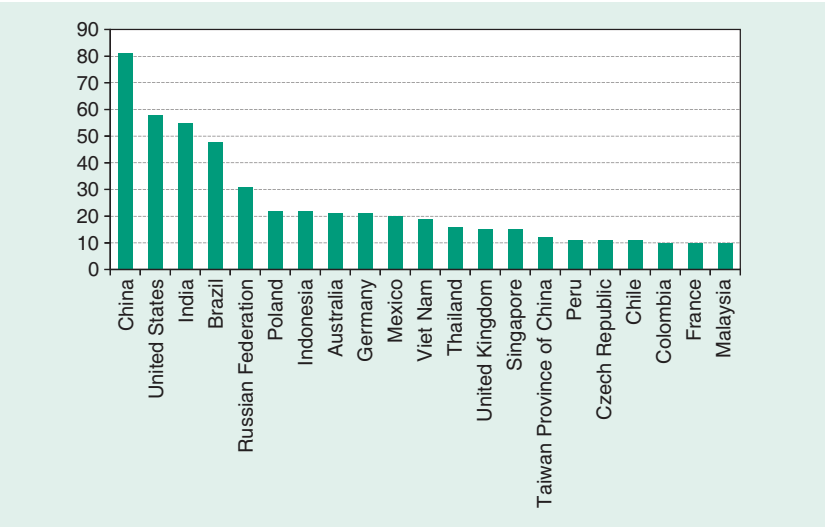
On 11 March 2011, the northern part of Japan experienced a devastating earthquake and tsunami. The region that was most badly affected is home to a number of niche hi-tech companies, all major producers of specialized components (e.g. Renasas Electronics, which controls a 30 per cent share of the global market for microcontrollers). The earthquake itself and the subsequent interruption of power supplies resulted in a severe disruption of supply chains, not only in Japan but internationally. Despite the severity of the damage, by June most of the supply chains had been restored: for example, production at Toyota had recovered to 90 per cent of its pre-earthquake level.

While Japanese firms have shown remarkable resilience, the chain of events has prompted Japanese manufacturers to reconsider their procurement strategies. In a recent survey of Japanese firms by the *Nikkei*,[a] one-quarter of the respondents said that they would increase procurement from abroad, while a further fifth intended to diversify their procurement sources within Japan. The survey indicated that about two-thirds of the firms intended to maintain or increase their level of total investment in the aftermath of this natural disaster.

In the short term, the supply disruption will have reduced the revenues of those foreign affiliates of Japanese TNCs that were affected by supply disruption, and thus their reinvested earning. On the other hand, the temporary loss of revenues might have induced the parent companies of these affiliates to extend intra-company loans. In the medium term, the strategy of diversifying procurement sources could strengthen outward FDI. However, the overall impact of the earthquake on outward FDI from Japan is likely to be limited, especially against the backdrop of buoyant outward FDI through M&A by Japanese firms. Over the long run, Japan will again be a leading investor for outward FDI.

Source: UNCTAD.
[a] Based on a survey of 100 CEOs by the *Nikkei* (29 May 2011).

Figure I.19. Top host economies for FDI in 2011–2013
(Number of times the country is mentioned as a top FDI priority by respondent TNCs)



Source: UNCTAD, forthcoming a.

etc.); the worsening sovereign debt crisis in some developed countries and the resultant fiscal austerity; regional instability; energy price hikes and risks of inflation; volatility of exchange rates; and fears of investment protectionism. Although each can serve as a disincentive to investment in its own right, the prominence of all of these risks at the same time could seriously obstruct FDI globally.

* * *

UNCTAD's WIPS and econometric model projections for FDI flows in the coming years paint a picture of cautious but increasing optimism, with global FDI flows set to increase to between $1.4 and $1.6 trillion in 2011, building upon the modest recovery experienced in 2010. At the high end of that range, FDI flows would be slightly more than the average pre-crisis level, yet would still be below the 2007 peak of $2 trillion. World trade, by contrast, is already back at pre-crisis levels (table I.5).

While the FDI recovery resumes, the worldwide demand for private productive investment is increasing as public investment, which rescued the global economy from a prolonged depression, declines in one country after another. With unsustainably high levels of public debt at both national and sub-national levels in many countries, and with nervous capital markets, governments must now rein in their deficits and let private investment take over the lead role in generating and supporting a sustained recovery.

The FDI recovery in 2010 was slow not because of a lack of funds to invest, or because of a lack of investment opportunities. Responses by TNCs to UNCTAD's WIPS (UNCTAD, forthcoming a) indicate increasing willingness to invest, and clear priority opportunity areas. However, the perception among TNC managers of a number of risks in the global investment climate, including financial instability and the possibility of a rise in investment protectionism, is acting as a brake on renewed capital expenditures.

A number of developed countries, where the need for private investment to take over from dwindling public investment is greatest, are ranked far lower on the investment priority list of TNCs than either the size of their economies or their past FDI performance would seem to warrant. Policymakers from those countries would be well advised to take a lead role among their international peers in continuing to ensure a favourable and stable global investment climate.

B. FDI AS EXTERNAL SOURCES OF FINANCE TO DEVELOPING COUNTRIES

Domestic investment still accounts for the majority of the total investment in developing and transition economies.[18] Foreign investment can only complement this. However, each form of foreign investment plays a distinct and important role in promoting growth and sustainable development, boosting countries' competitiveness, generating employment, and reducing social and income disparities.

Non-FDI flows may work either in association with FDI, or separately from it. As no single type of flow alone can meet investment needs, it is vital to leverage their combinations to maximize their development impact. This section will discuss the development implications of various forms of investment, and the benefits of combining FDI with other sources of external finance, be they private or public.

Foreign investors may finance their activities using a range of instruments in addition to FDI. These have different motivations, behave differently, and consequently have different impacts on development. This makes it necessary to review each instrument and the synergies between them. Differing motivations, characteristics and responses also drive different groups of investors in an enterprise – for instance, private investors (individuals, enterprises, funds etc.) and public investors (e.g. via ODA and other official finance).

The recovery of external capital flows to developing countries is under way, led by FDI. However, caution is needed as to its sustainability, as FDI may be volatile.

There is a sign of continued recovery in capital flows, but caution is needed. Since the first half of 2009, private capital flows to emerging and developing economies have been rebounding, led by FDI, but these remain below their peak of 2007 (table I.4).

However, is the recovery in development finance to developing and transition economies sustainable? The recovery is due to a combination of structural (long-term) and cyclical (short-term) pull and push factors. High expected GDP growth in developing countries is heralding profitable investment opportunities (cyclical pull), while policy frameworks are perceived to be more resilient to future shocks, especially in Asia (structural pull). Developed countries with excess liquidity, thanks to quantitative easing and low interest rates, are motivated to invest in developing countries with relatively higher rates and returns (cyclical push) (Akyuz, 2011; IMF, 2011b).[19] However, there remain concerns about volatility.

First, the capital surge is exposing developing and transition economies to greater instability, putting direct upward pressure on their exchange rates. And the low interest rate environment in developed economies cannot be sustained indefinitely.[20] As a positive sign for emerging and developing economies, FDI has been the main source of inflows during 2009–2010, implying greater stability and a return to confidence for longer-term, productive investment. Less positively, the global recovery may be more fragile, because FDI is relatively less significant this time in developed economies, which are now highly exposed to volatile portfolio and especially other capital elements such as bank loans.

Table I.4. Capital flows to developing countries, 2005–2010
(Billions of dollars)

Type of flows	2005	2006	2007	2008	2009	2010
Total	579	930	1 650	447	656	1 095
FDI	332	435	571	652	507	561
Portfolio investment	154	268	394	-244	93	186
Other investment[a]	94	228	686	39	56	348
Memorandum						
Official grants, excluding technical cooperation	56.9	106.9	76.1	86.4	95	..
Change in reserves	539	647	1 063	774	673	927
Workers' remittances	173	204	245	288	281	297

Source: UNCTAD, based on data from IMF, 2011a (on portfolio, other investment and reserve assets), from UNCTAD (on FDI inflows and workers' remittances) and from the World Bank (on official grants excluding technical cooperation).

[a] Other investments include loans from commercial banks, official loans and trade credits.

