

# GLOBAL INVESTMENT TRENDS

## CHAPTER I



## A. GLOBAL TRENDS: THE FDI RECOVERY FALTERS

### 1. Current trends

**The post-crisis FDI recovery that started in 2010 and 2011 has currently stalled, with global FDI flows falling to below the pre-crisis level. The FDI recovery will now take longer than expected.**

Global foreign direct investment (FDI) inflows fell by 18 per cent in 2012, down from a revised \$1.65 trillion in 2011 to \$1.35 trillion. The strong decline in FDI flows is in stark contrast to other macroeconomic variables, including GDP, trade and

employment growth, which all remained in positive territory in 2012 (table I.1).

FDI flows in 2013 are expected to remain close to the 2012 level, with an upper range of \$1.45 trillion. As macroeconomic conditions improve and investors regain confidence in the medium term, transnational corporations (TNCs) may convert their record levels of cash holdings into new investments. FDI flows may then reach the level of \$1.6 trillion in 2014 and \$1.8 trillion in 2015. Nevertheless, significant risks to this scenario persist, including structural weaknesses in the global financial system, weaker growth in the European Union (EU) and significant policy uncertainty in areas crucial for investor confidence.

#### a. FDI by geographical distribution

##### (i) FDI inflows

**In 2012, for the first time ever, developing economies absorbed more FDI than developed countries, with nine developing economies ranked among the 20 largest recipients in the world.**

FDI flows to developing economies remained relatively resilient in 2012, reaching more than \$700 billion, the second highest level ever recorded. In contrast, FDI flows to developed countries shrank dramatically to

\$561 billion, almost one third of their peak value in 2007. Consequently, developing economies absorbed an unprecedented \$142 billion more FDI than developed countries. They accounted for a record share of 52 per cent of FDI inflows

**Table I.1. Growth rates of global GDP, GFCF, trade, employment and FDI, 2008–2014**  
(Per cent)

Variable	2008	2009	2010	2011	2012	2013 <sup>a</sup>	2014 <sup>a</sup>
GDP	1.4	-2.1	4.0	2.8	2.3	2.3	3.1
Trade	3.0	-10.3	12.5	5.9	2.6	3.6	5.3
GFCF	2.3	-5.6	5.6	4.8	3.7	5.0	5.7
Employment	1.1	0.5	1.3	1.5	1.3	1.3	1.3
FDI	-9.3	-33.0	15.8	17.3	-18.2	3.6	17.1
<i>Memorandum:</i>							
FDI value (in \$ trillions)	1.82	1.22	1.41	1.65	1.35	1.40	1.6

Source: UNCTAD based on United Nations for GDP, IMF for GFCF and Trade, and ILO for employment.

<sup>a</sup> Projections.

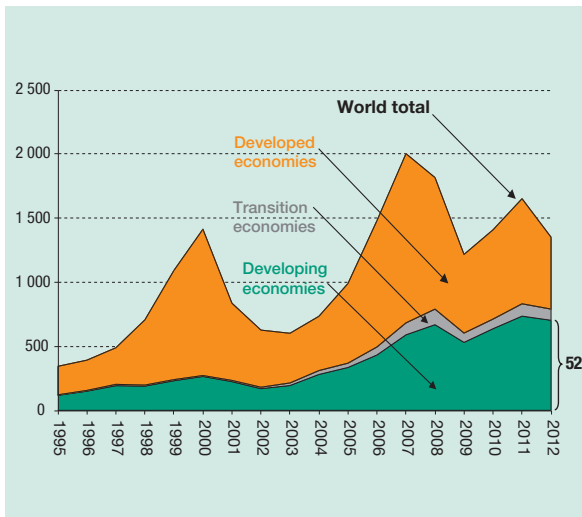
Note: GFCF = Gross fixed capital formation.

in 2012 (figure I.1). The global rankings of the largest recipients of FDI also reflect changing patterns of investment flows. For example, four developing economies now rank among the five largest recipients in the world; and among the top 20 recipients, nine are developing economies (figure I.2).

Among *developing regions*, FDI inflows to developing Asia fell by 6.7 per cent as a result of decreases across most subregions and major economies, including China, Hong Kong (China), India, the Republic of Korea, Saudi Arabia and Turkey. However, 2012 inflows to Asia still attained the second highest level recorded, accounting for 58 per cent of FDI flows to developing countries. FDI inflows to the Association of Southeast Asian Nations (ASEAN) went up by 2 per cent as most countries in this group saw their FDI rise. FDI flows to West Asia declined for the fourth consecutive year: with continuing political uncertainty in the region and subdued economic prospects globally, foreign investors were still wary of making further commitments in the region.

FDI to Latin America and the Caribbean maintained the high levels it reached in 2011, decreasing only slightly, by 2.2 per cent in 2012. The high levels

**Figure I.1. FDI inflows, global and by group of economies, 1995–2012**  
(Billions of dollars)



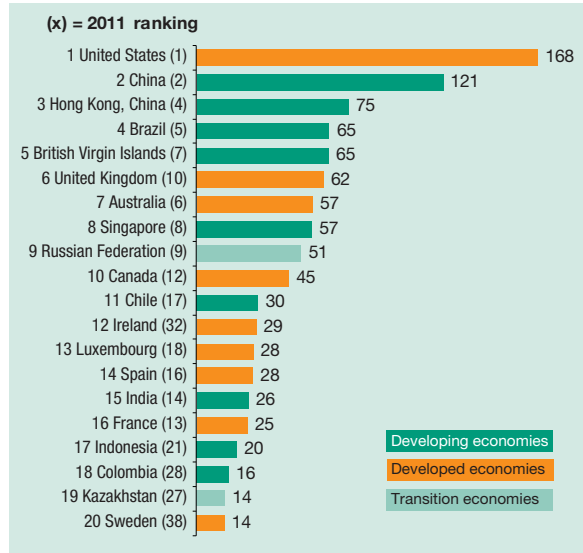
Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

of FDI flows to South America were driven mainly by the region’s economic buoyancy, attracting a significant number of market-seeking investments, and by the persistent strength of commodity prices. This continued to encourage investments in the extractive industries, particularly in Chile, Peru and Colombia. FDI to Brazil slowed but remained robust, elevating the country to the world’s fourth leading investment destination (see figure I.2). FDI flows to Central America decreased, mainly as a result of a decline in flows to Mexico.

Africa was the only region that saw FDI flows rise in 2012 (figure I.3). Flows to North Africa reversed their downward trend, and Egypt saw a rebound in investment from European investors. FDI inflows to sub-Saharan Africa were driven partly by investments in the extractive sector in countries such as the Democratic Republic of the Congo, Mauritania, Mozambique and Uganda. Angola – an important holder of FDI stock in Africa – continued to post divestments in 2012.

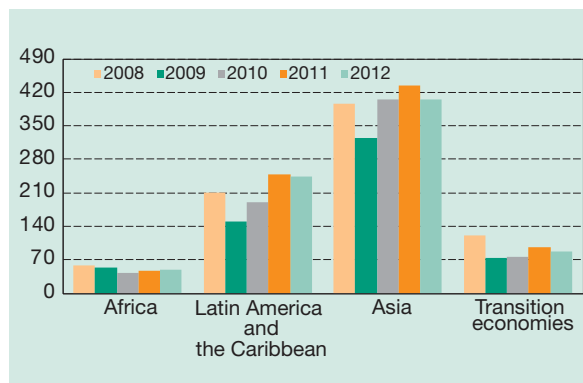
In 2012, the transition economies of South-East Europe and the Commonwealth of Independent States (CIS) saw a decline in FDI inflows, driven in large part by the plummeting value of cross-border mergers and acquisitions (M&As). In South-

**Figure I.2. Top 20 host economies, 2012**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

**Figure I.3. FDI inflows, by region, 2008–2012**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

East Europe, FDI flows almost halved as a result of reduced investment from EU countries, the main investors in the subregion. In the CIS, FDI flows fell only slightly as foreign investors continue to be attracted by these countries’ fast-growing consumer markets and natural resources. The Russian Federation saw FDI flows decline slightly, while those to Kazakhstan and Ukraine rose modestly.

FDI flows declined dramatically to *developed countries* in 2012, falling sharply both in Europe and in the United States. In Europe, Belgium and Germany saw sharp declines in FDI inflows. In Belgium – which, with a drop of more than \$100 billion, accounted for much of the fall – FDI flows are often volatile or inflated by the transactions of special purpose entities (SPEs). Germany posted a large decline of FDI from \$49 billion in 2011 to \$6.6 billion in 2012, owing to large divestments. Taken together, FDI flows to the Southern European countries affected by sovereign debt problems (Greece, Italy, Portugal and Spain) more than halved from 2011. The decline of inflows to the United States is largely explained by the fall in cross-border M&A sales. Despite that fall, the country remained the largest recipient of FDI flows in the world. A few developed countries bucked the trend and saw FDI inflows increase – namely Canada, Ireland, Japan and the United Kingdom – although none of these increases were significant in historic terms. Of note, however, Japan saw positive inflows after two years of net divestments. The return of greater stability and confidence in the Irish economy has revived the activity of TNCs in the country since the crisis.

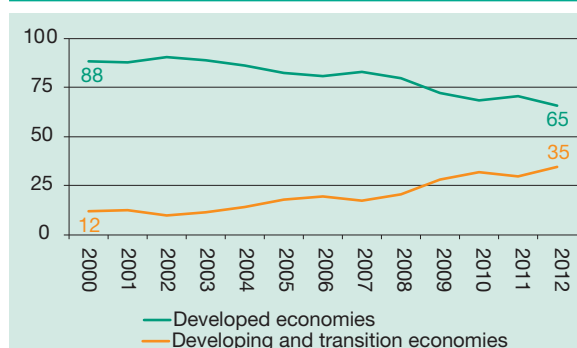
### (ii) FDI outflows

**Investors from developing economies remained bullish in 2012. In contrast, developed-country TNCs continued their wait-and-see approach or heavily divested their FDI assets.**

Global FDI outflows fell by 17 per cent to \$1.4 trillion, down from \$1.7 trillion in 2011. Developed economies, in particular those in the EU, saw their FDI outflows fall close to the trough of 2009, in part because of uncertainty about the euro. In contrast, investors from developing countries continued their expansion abroad. Together, the share of developing and transition economies in global outflows reached 35 per cent (figure I.4). Among developing and transition economies, the BRICS countries (Brazil, the Russian Federation, India, China and South Africa) continue to be important outward investors (box I.1).

In contrast to the sharp decline of FDI flows from developed countries, FDI flows from *developing economies* rose slightly in 2012, amounting to \$426 billion. As a result, their share in global outflows rose

**Figure I.4. Share of major economic groups in FDI outflows, 2000–2012**  
(Per cent)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

to a record 31 per cent. Among developing regions, FDI outflows from Africa nearly tripled, flows from Asia remained unchanged from their 2011 level, and those from Latin America and the Caribbean declined slightly (figure I.5). Asian countries remained the largest source of FDI in developing world, accounting for almost three quarters of the group's total.