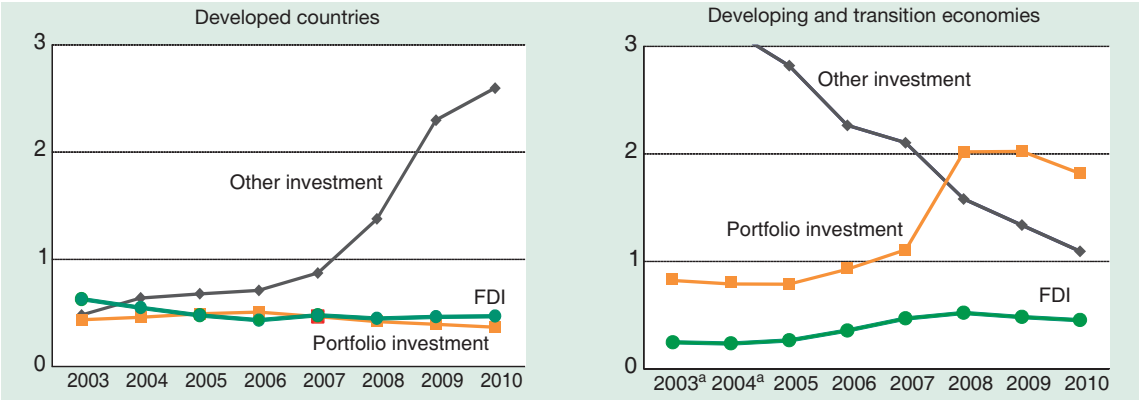
Second, FDI in recent years is gradually becoming more volatile in developing and transition economies, although it remains much less volatile than portfolio and other investments (such as commercial loans and trade credits) (figure I.20). It is argued that this might reflect its changing composition, for example a shift from equity to debt components, which would also make it more sensitive to the changes in United States monetary policy that have triggered previous crises. As a consequence, assumptions about FDI's stability relative to other types of capital should be treated with caution especially for emerging economies (IMF, 2011a), bearing in mind the dramatic rise and fall in FDI inflows to such countries as Brazil ($45 billion in 2008, $26 billion in 2009 and $48 billion in 2010), the Republic of Korea ($8.4 billion in 2008, $7.5 billion in 2009 and $6.9 billion in 2010) and South Africa ($9 billion in 2008, $5.4 billion in 2009 and $1.6 billion in 2010). FDI is also likely to contain some short-term and volatile flows, or "hot money". Stabilization of capital flows now represents an important challenge to many developing countries (box I.5).

Each of the three components of FDI flows (equity investment, reinvested earnings and intra-company loans) has reasons for fluctuation. Intra-company debt generally comes with more flexible terms and conditions than commercial loans, being related more to the decisions of the parent company in order to help its foreign affiliates to expand or cover the running costs during start-up, restructurings, or upswings.[21] Reinvested earnings fluctuate quite significantly, depending on profitability and the level of repatriation from abroad in the form of dividend payments. Although equity investment continues to be the most stable component of FDI, global production chains have changed considerably and it has become much easier for equity to relocate.

Despite the instability of FDI flows in recent years, the fact that net private flows to developing countries remain positive is largely due to FDI: the recovery has not extended yet to all private flows in all regions, and non-FDI flows were negative in many years and regions even during the FDI boom (figure I.21). FDI would therefore appear to be much less volatile than these other private flows (namely private portfolio and private other capital).

All private foreign capital flows – portfolio investment, bank loans and FDI – contribute to development. Thus, the recent crisis, and the nature and inherent fragility of the current upswing, are both matters of concern to developing countries. This makes the role of official development assistance (ODA) very important. ODA is less prone to fluctuations; however, failure by developed countries to meet stipulated objectives has led to deep scepticism about its effectiveness in addressing core development needs of beneficiary countries.

Figure I.20. The volatility of private capital flows, by type, 2003–2010



Source: UNCTAD.
[a] In 2003 and 2004, the value of standard deviation exceeded 3.

Note: The volatility of each type of capital flow is calculated as relative standard deviation for the immediately preceding 10 years. The relative standard deviation of 2010 is based on flows between 2001 and 2010.

Box I.5. FDI and capital controls

Some developing countries are concerned that a surge in capital inflows could exacerbate imbalances and complicate their macroeconomic policies. Against this backdrop, capital controls are back on their policy agenda. The IMF also has now softened its customary stance against capital controls (Ostry et al., 2011), making it easier for some Asian and Latin American countries to introduce measures to restrict short-term, volatile flows, while maintaining the more preferential treatment of long-term capital. In principle, these measures should not affect FDI, as the latter should contain only long-term flows. Reality is more complex, as flows recorded statistically under FDI could encompass some short-term flows.

In 2010, FDI flows rose significantly to some developing countries. In certain cases, the increase of FDI was not necessarily accompanied by investment in fixed assets or cross-border acquisitions. A part of this money might have entered developing host countries for the purpose of short-term capital gains. In countries where FDI inflows exceed considerably the capital expenditures of foreign affiliates, the latter may hold part of the funds received from their parent firms in assets other than immediate investment, for example speculative funds.

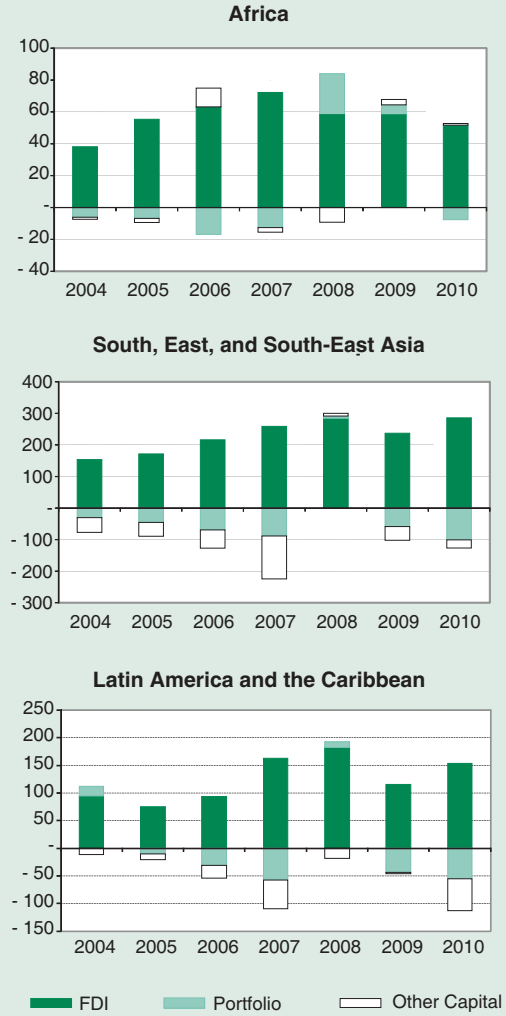
Moreover, short-term speculative flows may be misreported under FDI outflows when they leave the home country, but are not recorded as FDI inflows in host countries as the money transferred is spent instantaneously for speculative purposes, and does not stay long enough in the accounts of foreign affiliates. This kind of money is either reserved for special-purpose entities and financial holding companies, or is invested in real estate and property which may easily be liquidated. Indeed FDI in real estate is rising in many countries, in particular in China (chapter II) and in Latin America – as it at one time was in pre-crisis West Asia. Such misreporting happens because the distinction between long-term capital flows (FDI) and short-term capital flows is increasingly blurred. As a result of the growth of this short-term capital, recently FDI flows have become more volatile than before (figure I.20).

While some speculative short-term private capital flows may have become part of FDI statistics, most continue to be recorded under errors and omissions, as they usually escape being captured in the established items of the balance of payments. In 2009 (the most recent year for which data are available), the value of errors and omissions was equivalent to almost half that of all FDI inflows globally, up from only about 10 per cent in previous years.

As the markets for different types of capital flows are interrelated, the establishment of measures targeting exclusively short-term capital flows is increasingly difficult. Take for example the capital controls introduced in 2009–2010 in the real estate markets of various Asian economies: direct controls to limit the size of flows affected both short- and long-term capital flows (IMF, 2011a).

Source: UNCTAD

Figure I.21. Composition of private capital flows to developing and transition economies, 2004–2010
(Billions of dollars)



Source: UNCTAD, based on data from IMF, 2011a.

C. FURTHER EXPANSION OF INTERNATIONAL PRODUCTION

1. Accelerating internationalization of firms

International production is expanding, with sales, employment and assets of foreign affiliates all increasing (table I.5). UNCTAD estimates that TNCs worldwide, in their operations both at home and abroad, generated value added of approximately $16 trillion in 2010 (figure I.22), accounting for more than a quarter of global GDP. In 2010, foreign affiliates accounted for more than one-tenth of global GDP and one-third of world exports.

International production by TNCs (i.e. value added by foreign affiliates) accounts for around 40 per cent of TNCs' total value added (figure I.22), up from around 35 per cent in 2005. International production networks thus continue to expand, although the rate of growth was slower during the crisis, due to the drop in FDI flows.

This continuing expansion reflects the consistently high rates of return obtained by TNCs on FDI – back up to 7.3 per cent in 2010, after a one-year dip during the crisis (table I.5). Returns are thus back to pre-crisis levels, despite a steady decrease in leverage, as proxied by outward FDI stock over foreign assets. Leverage peaked during the FDI boom years from 2005 to 2007, with the stock (equity) over assets ratio declining from nearly 40 per cent to 25 per cent, but it has since decreased, with the equity/asset ratio climbing up to 36 per cent in 2009 and 2010.

Other indicators of international production also showed positive gains in 2010. Sales of foreign affiliates rose 9.1 per cent, reflecting strong revenues in developing and transition economies. Employment continued to expand, as efficiency-seeking investments expanded during the crisis.