The rise in outward FDI flows from Africa in 2012 – to \$14 billion – was mainly due to large flows from South Africa in mining, the wholesale sector and health-care products. In 2012, FDI outflows from developing Asia remained close to the record level of 2011, reaching \$308 billion. China has been one of the main drivers of outflows from Asia. Flows from the Republic of Korea, Malaysia, Saudi Arabia, Thailand and Turkey rose in 2012. In contrast, companies from Hong Kong (China), India and Singapore saw their investments abroad fall from 2011 levels. Outward FDI from Latin America and the Caribbean declined by 2 per cent in 2012, to some \$100 billion. Outflows from Brazil remained restrained by high levels of repayment of intercompany loans by Brazilian affiliates abroad to their parent companies in Brazil. In contrast, Mexico and Chile saw strong increases in their FDI outflows.

Outward FDI flows from *transition economies* declined in 2012, owing to a fall in FDI outflows by Russian investors. Although natural-resource-based TNCs supported by high commodity prices

### Box I.1. Rising BRICS FDI, globally and in Africa

The BRICS countries (Brazil, the Russian Federation, India, China and South Africa) have emerged as not only major recipients of FDI but also important outward investors. Their outward FDI rose from \$7 billion in 2000 to \$145 billion in 2012, or 10 per cent of world flows (up from only 1 per cent in 2000).

Overseas investment by BRICS countries is mainly in search of markets in developed countries or in the context of regional value chains. Over 40 per cent of their outward FDI stock is in developed countries, of which 34 per cent is in the EU (box table I.1.1). Some 43 per cent of outward FDI stock is in neighbouring economies of the BRICS – in Latin America and the Caribbean; transition economies; South Asia; South-East Asia and Africa.

**Box table I.1.1. Outward FDI stock from BRICS, by destination region, 2011**  
(Millions of dollars)

Partner region/economy	Value	Share
World	1 130 238	100
Developed economies	470 625	42
European Union	385 746	34
United States	31 729	3
Japan	1 769	0
Developing economies	557 055	49
Africa	49 165	4
Latin America and the Caribbean	175 410	16
Asia	331 677	29
Transition economies	31 891	3
Memorandum:		
BRICS	28 599	3

Source: UNCTAD FDI-TNC-GVC Information System and data from the IMF, CDIS (Coordinated Direct Investment Survey).

Note: Data for Brazil are based on information from the partner countries.

BRICS countries are becoming significant investors in Africa. Although Africa receives only 4 per cent of BRICS FDI outflows, BRICS countries have joined the ranks of top investing countries in Africa. In 2010, the share of BRICS in FDI inward stock in Africa reached 14 per cent and their share in inflows reached 25 per cent. Their share in the total value of greenfield projects in Africa rose from one fifth in 2003 to almost one quarter in 2012. Most BRICS FDI projects in Africa are in manufacturing and services. Only 26 per cent of the value of projects and 10 per cent of the number of projects are in the primary sector.

*Brazilian* FDI to Africa has been on the rise in recent years, with public financial institutions playing an important role in bringing the country's investors closer to Africa. Among these, the Brazilian Development Bank (BNDES) deserves special mention as its incentives and disbursements to sub-Saharan Africa have increased strongly over the past decade. It has played a key role in the expansion of Brazilian TNCs into the new African ethanol industry, in countries such as Angola, Ghana and Mozambique.

*Chinese* FDI stock in Africa stood at \$16 billion at the end of 2011. South Africa is the leading recipient of Chinese FDI in the continent, followed by the Sudan, Nigeria, Zambia and Algeria. China has joined the ranks of top investing countries in some least developed countries (LDCs), such as the Sudan and Zambia. In addition to resource-seeking FDI, the rapid industrial upgrading currently taking place in China provides opportunities for these countries to attract FDI in manufacturing.

With \$18 billion, *South Africa* was the fifth largest holder of FDI stock in Africa in 2011 and the second largest developing country investor globally after Malaysia. The majority of this outward stock can be attributed to reinvested earnings in the private non-banking sector. The largest share of the country's outward FDI stock in Africa is in Mauritius. One fourth of this stock is also concentrated in Nigeria and in two of South Africa's neighbours, Mozambique and Zimbabwe.

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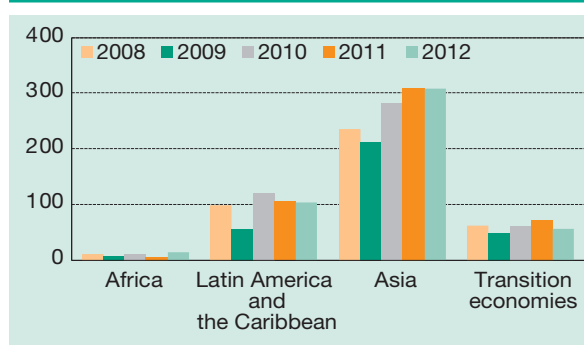
### Box I.1. Rising BRICS FDI, globally and in Africa (concluded)

Indian FDI in Africa has traditionally been concentrated in Mauritius, originally because of ethnic links that led to FDI in the garment industry, but more recently because of the country's offshore financial facilities and favourable tax conditions. As a result, the final destinations of recent investments have often been elsewhere. However, Indian TNCs have recently begun investing in other countries in the region, such as Côte d'Ivoire, Ethiopia, Senegal and the Sudan.

The expansion of Russian TNCs in Africa is fairly recent but has been rapid, reaching \$1 billion in 2011. The arrival of Russian TNCs has been motivated by a desire to enhance raw-material supplies and to expand into new segments of strategic commodities, as well as a desire to access local markets.

Source: UNCTAD.

**Figure I.5. FDI outflows, by region, 2008–2012**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

continued their expansion abroad, the largest acquisitions in 2012 took place in the financial industry.

The global ranking of the largest FDI investors shows the continuing rise of developing and transition economies (figure I.6). Two developing countries now rank among the five largest foreign investors in the world, and for the first time ever, China was the world's third largest investor, after the United States and Japan.