Table I.5. Selected indicators of FDI and international production, 1990–2010

Item	Value at current prices (Billions of dollars)					Annual growth rate or change on return (Per cent)				
	1990	2005–2007 average	2008	2009	2010	1991–1995	1996–2000	2001–2005	2009	2010
FDI inflows	207	1 472	1 744	1 185	1 244	22.5	40.1	5.3	-32.1	4.9
FDI outflows	241	1 487	1 911	1 171	1 323	16.9	36.3	9.1	-38.7	13.1
FDI inward stock	2 081	14 407	15 295	17 950	19 141	9.4	18.8	13.4	17.4	6.6
FDI outward stock	2 094	15 705	15 988	19 197	20 408	11.9	18.3	14.7	20.1	6.3
Income on inward FDI	75	990	1 066	945	1 137	35.1	13.1	32.0	-11.3	20.3
Rate of return on inward FDI [a]	*6.6*	*5.9*	*7.3*	*7.0*	*7.3*	*-0.5*	-	*0.1*	*-0.3*	*0.3*
Income on outward FDI [a]	122	1 083	1 113	1 037	1 251	19.9	10.1	31.3	-6.8	20.6
Rate of return on outward FDI [a]	*7.3*	*6.2*	*7.0*	*6.9*	*7.2*	*-0.4*	-	-	*-0.2*	*0.3*
Cross-border M&As	99	703	707	250	339	49.1	64.0	0.6	-64.7	35.7
Sales of foreign affiliates	5 105	21 293	33 300	30 213[b]	32 960[b]	8.2	7.1	14.9	-9.3	9.1
Value-added (product) of foreign affiliates	1 019	3 570	6 216	6 129[b]	6 636[b]	3.6	7.9	10.9	-1.4	8.3
Total assets of foreign affiliates	4 602	43 324	64 423	53 601[b]	56 998[b]	13.1	19.6	15.5	-16.8	6.3
Exports of foreign affiliates	1 498	5 003	6 599	5 262[c]	6 239[c]	8.6	3.6	14.7	-20.3	18.6
Employment by foreign affiliates (thousands)	21 470	55 001	64 484	66 688[b]	68 218[b]	2.9	11.8	4.1	3.4	2.3
GDP	22 206	50 338	61 147	57 920[d]	62 909[d]	6.0	1.4	9.9	-5.3	8.6
Gross fixed capital formation	5 109	11 208	13 999	12 735	13 940	5.1	1.3	10.7	-9.0	9.5
Royalties and licence fee receipts	29	155	191	187	191	14.6	10.0	13.6	-1.9	1.7
Exports of goods and non-factor services	4 382	15 008	19 794	15 783[d]	18 713[d]	8.1	3.7	14.7	-20.3	18.6

Source: UNCTAD.

[a] Calculated with FDI income for the countries that have the data for both this and FDI stock.

[b] Data for 2009 and 2010 are estimated based on a fixed effects panel regression of each variable against outward stock and a lagged dependent variable for the period 1980-2008.

[c] Data for 1995–1997 are based on a linear regression of exports of foreign affiliates against inward FDI stock for the period 1982–1994. For 1998–2010, the share of exports of foreign affiliates in world export in 1998 (33.3%) was applied to obtain values.

[d] Based on data from IMF, 2011a.

Note: Not included in this table are the value of worldwide sales by foreign affiliates associated with their parent firms through non-equity relationships and of 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 Australia, Austria, Belgium, Canada, Czech Republic, Finland, France, Germany, Greece, Israel, Italy, Japan, Latvia, Lithuania, Luxembourg, Portugal, Slovenia, Sweden, and the United States for sales; those from the Czech Republic, France, Israel, Portugal, Slovenia, Sweden, and the United States for value-added (product); those from Austria, Germany, Japan and the United States for assets; those from Czech Republic, Japan, Portugal, Slovenia, Sweden, and the United States for exports; and those from Australia, Austria, Belgium, Canada, Czech Republic, Finland, France, Germany, Italy, Japan, Latvia, Lithuania, Luxembourg, Macao (China), Portugal, Slovenia, Sweden, Switzerland, and the United States for employment, on the basis of the shares of those countries in worldwide outward FDI stock.

Underlying this improvement in international production has been an acceleration of the internationalization of TNCs – and, indeed, of the initial internationalization of previously non-TNC firms. Three of the major factors driving this "new" burst of internationalization are: first, the crisis caused firms to rationalize their corporate structure and increase efficiencies wherever possible (including the options to close down or to sell to others), often by relocating business functions to cost-advantageous locations; second, the rapid recovery in emerging market economies, compared to the relatively weak response in developed economies, forced many TNCs to embrace these markets, in an effort to protect profits and generate growth; and the rise of emerging market TNCs including State-owned TNCs.

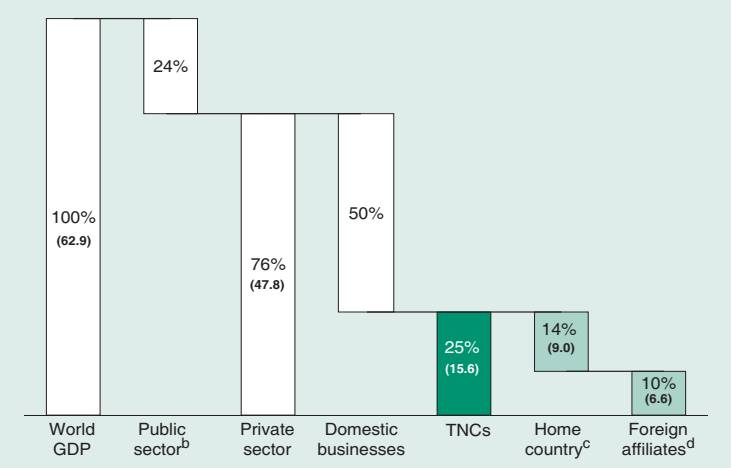
In 2010, foreign activity of the largest non-financial TNCs rebounded, and its share in total activity remained high.

During the economic and financial crisis, many companies embarked on significant layoffs and organizational restructuring in order to remain profitable. For TNCs in developed economies, which make up nearly 80 per cent of the TNCs in the world, and account for some 70 per cent of global FDI outflows, this often meant making cuts in their home economy operations, while moving or opening new facilities abroad to take advantage of specific comparative advantages in those locations. In 2010, foreign activity of the largest non-financial TNCs' rebounded, and its share in total activity remained high. However not all of the largest TNCs increased their internationalization. Financial TNCs, for example, experienced significant difficulties in 2010 (box I.6).

These trends are plainly manifest in the findings of UNCTAD's annual survey of the largest TNCs in the world (table I.6). These firms, predominantly from developed economies, expanded their footprint outside their home countries, registering a continued increase in their foreign assets in 2010. Rising cross-border M&A activity by the largest TNCs, especially targeting strategic firms, has given further momentum to the expansion of foreign assets.[22] Employment and sales also rose both at home and abroad.

The largest TNCs from developing and transition economies experienced subtly differing pressures. Given the tremendous growth registered in many of their home economies, in some cases stoked by significant public stimulus packages, these TNCs struggled to balance responding to growth at home

Figure I.22. TNCs account for one-quarter of world GDP, 2010
(Per cent and trillions of dollars[a])



Source: UNCTAD.
[a] Current prices, current exchange rates.
[b] ISIC L, M, N, Q, X, 92, P (Public administration, Defence, Social security, Health, Sanitation, Community services, Private household employment).
[c] As estimated by the weighted average size of home economies.
[d] Table I.5 in this report.

with long-term internationalization goals and the desire to acquire international brands, technologies, and access to natural resources. Therefore, the share of foreign operations in total activity (i.e. sales and employment) continued to rise (table I.6). These firms continued to expand their balance sheets abroad at a rapid pace, with foreign assets rising 11 per cent in 2009 (the latest year for which data are available) to almost $1 trillion (table I.6).

The rising importance of developing and transition economies

Strong profits of TNCs in emerging markets incentivizes further investments

The crisis drew attention to the importance of developing and transition economies, especially the emerging markets of Brazil, India, China and the Russian Federation (BRICs), as key destinations for both efficiency- and market-seeking investors. Not only are these economies attractive for their lower labour costs, they are also seen increasingly as important markets in their own right. This trend is apparent in both the share of operating profits generated in these economies, and the number of investments targeting them.

Corporate profits, which were slashed by the crisis, have rebounded sharply for many of the largest TNCs in the world (section A). The swift economic recovery of the largest developing economies played an important role in restoring these firms to income growth. In some cases, income from developing and transition economies has grown to account for a significant share of TNCs' operating income. This trend spans industries, with TNCs as varied as Coca-Cola (United States), Holcim (Switzerland), and Toyota Motors (Japan) deriving more than one-third of their operating income from developing economies (figure I.23).