Outward FDI from *developed countries* fell by more than \$274 billion in 2012, which accounted for almost the entire decline in global outflows. Belgium, the United States and the Netherlands saw the largest declines. FDI dropped in 22 of 38 developed economies, including most of the major source countries. The continuing Eurozone crisis appears to have deterred United States investors from investing in Europe, their main target region. European TNCs,

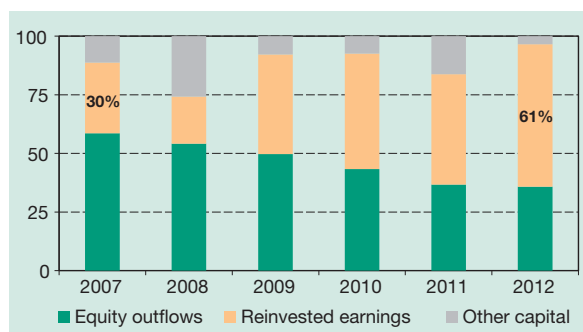
**Figure I.6. Top 20 investor economies, 2012**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

mainly in the financial industry, heavily divested their assets abroad. In contrast, Japan kept up the momentum of the previous year to become the second largest source of FDI worldwide. A growing part of outward FDI from developed countries is made up of reinvested earnings, now a record 61 per cent of the total (figure I.7). While this reflects a growing tendency of developed-country TNCs to finance overseas expansion from foreign earnings, it also reflects the tendency of developed-country TNCs to hold large cash reserves in their foreign affiliates in the form of retained earnings.

**Figure I.7. FDI outflows by components for 37 selected developed countries,<sup>a</sup> 2007–2012**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

<sup>a</sup> Countries included are Australia, Austria, Belgium, Bermuda, Bulgaria, Canada, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States.

Note: Data for reinvested earnings may be underestimated as they are reported together with equity in some countries.

### b. FDI by mode and sector/ industry

**The deterioration of the global crisis hit FDI in all three sectors. Services displayed higher resilience and gained share at the expense of both the primary and manufacturing sectors.**

In 2012 the deterioration of the global economic situation – in particular the deepening of the crisis in the Eurozone and the slowing of growth in the emerging economies – clearly depressed investors'

drive to launch cross-border investment initiatives. Generally speaking, the weakening of global demand and the resulting competitive pressure pushed most operators to turn their focus to the solidity of their balance sheet and the preservation of shareholders' returns rather than on investments and growth. This trend involved both greenfield and M&A projects.

In the absence of published FDI data by sector for 2012, this section relies on data on cross-border M&As and on announced greenfield FDI investments<sup>1</sup> (see web annex tables for FDI by sector and industry in 2011). The estimated capital expenditure of announced greenfield projects fell by 33 per cent compared with 2011, reaching \$600 billion, the

lowest level in the past 10 years (figure I.8). The contraction was even more pronounced in developing economies (-38 per cent), raising additional concerns about the development impact of the downturn.

The value of cross-border M&As declined by 45 per cent, back to levels similar to those of 2009 and 2010 (figure I.8), after the financial crisis had knocked down M&A activity in developed economies.

Compared with the decline in the value of FDI projects, the decline in the number of projects was more moderate (-15 per cent for greenfield projects and -11 per cent for M&A deals). The discrepancy is explained by a significant reduction in the size of projects; specifically, the average investment value decreased by 21 per cent for greenfield projects and 38 per cent for cross-border M&As.

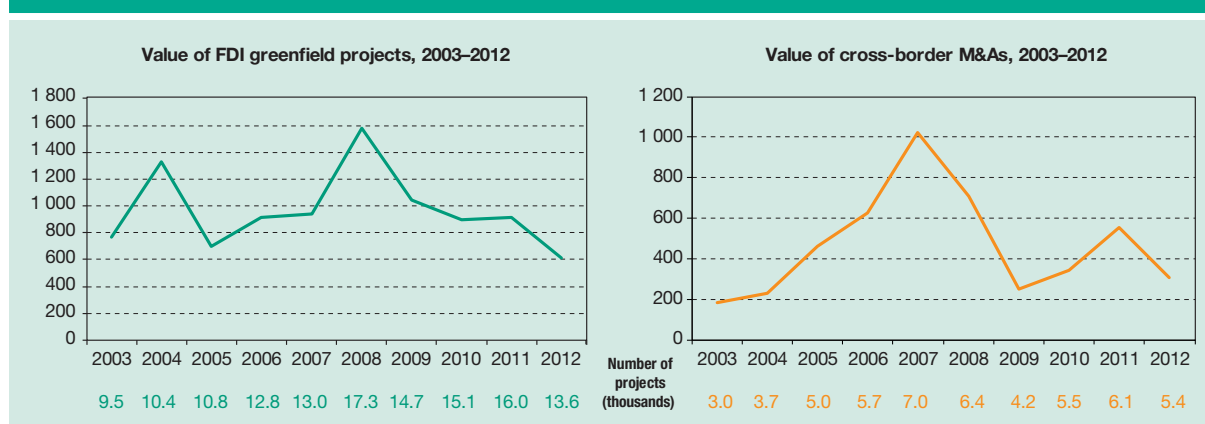
All three sectors were heavily hit by the downturn, although with different intensities (figure I.9).

The *primary sector* was the most heavily hit in relative terms, in both greenfield projects and cross-border M&As. The decline was driven by the downturn in the mining, quarrying and petroleum industry, which represents the bulk of the overall FDI activity in the sector. The contraction was particularly dramatic in developing countries, where the announced value of greenfield projects fell to one fourth of the 2011 value. Similarly, FDI inflows to developing economies generated by cross-border M&A activities plunged from some \$25 billion in 2011 to a slightly negative value, revealing a predominant divestment trend by foreign investors in the sector.

*Manufacturing* was the sector with the largest decrease in FDI project value in absolute terms, originating mainly from a decline in the value of greenfield projects across all three groups of economies – developed, developing and transition economies. The retreat in greenfield project activity is confirmed by a significant decline in the number of such projects, down by 21 per cent globally. By contrast, the decline in the value of cross-border M&As was driven primarily by a decrease in the average deal value, as weak business sentiment – particularly in some developed economies – prevented companies from engaging in large projects.

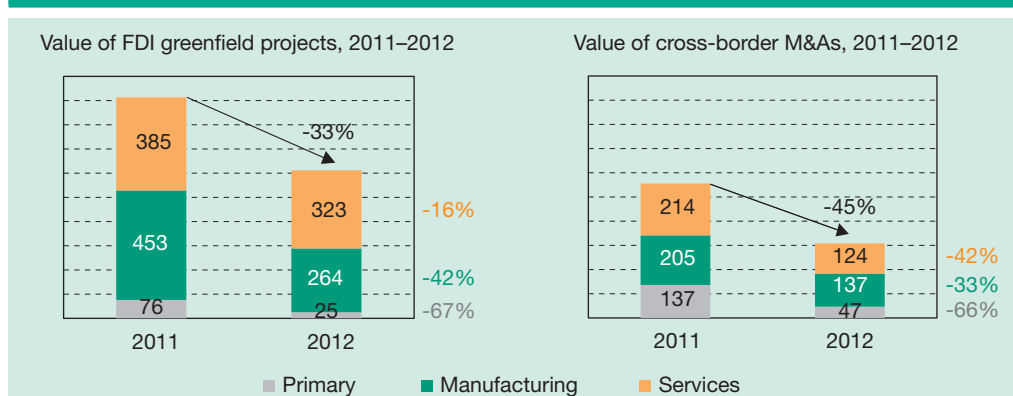
*Services* turned out to be the sector least affected, despite sharing the overall fall with the primary and

**Figure I.8. Historic trend of FDI projects, 2003–2012**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

**Figure I.9. FDI projects by sector, 2011–2012**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

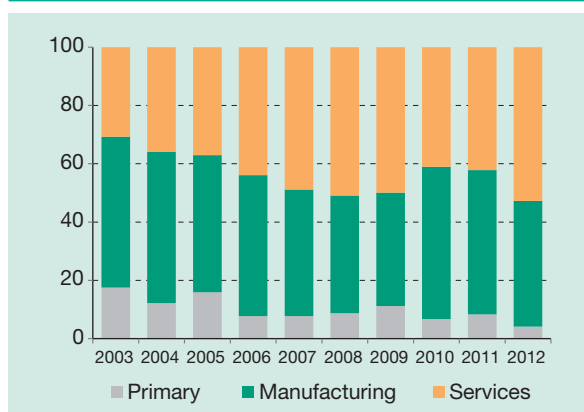
manufacturing sectors. In particular, the relatively limited decrease in the number of greenfield projects (-8 per cent), especially to developing countries (-4 per cent), offers reassurance about the fundamental resilience of highly strategic services industries such as business services, trade, finance and transport. These industries have represented a key FDI growth engine in recent years and also contributed to the creation of a stronger entrepreneurial environment. On the negative side, a significant decrease in the average value of greenfield FDI projects (-16 per cent in developing countries) lowered the level of capital flows considerably. Similar dynamics held

for M&A initiatives, where the fall in value was due primarily to the lower propensity of investors to enter high-value deals rather than to a decline in the volume of activity.

The different sectoral performances changed the composition of the value of FDI projects with some remarkable effects, especially for greenfield projects (see figure I.10). In fact, as the global crisis in some key developed countries worsened and spread from the “financial” to the “real” sphere, the manufacturing sector lost ground to the services sector. The long-term trend leading



**Figure I.10. Distribution of the value of greenfield investment projects, by sector, 2003–2012**  
(Per cent)



Source: UNCTAD based on information from the Financial Times Ltd, fDi Markets ([www.fDimarkets.com](http://www.fDimarkets.com)).

to the dominance of services activity in FDI was reinforced, though its amount declined. Also, growing marginalization trend of the primary sector seems to have picked up, with the sector's share in announced greenfield projects declining to some 4 per cent, corresponding to half of its 2011 share and less than one fourth of its 2003 share.

Although the impact of the crisis was widespread, across the spectrum of productive activities, clear

differences became apparent in how individual industries were affected (figure I.11).

*Mining, quarrying and petroleum*, representing by far the bulk of the primary sector, was heavily hit by falling commodity prices and declining demand. Manufacturing industries that are closely linked upstream to extractive activity were exposed to similar adverse industrial dynamics, resulting in a comparably poor FDI performance. In fact, the three industries in which FDI declined most in 2012 were *mining, quarrying and petroleum* and two manufacturing industries (*metals and metal products* and *coke, petroleum products and nuclear fuel*) that process extractive material. Together, the three industries accounted for almost 50 per cent of the overall decrease in the value of announced greenfield projects (corresponding to some \$130 billion).

The FDI contraction was particularly dramatic in developing economies, where the already unstable market environment was further complicated by the changes of the investment climate in some countries rich in natural resources.