Investment activity by the 100 largest TNCs in the world has now shifted decidedly towards developing and transition economies. Comparing international greenfield projects between 2007–2008 and 2009–2010, the number of projects targeting these economies increased by 23 per cent, compared

Box I.6. Recent trends in internationalization of the largest financial TNCs in the world

Financial TNCs, which accounted for more than 20 per cent of FDI outflows during 2006–2008, have seen their fortunes fluctuate dramatically over recent years. Since the crisis, during which a number were forced into government receivership, they have been stabilizing their situations – as witnessed by the strong rebound in their profits.[a] Nevertheless, the crisis has played havoc with the internationalization programmes of many of the largest financial TNCs. In some cases, firms were forced to consolidate by regulators, or by their new State owners, shifting their focus to domestic markets at the expense of foreign businesses. For example, RBS (United Kingdom), which was saved only by significant government intervention, has sold a number of its foreign assets. Icelandic and Irish banks suffered the same fate. In other cases the crisis hastened previously laid plans, for example Citigroup's (United States) sale of non-retail banking assets in Japan (chapter II).[b]

Given the pressures facing the largest financial TNCs, a slowdown in their internationalization in 2010 was almost inevitable. UNCTAD's measure of the average geographical spread[c] of the 50 largest financial TNCs rose only 1.4 points to 44.9 for the year, compared to 43.5 in 2009. Individual firm performance was mixed, with sharp drops registered by a number of European financial institutions. A number of financial TNCs in the United States also posted declines. Japanese financial TNCs, in contrast, increased their internationalization, making strategic international acquisitions during the crisis.[d]

A new wave of financial industry M&As may materialize in the coming years, but financial TNCs in developed markets may find that their entry into fast-growing developing markets encounters various capital control measures (box I.5). During the crisis, policymakers in many of the largest developing countries, in particular Brazil and China, viewed State-owned financial institutions as important agents of healthy financial markets. Without easy access to the largest and fastest-growing markets, financial TNCs will find it difficult to uphold the long-term rationale for internationalization: balancing the earnings of developed, relatively stable, markets with those of quick-growing, and volatile, developing markets (Schildbach, 2009).

Source: UNCTAD.

[a] "Banking industry posts best quarter of profits since early 2007", *Washington Post*, 25 May 2011.
[b] "Citigroup to sell shares in Japanese brokerage monex", *Bloomberg*, 21 September 2010.
[c] Geographical spread is calculated as the square root of the share of foreign affiliates in total affiliates (the Internationalization Index), multiplied by the number of host economies.
[d] "The big boys are back", *Economist*, 25 September 2008.

Table I.6. Internationalization statistics of the 100 largest non-financial TNCs worldwide and from developing and transition economies
(Billions of dollars, thousands of employees and per cent)

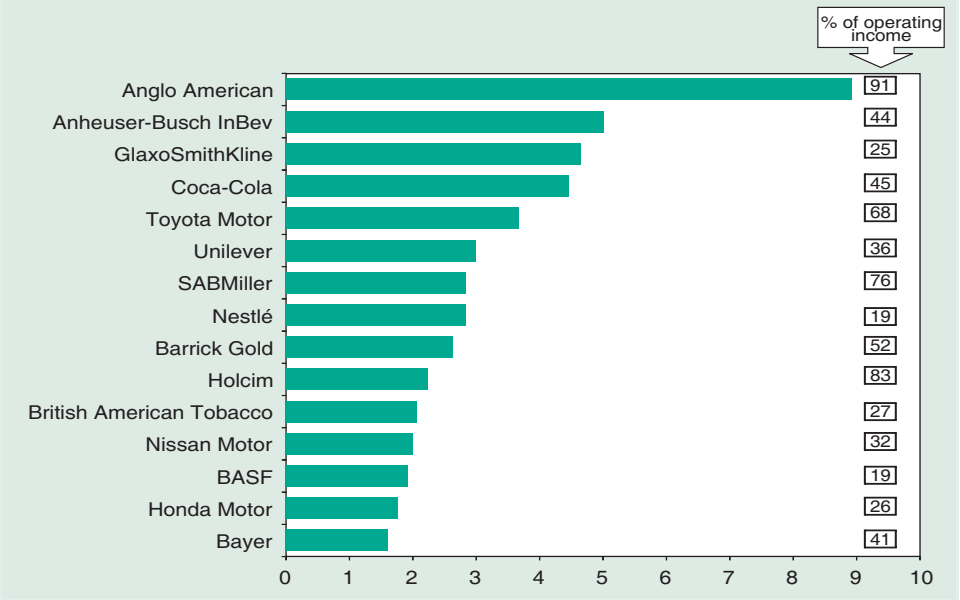
Variable	100 largest TNCs worldwide					100 largest TNCs from developing and transition economies		
	2008	2009	2008–2009 % change	2010[b]	2009–2010 % change	2008	2009	% change
Assets								
Foreign	6 161	7 147	16.0	7 512	5.1	899	997	10.9
Total	10 790	11 543	7.0	12 075	4.6	2 673	3 152	17.9
Foreign as % of total	57	62	4.8 [a]	62	0.3 [a]	34	32	-2.0 [a]
Sales								
Foreign	5 168	4 602	-10.9	5 005	8.8	989	911	-7.9
Total	8 406	6 979	-17.0	7 847	12.4	2 234	1 914	-14.3
Foreign as % of total	61	66	4.5 [a]	64	-2.2 [a]	44	48	3.3 [a]
Employment								
Foreign	9 008	8 568	-4.9	8 726	1.8	2 651	3 399	28.2
Total	15 729	15 144	-3.7	15 489	2.3	6 778	8 259	21.9
Foreign as % of total	57	57	-0.7 [a]	56	-0.2 [a]	39	41	2.0

Source: UNCTAD.
[a] In percentage points.
[b] Preliminary results.
Note: From 2009 onwards, data refer to fiscal year results reported between 1 April of the base year to 31 March of the following year. 2010 data are unavailable for the 100 largest TNCs from developing and transition economies due to lengthier reporting deadlines in these economies.

to only a 4 per cent rise in developed economies. While investments in developing Asia have dominated, growing poles of investment are now discernible in Latin America and in Africa (figure I.24).

Metro AG (Germany) is pursuing growth in both developing and transition economies, opening new stores in the Russian Federation (17), China (7), Kazakhstan (4), and Viet Nam (4) during 2010, while

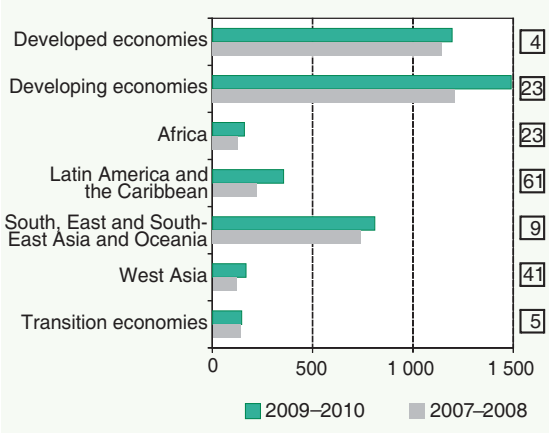
Figure I.23. Operating profits derived from operations in developing and transition economies, selected top 100 TNCs, 2010
(Billions of dollars and share of total operating profits)



Source: UNCTAD.
Note: Regional reporting by TNCs differs, in this case segments that were either completely or mainly located in developing or transition economies were included.

closing stores in developed markets in Europe.[23] General Electric (United States), the world's largest TNC in terms of foreign assets, is also emblematic of this shift, having announced recently that it intends to intensify its focus on emerging markets – which account for 40 per cent of the firm's industrial revenues – in order to reduce costs and increase revenue growth.[24]

Figure I.24. Greenfield investments by the largest 100 TNCs in the world, by host region, 2007–2008 and 2009–2010
(Number of projects and percent change between periods)



Source: UNCTAD.

2. State-owned TNCs

The emergence of State-owned TNCs, especially those from developing economies, as important outward investors, has implications for both home and host economies.

The internationalization of large State-owned enterprises (SOEs) from developing and transition economies constitutes an important component of FDI. State-owned TNCs from developed countries are also extant internationally, albeit not widely recognized. The ownership difference from traditionally private or shareholder-owned TNCs – putatively impacting on their objectives, motives and strategies – has become an issue of intense interest and debate, if not yet of extensive research.

State-owned TNCs are defined as enterprises comprising parent enterprises and their foreign affiliates in which the government has a controlling interest (full, majority, or significant minority), whether or not listed on a stock exchange. Definitions of what constitutes a controlling stake differ, but in this *Report,* control is defined as a stake of 10 per cent or more of the voting power, or where the government is the largest single shareholder. State-owned refers to both national and sub-national governments, such as regions, provinces and cities. Importantly, this definition excludes international investments by SWFs, which have become more visible investors in recent years[25] (see section A.1.e for a review of recent trends in SWF-sponsored FDI), because they are not enterprises and are not necessarily governed by the usual corporate mechanisms. Some illustrative examples of factors determining what constitutes a State-owned TNC – for example, France Telecom, in which the State has a roughly 26 per cent-stake – are included in box I.7.

a. The universe of State-owned TNCs

Relatively small as a group, State-owned TNCs nevertheless rank among the largest TNCs in the world.

In 2010 there were at least 650 State-owned TNCs, with more than 8,500 foreign affiliates, operating around the globe.[26] While this makes them a minority in the universe of all TNCs (see section C.1 for more details), they nevertheless constituted a significant number (19 companies) of the world's 100 largest TNCs of 2010 (also in 2009), and, more especially, of the top 100 TNCs from developing and transition economies of 2009 (28 companies). The largest 15 of these State-owned TNCs, from both developed and developing economies, are a relatively well-known group with recognizable names (table I.7). It is important to note that this enumeration of State-owned TNCs refers only to parent firms, which has the effect of reducing some widespread conglomerates to a single entry. Additionally, a number of the State-owned TNCs are identified such only due to a recent crisis-induced intervention, thus their membership on this list should be considered temporary (General Motors, for example).