On the M&A side, the FDI picture confirms a pessimistic investment outlook for the extractive

**Figure I.11. Ten industries with the largest declines in greenfield FDI projects in 2012**  
(Billions of dollars and per cent)

	Loss in value, 2012 vs 2011		Loss in number of projects, 2012 vs 2011	
	\$ billion	Per cent	Number	Per cent
Mining, quarrying and petroleum	51	-67%	76	-46%
Coke, petroleum products and nuclear fuel	46	-69%	71	-49%
Metals and metal products	33	-53%	135	-27%
Electricity, gas and water	26	-28%	116	-30%
Transport, storage and communications	26	-35%	26	-3%
Chemicals and chemical products excl. pharmaceuticals	21	-39%	175	-28%
Motor vehicles and other transport equipment	21	-25%	251	-22%
Electrical and electronic equipment	19	-41%	251	-22%
Business services	15	-21%	94	-3%
Rubber and plastic products	12	-48%	154	-32%
All	302	-33%	2 381	-15%

Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets ([www.fDimarkets.com](http://www.fDimarkets.com)).

industry, characterized by a prevalence of divestments in developing economies as highlighted by the negative value of M&A flows. Specific examples include the divestments of Anglo American PLC of part of its activities in copper ore mining in Chile, for \$2.9 billion, and in other metal ores in South Africa and Zimbabwe, for a total of \$0.7 billion. Another example is the sale by BG Group PLC of a majority stake in the Companhia de Gas de São Paulo in Brazil, valued at \$1.7 billion.

Other manufacturing industries responded differently to the downturn. Consumer industries, such as *motor vehicles and other transport equipment* and *electrical and electronic equipment*, were among those most affected. Because of their highly cyclical nature, they are more affected by weak global demand than are other manufacturing industries. Two factors contributed to depressed demand: the crisis in the Eurozone and the deceleration of growth in emerging market economies, in particular China and India. As weak demand squeezed industry margins, companies increasingly resorted to investment cuts in an attempt to mop up large overcapacity, restore financial strength and save cash. However, some less cyclical manufacturing activities, such as *food, beverages and tobacco* and *pharmaceuticals*, managed to limit FDI losses.

*Industries in the services sector* were more resilient than other industries. For example, *business services* and *transport, storage and communication* managed to preserve their volume of projects despite significant reductions in announced investment value owing to the smaller sizes of individual projects. This shows that international companies were still actively seeking opportunities to expand their service activities, especially into developing countries, though with less aggressive investment operations than in 2011. The decrease in *electricity, gas and water* was confined almost entirely to developed economies, where it reflects the declining demand caused by the current crisis. On a positive note, for the first time since the onset of the crisis in 2008 the *construction* industry registered an increase in both the value and the number of FDI projects, raising hopes for a more structural recovery.

### c. FDI by selected types of investors

This section focuses on international investment by some important new types of investors. It makes a distinction between State-controlled entities (SCEs), including sovereign wealth funds (SWFs), and State-owned enterprises (SOEs), on the one hand, and private equity funds, on the other. From a development perspective, this distinction is important as the primary motivation for SCEs' international investment decisions may be criteria other than financial return, such as strategic industrial development objectives. In practice this distinction may be less important because governments increasingly favour the use of holding companies as a form of ownership, but may have limited involvement in the running of a firm or affiliate. Moreover, investors of all types are increasingly intertwined as the process of globalization becomes more complex and geographically widespread: for example, SWFs are investors in private equity funds.

#### (i) Sovereign wealth funds (SWFs)

In 2012, SWFs were estimated to have \$5.3 trillion worth of assets under management,<sup>2</sup> 80 per cent of which were in the hands of developing economies.

In 2012, there were 73 recognized SWFs globally, 60 per cent of which were established in the past decade; and another 21 countries are considering establishing their own SWFs (Santiso, 2012). UNCTAD has highlighted the role that these funds could play in supporting sustainable development outcomes and, in particular, the further potential for their deployment as development-enhancing FDI in developing countries (e.g. UNCTAD, 2011, 2012).

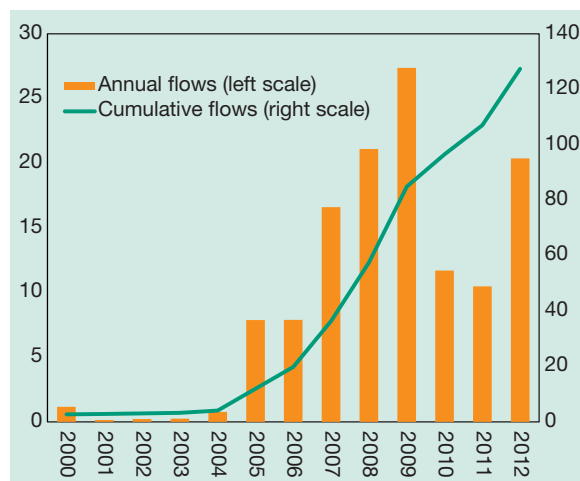
SWF FDI flows doubled in 2012, from \$10 billion to over \$20 billion, bucking the global trend (figure I.12). Cumulative FDI by SWFs, at \$127 billion, nonetheless remains somewhat small as a proportion of total SWF assets under management. However, UNCTAD figures for FDI by SWFs capture only investments in which SWFs are the sole and immediate investors. The data do not include

**FDI by sovereign wealth funds in 2012 remained small at \$20 billion, though it doubled from the year before.**

investments by other entities established by SWFs or those made jointly with other investors. It is likely that total SWF FDI is in fact higher than the figure above suggests.