Government control of State-owned TNCs spans a spectrum from full control to substantive influence. Roughly 44 per cent of State-owned TNCs are majority-owned by their respective governments (figure I.25). These include companies that are fully

Box I.7. What is a State-owned enterprise: the case of France

In France there is no specific law defining "State-owned" or "State-controlled" enterprises. The economic definition, as given by the French National Institute of Statistics and Economic Studies (INSEE), is as follows: "[a] State-owned enterprise is a company in which the State holds, directly or indirectly, a dominant influence, due to the owning of the property or of a financial participation, by owning either the majority of the capital or the majority of votes attached to the emitted shares." This very broad definition encompasses a large variety of situations and types of company, and should be analysed in terms of "control" rather than mere "ownership". Basically, it is possible to identify four main categories of "State-owned" enterprises falling under the INSEE definition:

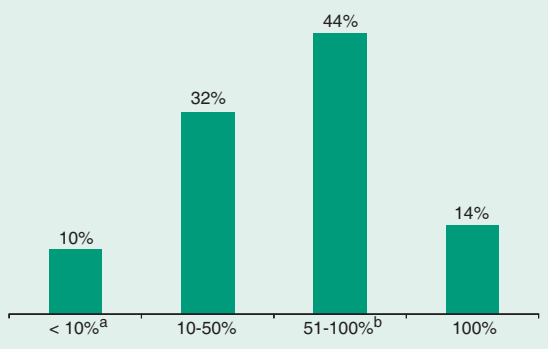
1. Non-listed companies totally owned by the State, the so-called public establishments (Etablissements publics). These firms fill a specific function and may not diversify. Examples include RATP, SNCF, Réseau Ferré de France, Banque de France, etc.
2. Listed companies totally owned by the State.[a] These firms, falling within the legal framework of the "free market", may diversify their activities. The French State's stake may be reduced or eliminated at any time, unless this is prohibited by law in a particular case. Examples include La Poste.
3. Listed companies in which the French State has a stake of more than 50 per cent, allowing it full control of the company's management. Examples include EDF (a former "public establishment"), Aéroport de Paris, and various other large airports and ports in the country.
4. Listed companies in which the French State has a direct or indirect stake of less than 50 per cent. Examples include France Telecom (a former "public establishment", 26 per cent stake) and GDF-Suez (formed through the merger of GDF, a former "public establishment", and Suez, a private firm).

Source: UNCTAD.
[a] This situation is possible when the SOE has to be privatized or become publicly-owned. The State owns 100 per cent of shares before they are sold publicly.

integrated into the State, usually as an extension of a particular ministry, as well as those firms which are publically listed, but in which the State owns more than 50 per cent of the voting shares. For 42 per cent of identified State-owned TNCs, the government had a stake of less than 50 per cent. Of these, 10 per cent had a stake of less than 10 per cent. For these firms the government is often the largest of the minority stakeholders, or holds so-called "golden shares" and therefore exerts a significant or preponderant influence on the composition of the board of directors and the management of the enterprise.

Geographically, 56 per cent of State-owned TNCs worldwide are from developing and transition economies (table I.8). Among these economies, South Africa (54), China (50), Malaysia (45), United Arab Emirates (21) and India (20) are the top five source countries. In developed economies, the majority of State-owned TNCs are located in Europe, especially in Denmark (36), France (32), Finland (21) and Sweden (18). These overall figures, however, belie very different government ownership strategies: for example, South Africa owes its relatively large number of SOEs to investment of public pension funds (through the Public Investment Corporation) in various businesses throughout the domestic economy, resulting in the State taking a stake in a number of firms, though normally a small (less than 15 per cent) stake. State-owned TNCs from China, on the other hand, tend to be more firmly controlled directly by the State, through majority or full-ownership stakes. These numbers

Figure I.25. Ownership structure of State-owned TNCs, 2011
(Per cent of State-owned TNCs by size of government stake)



Source: UNCTAD, based on 653 TNCs.
[a] The State is the largest shareholder or owns golden shares.
[b] Includes those State-owned TNCs where the government stake is unknown, but is assumed to be majority-owned.

Table I.7. The top 30 non-financial State-owned TNCs, ranked by foreign assets, 2009 [a]

(Millions of dollars and number of employees)

Corporation	Home economy	Government stake [b]	Industry [c]	Assets		Sales		Employment		TNI [e] (per cent)
				Foreign	Total	Foreign	Total	Foreign [d]	Total	
Enel SpA	Italy	34.7	Electricity, gas and water	157	231	44	86	43	81	57.2
Volkswagen Group	Germany	20.0	Motor vehicles	156	255	105	146	196	369	61.9
GDF Suez	France	36.4	Utilities (Electricity, gas and water)	146	247	68	111	96	197	56.5
EDF SA	France	84.7	Utilities (Electricity, gas and water)	134	348	40	92	58	169	39.0
Deutsche Telekom AG	Germany	31.7	Telecommunications	113	184	53	90	108	258	54.1
Eni SpA	Italy	30.3	Petroleum expl./ref./distr.	102	169	78	117	40	78	59.2
General Motors Co	United States	32.0	Motor vehicles	76	136	55	105	114	217	53.7
France Telecom SA	France	26.7	Telecommunications	73	133	31	64	64	167	47.0
EADS NV	France	22.4	Aircraft	72	116	54	60	75	120	71.9
Vattenfall AB	Sweden	100	Electricity, gas and water	72	83	22	27	34	40	84.9
Veolia Environnement SA	France	10.7	Utilities (Electricity, gas and water)	52	72	29	48	212	313	66.9
CITIC Group	China	100	Diversified	44	315	11	31	25	125	23.2
Statoil ASA	Norway	67.0	Petroleum expl./ref./distr.	43	97	17	74	11	29	34.4
Deutsche Post AG	Germany	30.5	Transport and storage	39	50	44	67	258	425	68.3
Vale SA	Brazil	5.5 (12 golden shares)	Mining & quarrying	39	102	20	24	13	60	48.2
Petronas - Petroliam Nasional Bhd	Malaysia	100	Petroleum expl./ref./distr.	34	126	28	63	8	41	30.7
TeliaSonera AB	Sweden	37.3	Telecommunications	32	37	10	14	20	29	73.3
Renault SA	France	18.3	Motor vehicles	30	92	29	47	66	121	50.2
Japan Tobacco Inc	Japan	50.0	Food, beverages and tobacco	30	42	29	66	25	50	55.4
Finmeccanica Spa	Italy	30.2	Machinery and equipment	29	44	20	25	32	73	62.7
China Ocean Shipping (Group) Company	China	100	Transport and storage	28	36	18	28	4	72	49.7
Lukoil OAO	Russian Federation	13.4	Petroleum and natural gas	24	79	38	68	22	143	34.0
Singapore Telecommunications Ltd	Singapore	54.4	Telecommunications	23	27	8	12	10	23	64.3
Zain	Kuwait	49.2	Telecommunications	19	20	7	8	12	13	92.1
Qatar Telecom	Qatar	55.0	Telecommunications	18	23	5	7	1	2	78.0
Tata Steel Ltd	India	12.9	Metal and metal products	16	24	16	22	47	81	65.2
Petroleo Brasileiro SA	Brazil	39.8	Petroleum expl./ref./distr.	15	200	29	116	8	77	14.2
Abu Dhabi National Energy Co PJSC	United Arab Emirates	100	Utilities (Electricity, gas and water)	14	25	3	5	3	4	67.2
Petróleos de Venezuela SA	Venezuela, Bolivarian Rep. of	100	Petroleum expl./ref./distr.	12	150	33	75	5	92	19.0
China National Petroleum Corporation	China	100	Petroleum expl./ref./distr.	12	325	5	178	30	1 585	2.7

Source: UNCTAD.

[a] All data are based on the companies' annual reports unless otherwise stated.

[b] Based on most recent data available from Thomson Worldscope (retrieved 31 May 2011).

[c] Industry classification for companies follows the United States Standard Industrial Classification as used by the United States Securities and Exchange Commission (SEC).

[d] In a number of cases foreign employment data were calculated by applying the share of foreign employment in total employment of the previous year to total employment of 2009.

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

Table I.8. Distribution of State-owned TNCs by home region/economy, 2010

Region/economy	Number	Share
World	653	100
Developed countries	285	43.6
European Union	223	34.2
Denmark	36	5.5
Finland	21	3.2
France	32	4.9
Germany	18	2.8
Poland	17	2.6
Sweden	18	2.8
Others	81	12.4
Other European countries	41	6.3
Norway	27	4.1
Switzerland	11	1.7
Others	3	0.5
United States	3	0.5
Other developed countries	18	2.8
Japan	4	0.6
Others	14	2.1
Developing economies	345	52.8
Africa	82	12.6
South Africa	54	8.3
Others	28	4.3
Latin America and the Caribbean	28	4.3
Brazil	9	1.4
Others	19	2.9
Asia	235	36.0
West Asia	70	10.7
Kuwait	19	2.9
United Arab Emirates	21	3.2
Others	30	4.6
South, East and South-East Asia	165	25.3
China	50	7.7
India	20	3.1
Iran, Islamic Republic of	10	1.5
Malaysia	45	6.9
Singapore	9	1.4
Others	31	4.7
South-East Europe and the CIS	23	3.5
Russian Federation	14	2.1
Others	9	1.4

Source: UNCTAD.
Note: While the number is not exhaustive, major SOE investors are covered.

also are dwarfed, in most cases, by the total number of SOEs in each respective economy. For example, there are some 900 SOEs in France, while in China, State sole-funded enterprises and enterprises with the State as the largest shareholder numbered roughly 154,000 in 2008. This suggests that the number and proportion of SOEs that have become transnational is relatively small.

State-owned TNCs tend to be most active in financial services and industries that are capital-intensive, require monopolistic positions to gain the necessary economies of scale, or are deemed to be of strong strategic interest to the country. Roughly 70 per cent of State-owned TNCs operate in the services sector, led by financial services, which accounts for 19 per cent of all State-owned TNCs, transport, storage and communications (16 per cent) and electricity, gas, and water (10 per cent). Some 22 per cent of State-owned TNCs are in manufacturing industries, mainly automotive and transport equipment (4 per cent of all State-owned TNCs), chemicals and chemical products (3 per cent) and metals and metal products (3 per cent) (table I.9). The remaining 9 per cent are located in the primary sector and are mainly active in extractive industries.

Table I.9. Distribution of State-owned TNCs by sector/industry, 2010

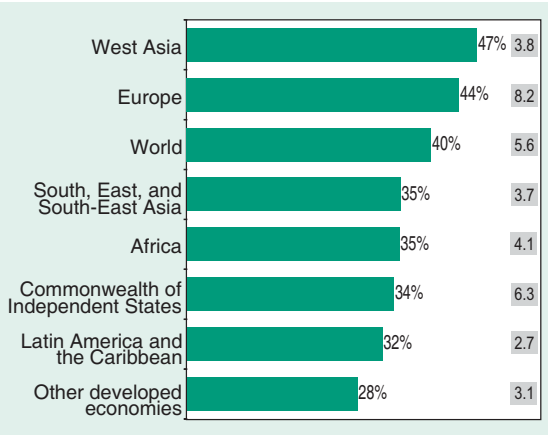
Sector/industry	Number	Share
Total	653	100
Primary	56	8.6
Mining, quarrying and petroleum	48	7.4
Others	8	1.2
Manufacturing	142	21.7
Food, beverages and tobacco	19	2.9
Wood and wood products	12	1.8
Coke, petroleum and nuclear fuel	11	1.7
Chemicals and chemical products	20	3.1
Metals and metal products	20	3.1
Motor vehicles and other transport equipment	27	4.1
Others	33	5.1
Services	455	69.7
Electricity, gas and water	63	9.6
Construction	20	3.1
Trade	42	6.4
Transport, storage and communications	105	16.1
Finance	126	19.3
Holding	27	4.1
Insurance	17	2.6
Rental activities	14	2.1
Business services	18	2.8
Others	23	3.5

Source: UNCTAD.
Note: While the number is not exhaustive, major SOE investors are covered.

The transnationality index (table I.7), and the share of their affiliates located abroad (figure I.26), are each indicative of the internationalization of State-owned TNCs. State-owned TNCs from West Asia show the highest levels of internationalization by the latter measure (the former measure is not available for many developing country State-owned TNCs), with on average 47 per cent of their affiliates being located abroad. Those based in the other major developing regions – Africa, Latin America and the Caribbean, and South, East, and South-East Asia – are less internationalized, with less than half of

their affiliates located in foreign countries. These numbers are, however, very small compared with the internationalization of the world's top 100 TNCs, which on average have roughly 70 per cent of their affiliates abroad, or compared with the largest 100 TNCs from developing countries, which on average have 51 per cent of their affiliates abroad (*WIR08*). The geographical spread of State-owned TNCs' operations appears to be relatively limited: in terms of the number of host economies in which they operate, State-owned TNCs from Europe have a wider footprint (operating in 8.2 foreign economies, on average) compared to their counterparts from developing and transition economies (between 2.7 and 6.3 foreign economies, on average) (figure I.26).

Figure I.26. West Asian State-owned TNCs are more internationalized than others, 2011
(Average internationalization index[a] and average number of host economies)



Source: UNCTAD.
[a] Calculated as the number of foreign affiliates divided by the number of all affiliates.

b. Trends in State-owned TNCs' FDI

Surging FDI by State-owned TNCs, especially those from developing economies, has raised their profile on the global investment scene.

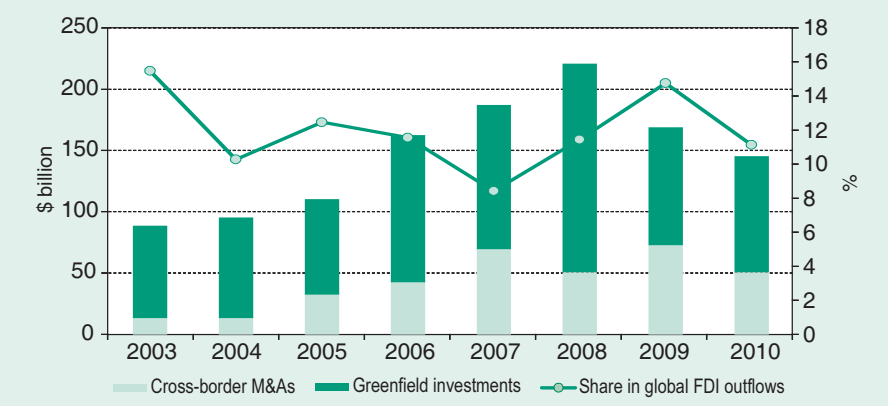
An analysis of FDI projects (including both cross-border M&A purchases and greenfield investments) indicates that State-owned TNCs are active investors around the world.[27] In 2010, their FDI, as measured by the value of these projects, totalled some $146 billion, or roughly 11 per cent of global FDI flows (figure I.27), a higher share than represented by their number in the universe of TNCs (less than one per cent of all TNCs). During 2003–2010, FDI projects by State-owned TNCs made up an average of 32 per cent of total outflows from developing countries. Emblematic of this surge is the number of developing country State-owned TNCs responsible for the largest mega-deals in the past five years (table I.10). Four of the six FDI projects with a value of more than $10 billion (one M&A deal and three greenfield investment projects) were undertaken by developing country State-owned TNCs. While official statistics of the FDI stock controlled by State-owned TNCs do not exist, a rough estimate suggests that in 2010 their share of global outward stock was no less than 6 per cent.[28]

State-owned TNCs as major international investors are a relatively new phenomenon, judging by their cross-border M&A purchases from the early 1980s to 2010. During that period there appear to have been two key phases of activity: first, the period from the early 1980s to the end of the 1990s, when State-owned TNCs from developed countries were more important in FDI flows; and secondly, from the beginning of 2000 onwards, when surging outward FDI by State-owned TNCs from developing economies made up the majority of State-owned TNC FDI flows (figure I.28).

During 2003–2010, a period for which data on both M&As and greenfield investments are available, outward FDI of all State-owned TNCs was tilted towards developing and transition economies (56 per cent of the total) (table I.11). State-owned TNCs from developing and transition economies are significant players in South–South investment flows, investing $458 billion in FDI projects in other developing and transition economies over the period, or slightly more than two-thirds of all FDI projects from those economies ($663 billion). The direction of FDI also differs by mode of investment: in the case of cross-border M&As, two-thirds of such deals conducted by State-owned TNCs worldwide were directed to developed countries; in contrast, developing and transition economies received 68 per cent of total greenfield investment.

Differences by mode of investment and by source also appear in sectoral/industry activity. While

Figure I.27. The value of FDI projects[a] by State-owned TNCs,[b] and its share in total FDI outflows, 2003–2010

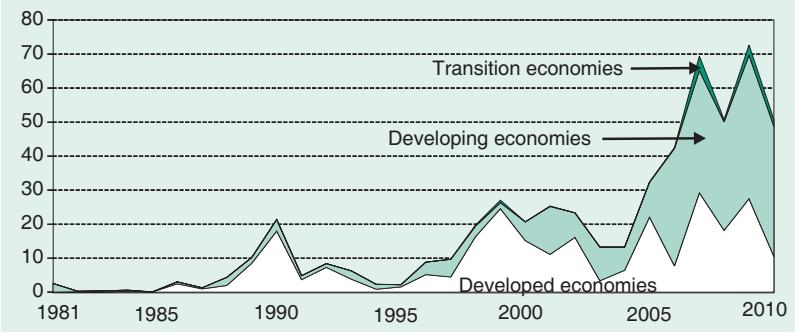


Source: UNCTAD.
[a] Comprises cross-border M&As and greenfield investments. The latter refers to the estimated amounts of capital investment.
[b] Cross-border M&A data refers only to TNCs in which the State has a stake of 50 per cent or more.
Note: The values may be overestimated, as the value of greenfield FDI refers to estimated amount of capital investment of the entire project.

about 40 per cent of State-owned TNCs' FDI projects, in terms of value, are in the primary sector, the shares of manufacturing and services sectors differ somewhat between cross-border M&As and greenfield investments. State-owned TNCs' cross-border M&As between 1981 and 2010 largely targeted extractive industries, utilities, and telecommunications (figure I.29). However, FDI from State-owned TNCs based in developed economies largely focused on utilities (33 per cent of the total), such as electricity, gas and water, and telecommunications (19 per cent); whereas State-owned TNCs from developing and transition economies, in contrast, targeted extractive industries (37 per cent) and telecommunications (20 per cent).