During the period 2003–2012, cross-border M&As accounted for 89 per cent of SWF FDI, reflecting their position as strategic investment funds, in contrast to the bulk of global FDI, which is invested through greenfield projects. Strategically, the majority of SWF investment through FDI targets the services sector (70 per cent), and in particular finance, real estate, construction and utilities. Finance remains the most popular industry for SWF investment, attracting over \$21 billion in cumulative flows over the period 2003–2012 (figure I.13). Following the large jump in investment by SWFs in the utilities industries in 2011 (electricity, gas and water), the trend continued in 2012, with cumulative flows increasing by 26 per cent. A similar story can be seen in real estate, where cumulative flows leapt by 44 per cent between 2011 and 2012. Despite attracting lower levels of FDI in absolute terms, the transport, storage and communications industries experienced a 81 per cent jump in flows from 2011 to 2012, from \$6 billion to \$11 billion. These trends

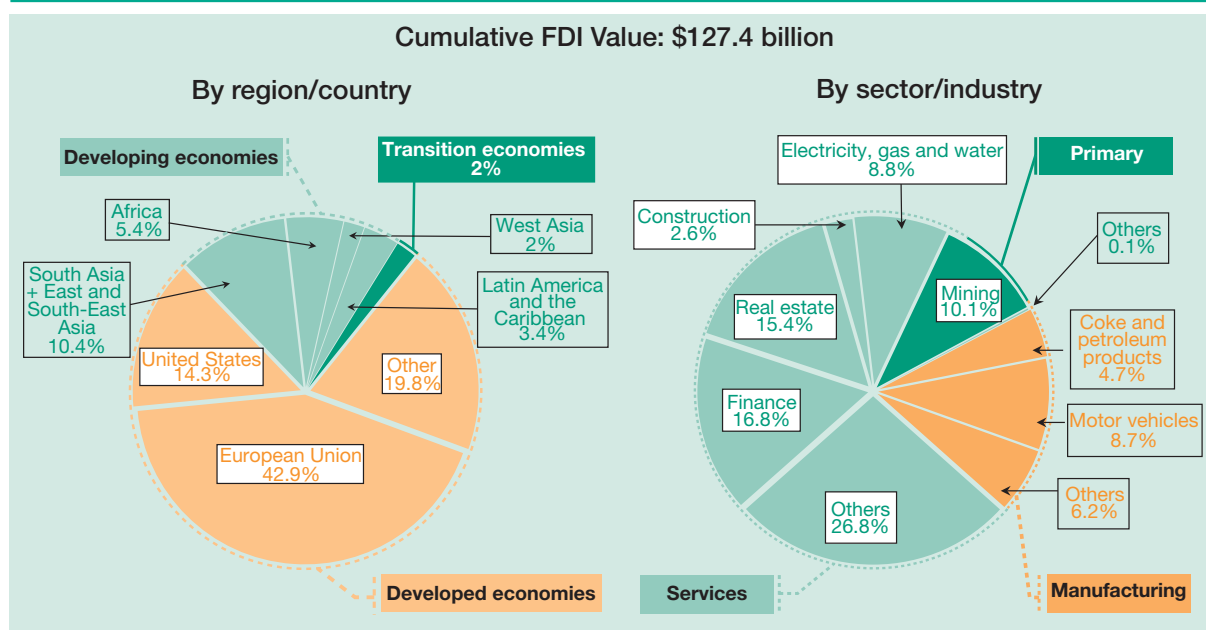
**Figure I.12. Annual and cumulative value of FDI by SWFs, 2000–2012**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

Note: Data include value of flows for both cross-border M&As and greenfield FDI projects and only investments by SWFs which are the sole and immediate investors. Data do not include investments made by entities established by SWFs or those made jointly with other investors. In 2003–2012, cross-border M&As accounted for 89 per cent of total.

**Figure I.13. FDI by SWFs, cumulative value, by region and by sector/industry, 2012**  
(Per cent)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

in non-finance sectors may reflect the changing priorities of SWFs in terms of their investment strategies.

With regard to geographical distribution, the majority of SWF FDI is in developed economies, which received more than 70 per cent of inflows in 2012. Of this figure, Europe accounts for nearly two thirds, but the United States experienced a noticeable jump (39 per cent) in inward SWF FDI. Although cumulative SWF FDI to developing and transition countries increased from 2011 to 2012, the share of these countries in global SWF FDI actually fell, from 25 per cent to 23 per cent. This share has been in constant decline since its high of over 30 per cent in 2008, which may suggest changing SWF investment strategies, in terms of the geographical orientation of their FDI.

In the face of the multitude of complex and unpredictable challenges confronting all countries, long-term financial planning and investment (including overseas) provide countries with a necessary form of self-insurance. Some of the strategic concerns that a government may seek to address through a SWF include correcting currency fluctuation and maintaining macroeconomic stability (as in the case of Brazil's SWF); addressing long-term population changes such as aging; hedging against the existential threat of climate change (one of the reasons that the Government of the Maldives established its SWF); and intergenerational equity and preserving current revenues for future generations (e.g. Norway).

Distinct objectives, motives and approaches of individual SWFs may also have a bearing on their investment decisions in terms of sector, asset class and geographical scope, and different SWFs deploy different investment strategies accordingly. Looking ahead, the increase in the number of countries seeking to establish SWFs means that SWF investments, including FDI, are almost certain to increase in the near future. Although several developed countries, including Italy and France, have established SWFs in the past few years, the main home countries of sovereign investment are likely to remain in emerging markets in the global South. However, it is still not clear how SWF investment potential will be realized as it will probably vary by country and fund.