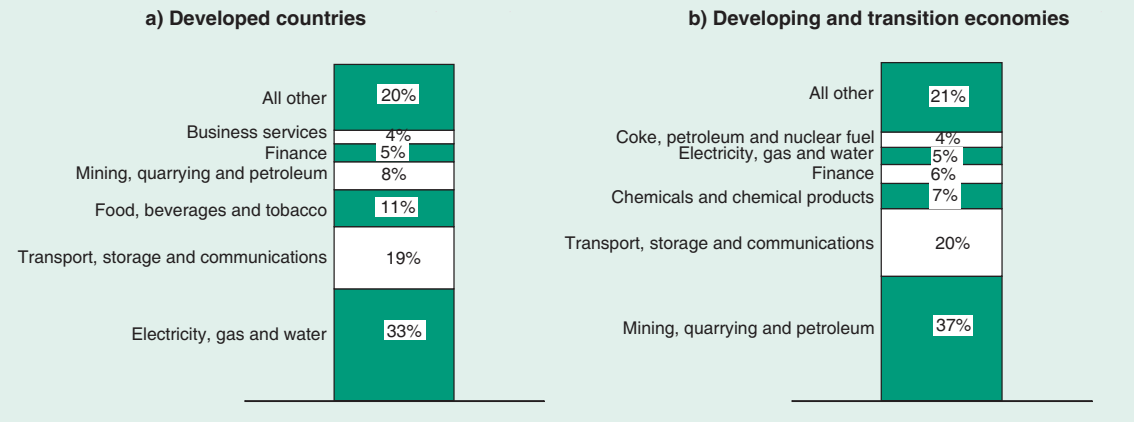
The difference between the patterns of investment by State-owned TNCs from developed as opposed to developing countries reflects, to some extent, the principal actors involved and their differing strategic aims. The most active State-owned TNCs from developed economies are large national utilities, which engage in FDI in order to capitalize on their firm-specific advantages and to generate

Figure I.28. Cross-border M&A purchases by State-owned TNCs,[a] by home region, 1981–2010
(Millions of dollars)



Source: UNCTAD.
[a] Refers only to TNCs in which the State has a stake of 50 per cent or more.

Figure I.29. Cumulative cross-border M&A purchases by State-owned TNCs,[a] by economic grouping of ultimate acquirer and industry of target, 1981–2010
(Per cent)



Source: UNCTAD.
[a] Refers to the TNCs in which the State has a 50 per cent or more stake only.

growth in markets outside their own. In contrast, State-owned TNCs active in extractive industries are more commonly from developing economies. This is largely in keeping with many emerging economies' national goals to secure access to necessary natural resources.

c. Issues related to corporate governance

Corporate governance structures play an important role in determining FDI decisions of State-owned TNCs – raising concerns in host economies.

There is a significant diversity in the behaviour of SOEs around the world, as State-owners differ in their interest and political systems. Even SOEs owned by the same State differ, for instance in their mission, technologies, industry and market context. SOEs may have multiple objectives – for instance, political, social, or cultural, or income redistribution. Many of them were created originally to pursue public policy objectives. These aspects complicate the understanding (in comparison with private companies) of how SOEs operate, the way they are governed and how their relationship with the State plays out.[29]

At a general level, the development of SOEs as TNCs is influenced by the political and economic underpinnings of the country of origin. First, it is important to distinguish between countries where free market policies or interventionism are preponderant. Second, State-owned TNCs' internationalization process may be influenced by the level of development of the country. The less developed a country, it can be argued, the more the State will tend to intervene in SOE management as SOEs become an important tool for the country's development. In some cases the government might hinder FDI by SOEs, as this could reduce their contribution and role (e.g. social, industrial) in the domestic economy; however, in other cases, the State might be willing to support FDI by SOEs as this may help to build economies of scale and/or further develop the competitive position of the firm and that of the home country (e.g. Deng, 2004; Child and Rodrigues, 2005). Third, influencing the possibilities and modalities of SOEs' internationalization are specific government industrial, technological, financial, social and foreign policies.

Thus, it is important to distinguish between cases where the link to the State might either hinder or support SOEs' FDI and performance:

- Government as hindrance to internationalization (e.g. in Italy, where there has been repeated concern about the potential effects of SOEs' internationalization on local unemployment rates).

Table I.10. The 10 largest cross-border M&A purchases and 10 largest greenfield investments by State-owned TNCs, 2006–2010
(Millions of dollars and per cent)

(a) Cross-border M&As

Year	Value ($ million)	Host economy	Acquired company	Industry of acquired company	Ultimate acquiring company	Ultimate home economy	Shares acquired (%)
2009	16 938	United Kingdom	British Energy Group PLC	Electric services	EDF	France	73
2007	14 684	United Kingdom	Gallaher Group PLC	Cigarettes	Japan Tobacco Inc	Japan	100
2007	11 600	United States	GE Plastics	Plastics materials and synthetic resins	SABIC	Saudi Arabia	100
2009	7 157	Switzerland	Addax Petroleum Corp	Crude petroleum and natural gas	Sinopec Group	China	100
2010	7 111	Brazil	Repsol YPF Brasil SA	Crude petroleum and natural gas	Sinopec Group	China	40
2006	6 899	United Kingdom	Peninsular & Oriental Steam Navigation Co	Deep sea foreign transportation of freight	Dubai World	United Arab Emirates	100
2008	6 086	United Kingdom	British Energy Group PLC	Electric services	EDF	France	26
2007	5 483	Italy	FASTWEB SpA	Information retrieval services	Swisscom AG (Swiss Confederation)	Switzerland	82
2009	4 500	United States	Constellation Energy Nuclear Group LLC	Electric services	EDF	France	50
2006	4 388	Hong Kong, China	Hutchison Port Holdings Ltd	Marine cargo handling	PSA Corp Ltd (Ministry of Finance)	Singapore	20

(b) Greenfield investments

Year	Value ($ million)	Host economy	Investing company	Industry of investing company	Home economy
2006	18 725	Pakistan	Emaar Properties PJSC	Real estate	United Arab Emirates
2010	16 000	Australia	Petroliam Nasional Berhad	Coal, oil and natural gas	Malaysia
2007	14 000	Tunisia	Dubai Holding LLC	Real estate	United Arab Emirates
2006	9 000	China	Kuwait Petroleum Corporation	Coal, oil and natural gas	Kuwait
2006	6 000	Turkey	Indian Oil Corporation Ltd	Coal, oil and natural gas	India
2010	5 800	Cuba	China National Petroleum Corporation	Coal, oil and natural gas	China
2010	5 740	Nigeria	China State Construction Engineering Corporation	Coal, oil and natural gas	China
2008	5 000	Morocco	International Petroleum Investment Company PJSC	Coal, oil and natural gas	United Arab Emirates
2010	5 000	Cameroon	GDF Suez SA	Coal, oil and natural gas	France
2008	4 700	United States	AREVA Group	Alternative/renewable energy	France

Source: UNCTAD.

- Government as supporter of internationalization (e.g. China's "Go Global" policy, GCC countries' economic diversification policy (see chapter II.A.3), the Republic of Korea's Overseas Investment Policy Package, and South Africa's outward FDI policies – *WIR06*).
- Government as indifferent to SOE internationalization, but with general support and with greater regard to developmental impact (e.g. Vattenfall (Sweden) in Africa).

In general terms it is argued that the extent to which SOEs are free of, or subject to, government involvement in operational and management matters (including FDI) is critical. Active government participation in SOEs is often regarded as a limit to good economic performance. However, if the degree of autonomy is very high, the SOE could behave just like a private firm, and this may impact on its original mission and public policy role. This situation suggests that although a certain level

Table I.11. Cumulative value of FDI projects[a] by State-owned TNCs[b], by source and target economy, 2003–2010
(Millions of dollars and per cent)

Source economy	Host economy			
(a) By value (millions of dollars)				
	Developed economies	Developing economies	Transition economies	Total
Developed economies	292 109	180 641	45 748	518 498
Developing economies	176 314	394 935	18 826	590 076
Transition economies	28 556	16 916	26 987	72 460
Total	496 979	592 493	91 562	1 181 034
(b) By destination of source economy (per cent)				
	Developed economies	Developing economies	Transition economies	Total
Developed economies	56	35	9	100
Developing economies	30	67	3	100
Transition economies	39	23	37	100
Total	42	50	8	100

Source: UNCTAD.
[a] Comprises cross-border M&As and greenfield investments. The latter refers to the estimated amounts of capital investment.
[b] Cross-border M&A data refers only to TNCs in which the State has a stake of 50 per cent or more.
Note: The value may be overestimated as the value of greenfield FDI refers to estimated amount of capital investment of the entire project.

of State intervention can be good for SOEs' performance, including international diversification, too much State intervention might be detrimental.

The level and mode of FDI by SOEs is also influenced by host country policies that regulate inward FDI. State-owned TNCs might be perceived either favourably or unfavourably, depending on conditions and the attitude of the host country. For example, there are persistent claims of "unfair" competition by State-owned TNCs, as well as concerns about State-owned TNCs as instruments of foreign policy (e.g. Mazzolini, 1980; Mascarenhas, 1989; Anusha and Nandini, 2008; Athreye and Kapur, 2009). Partly in response, host countries – particularly in the developed world – have over the past few years focused attention on developing legal frameworks and processes to provide the necessary instruments for identifying and preventing deemed adverse consequences arising from State-owned TNC investments (e.g. Australia, Canada).

However, there are also countries with more favourable attitudes concerning FDI by foreign SOEs. For instance there are cases in which two States, because they do not yet have established political ties, perceive FDI by their SOEs as a step – among others – towards establishing a closer relationship between them. Examples include the case of Malaysian State-owned TNCs such as Petronas and some African countries, in which investments were often fostered by the Government of Malaysia (*WIR06*). There are also cases in which, because of the already existing strong ties between States, FDI by SOEs is perceived as further strengthening these ties. Their international business operations became part of ODA packages.

Typical potential corporate governance concerns regarding State-owned TNCs are related to their objectives arising from State ownership (which may diverge from the commercial norms), a perceived lower level of transparency, potentially inexperienced boards of directors, and poor relationships with other shareholders and stakeholders.[30] As many SOEs may have no public reporting requirements, and relevant information may only be available to the State, this hinders monitoring, limits accountability and, under some conditions, may create opportunities for corruption.

In light of this situation, the future policy agenda that host governments may wish to deal with revolves around the core differences between State-owned and private TNCs, and focuses on alleviating these concerns:

- National security concerns were particularly prominent when State-owned TNC activity increased in the mid-2000s. It was argued that sometimes their investments would endanger the national security position of any host country. For instance, an acquisition of port management businesses in six major United States seaports in the United States by DP World (UAE) in 2006 came under close scrutiny, because of fears of compromising port security. Political resistance ultimately forced DP World to divest these assets. Explicitly defining and reaching an agreement (between the State and SOE governance) on SOE objectives can help reduce concerns in both host and home countries, clarify management goals, improve performance monitoring, and reduce opportunism.
- Competition concerns may be voiced where foreign investment is deemed a threat to national core industries and "national champi-

ons", but they may also be raised in the context of knowledge and technology transfer issues. A recent controversial case that failed for these reasons concerned a proposed second deal in 2009, in the mining industry, which otherwise would have led to the Aluminum Corporation of China (Chinalco), China's State-owned metals group, purchasing more stake in Rio Tinto (Australia/United Kingdom), a leading global mining company.

- Concerns over governance and social and environmental standards might become more prominent in the future for host countries as investments from State-owned TNCs increase, although such concerns are already being voiced with regard to extractive industries and agriculture. To improve transparency, SOEs are also expected to comply with high standards of accounting and auditing. In reality, less than one-fifth, or 119 firms, of 653 State-owned TNCs in UNCTAD's database subscribe to the United Nations' Global Compact, and only 3 per cent (or 17 firms) use the Global Reporting Initiative (GRI) standards, compared to 60 per cent in both initiatives for the world's top 100 TNCs (UNCTAD, 2011e).[31] The OECD has prepared guidelines regarding provision of an effective legal and regulatory framework (OECD, 2005).

Also, from the perspective of home countries, there are concerns regarding the openness to investment from their State-owned TNCs. Given the current absence of any broader consensus on the future rules of engagement of State-owned TNCs as sources of FDI, it is critical that home and host economies determine and define more clearly the rules and regulations under which State-owned TNCs pursue their investment activities.

This policy agenda determines part of future work in this area. Research should look at how specific government industrial and technological, financial, social and foreign policies influence the possibilities and modalities of SOEs' internationalization. In particular, SOEs' internationalization drivers should be identified and examined, as should be SOEs' FDI impact on key aspects such as employment conditions, technology transfer, market access and environmental issues.

Notes

1 In October–December 2008 the Russian Government provided financial help amounting to $9.78 trillion to the largest Russian companies through the State corporation Bank for Development and Foreign Economic Affairs (Filippov, 2011).

2 Due to unavailability of data on FDI flows (on a balance-of-payments basis) by sector or by country, data on FDI projects (cross-border M&As and greenfield investments) are used in this Report.

3 The acquisition of Solvay Pharmaceuticals (Belgium) by Abbott Laboratories (United States) for $7.6 billion and the takeover of Millipore (United States) by the drug and chemical group Merck (Germany) for $6 billion (annex table I.7).

4 Nestlé, for example, registered a net profit of $34 billion in 2010, while the acquisition of Cadbury (United Kingdom) by Kraft Foods (United States) for $19 billion was the largest deal recorded in 2010 (annex table I.7).

5 Private equity firms are engaged in buying out or acquiring a majority of the existing firms, rather than establishing new companies (greenfield investment).

6 Bain & Company, *Global Private Equity Report 2011*, Boston.

7 Commission of the European Communities, 2009. Directive of the European Parliament and of the Council on Alternative Investment Fund Managers, COM(2009) 207 final, Brussels: European Commission.

8 Public Law 111-202-July 21, 2010, Dodd-Frank Wall Street Reform and Consumer Protection Act.

9 International Working Group of Sovereign Wealth Funds: Generally Accepted Principles and Practices, the Santiago Principles, 8 October 2008.

10 Truman (2011: 11). Note that the size of the SWF universe depends on the qualifying criteria used in the underlying SWF definition. The Monitor Group, for example, includes 33 funds in its Monitor-FEEM SWF Transaction Database. The membership base of the International Working Group for Sovereign Wealth Funds comprises 26 SWFs from 23 countries, managing assets of around $2.3 trillion. The analysis in this report is based on a consolidated universe drawn from these two samples.

11 Some SWFs have acquired large stakes in leading private equity firms, such as the Carlyle Group, Blackstone Group and Apax Partners. A good example for a private equity-SWF investment syndication is the co-ownership of Gatwick Airport by the California Public Employees Retirement System, the Abu Dhabi Investment Authority, the Republic of Korea's National Pension Service, the Australian Future Fund and the private equity firm

Global Infrastructure Partners ("Future fund gets Gatwick go-ahead", *Financial Times*, 20 December 2010).

12 Institute of International Finance, GCC Regional Overview, 29 October 2010.

13 "CIC set for up to $200bn in fresh funds", *Financial Times*, 25 April 2011.

14 Government Pension Fund Global, Annual Report 2009, Oslo: Norges Bank Investment Management, p.22.

15 Based on 600 major companies. *Nikkei*, 12 April 2011.

16 For United States firms, data from Thomson Reuter (*Nikkei*, 10 April 2011) and for Japanese firms, compiled by the *Nikkei* (14 May 2011).

17 This year's survey provides an outlook on future trends in FDI as seen by 205 largest TNCs and 91 IPAs.

18 For detailed discussion on FDI and domestic investment, see UNCTAD, 2010a and 2011a.

19 This is because in home economies, banks are reluctant to lend, as there are concerns about the recovery, heavily indebted consumers have little appetite to borrow or spend, and enterprises facing weak market prospects are discouraged from investing.

20 For example, sudden increases in United States interest rates especially have in the past triggered crises in developing countries, including the debt crisis of the 1980s, and various emerging markets crises of the 1990s.

21 Intra-company loans often have flexible terms and conditions. including low or zero interest rates, and variable grace and maturity periods (Bhinda and Martin, 2009).

22 Examples include a $18.8 billion acquisition of Cadbury (United Kingdom) by Kraft Foods (United States) – the largest M&A deal of the year (annex table I.7).

23 Annual Report 2010, Metro AG.

24 Annual Report 2009, General Electric.

25 TNCs where the State's stake is held by an SWF (e.g. Singapore Telecom – which is majority owned by Temasek, an SWF) are included in the universe of State-owned TNCs.

26 In those cases where it was not possible to fully apply the restriction related to government stakes of less than 10 per cent, the State-owned TNC in question was retained in the count.

27 Due to data limitations, the analysis presented in this section refers to the State-owned TNCs where the State has a 50 per cent or greater stake. This data also excludes FDI projects of SWFs, which are reviewed in section A.1.e.

28 Comparing the cumulative sum of their gross cross-border M&A purchases and greenfield capital expenditures from 2003–2010.

29 A more extensive study on the issue of State-owned TNCs' governance and FDI is ongoing and will be published soon by UNCTAD.

30 At SOE firm-level discussions on governance typically revolve around specific governance decisions, such as who should be appointed as board members and CEO, compensation and incentives for management, amount of reporting and new investments.

31 This 100 TNC list, which is used for the study on CSR (UNCTAD 2011e), includes 14 State-owned TNCs, all of which are signatories to the Global Compact and two use the GRI reporting standard.