### *(ii) State-owned enterprises (SOEs)*

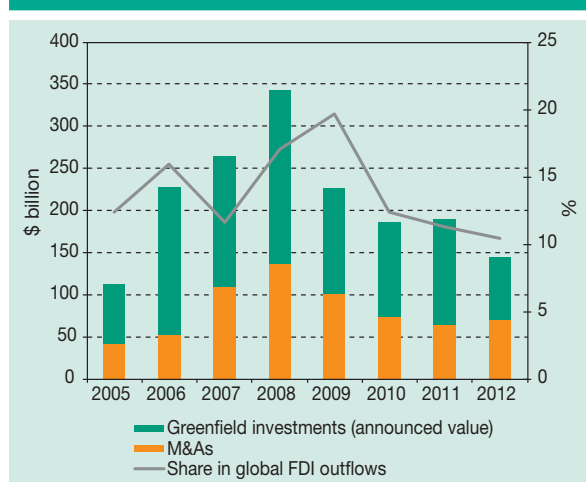
The trend towards liberalization and privatization in the past 30 years has been accompanied by the rising importance of the State in foreign ownership. This is true for SWFs and also for SOEs, which are increasingly internationalizing and becoming leading players in international investment. Although the number of SOEs has been shrinking, their market power has been increasing, in part due to their consolidation into national champions across a range of strategic industries.<sup>3</sup> There are now 18 SOEs among the world's top 100 TNCs. The Chinese State is the largest shareholder in that country's 150 biggest firms, and State companies make up 80 per cent of the stock market value; in the Russian Federation, they account for 62 per cent and in Brazil, 38 per cent. With this increasing market power and financial strength, many SOEs are expanding abroad; indeed, their share of acquisitions in total FDI flows is much greater than the share of SOEs in the total number of TNCs (UNCTAD, 2011).

State-owned TNCs (SO-TNCs) remained important international investors. Their number increased from 659 in 2010 to 845 in 2012, and they account for one tenth of global FDI outflows (figure I.14). Overall, however, FDI by SO-TNCs fell by 23 per cent, from \$189 billion to \$145 billion.

Looking at FDI projects (including cross-border M&A purchases and greenfield investments), SO-TNCs – unlike SWFs – have historically preferred greenfield investment as their dominant mode of entry. Since 2009, however, the value of greenfield projects has been declining significantly relative to the value of M&As. In 2012, greenfield investment appeared to collapse by a further 40 per cent to \$75 billion, or roughly half of all SO-TNC investment. This is in direct contrast to global greenfield investment, which still represents two thirds of all FDI flows despite falling to its lowest level ever in 2012. This trend can be accounted for primarily by SOEs based in developed countries, whose new investments have been seriously affected by the financial crisis.

**State-owned enterprises slowly continued their international expansion, with the value of their cross-border M&As increasing by 8 per cent in 2012, mostly led by developing country firms in pursuit of strategic assets.**

**Figure I.14. Value of FDI projects<sup>a</sup> by SO-TNCs<sup>b</sup> and share in total FDI outflows, 2005–2012**  
(Billions of dollars and per cent)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

<sup>a</sup> Includes both greenfield investments and cross-border M&As. The value of the former dataset refers to estimated amounts of capital investment of the project.

<sup>b</sup> Data cover only SO-TNCs where the state has a 50 per cent or more share.

The absolute value of M&As by SO-TNCs increased by 8 per cent from 2011 to 2012, mirroring the overall rise in M&A activity by TNCs from developing countries, where the majority of global SO-TNC M&As originate. This perhaps also reveals the strategic nature of SOE investments abroad, which seek to acquire technology, intellectual property or brand names, as well as natural resources.

SOEs continue to internationalize, as the number of SO-TNCs has increased significantly in the past two years, to 845 in 2012.<sup>4</sup> Their composition is changing. The relative share of developing and transition country SO-TNCs in the total number of SOEs investing abroad also rose, from 53 per cent of all major SOE international investors in 2010 to over 60 per cent in 2012. Notable home countries include Malaysia, India and the Russian Federation, where the number of SOEs investing abroad has more than doubled since 2010.

The distribution of SO-TNC investment by sector and industry has not changed much in the past two years: the vast majority of SOEs investing abroad (about 70 per cent of firms) are in the services sector – in particular, financial services,

transportation and communications, and utilities (electricity, gas and water). In 2012, the international investment strategies of developed and developing country SO-TNCs continued to reflect the sectors in which their principal SOEs are involved: the most active SO-TNCs from developed countries tend to be utilities; in developing economies, they are more likely to be involved in extractive industries.

### (iii) Private equity funds

Although private equity is considered separately in this section, institutional investors, like government-owned pension funds and SWFs, also participate in private equity funds, which makes public-private distinctions less clear cut.

**Private equity firms engaged in a growing number of M&A deals, though their net FDI fell by 34 per cent.**

Following the crash in private equity investment after the global economic crisis, there was a small recovery in flows from 2009 to 2011. This recovery appears to have come to an end in 2012, with net private equity FDI falling by 34 per cent, from \$77 billion to \$51 billion (table I.2). At the same time, divestment of foreign affiliates by private equity funds increased, illustrated by the growing ratio of net to gross deals, which is the largest on record for which data are available (table I.2). However, while the value of deals fell, the net number of deals involving private equity and hedge funds stood at its second highest level (and the gross number at an all-time high), increasing by 22 per cent from 2011. The period of the mega-deal appears over, but the proliferation in the number of deals last year demonstrates that private equity is still viable, despite being constrained by a less favourable credit environment since the global crisis.

Debt-driven private equity deals – leveraged buy-outs (LBOs) – which peaked just before the economic crisis in 2007 will continue to face refinancing problems in 2014. The favourable credit conditions that characterized pre-crisis debt markets helped fuel the increase in private equity, and in particular highly leveraged acquisitions; post-crisis, credit conditions have become less favourable, partly explaining the fall in the value of LBOs.

A look at the sectoral distribution of cross-border M&As by private equity firms shows a preference for

investment in the services sector, with finance and other services accounting for 74 per cent of all private equity investment (figure I.15). Since 2011, mining, quarrying and petroleum has slightly increased its

share in the distribution of private equity investment, although food, beverages and tobacco has shrunk to its lowest share at less than 1 per cent of total private equity investment, from almost 10 per cent in 2011.

**Table I.2. Cross-border M&As by private equity firms, 1996–2012**

(Number of deals and value)

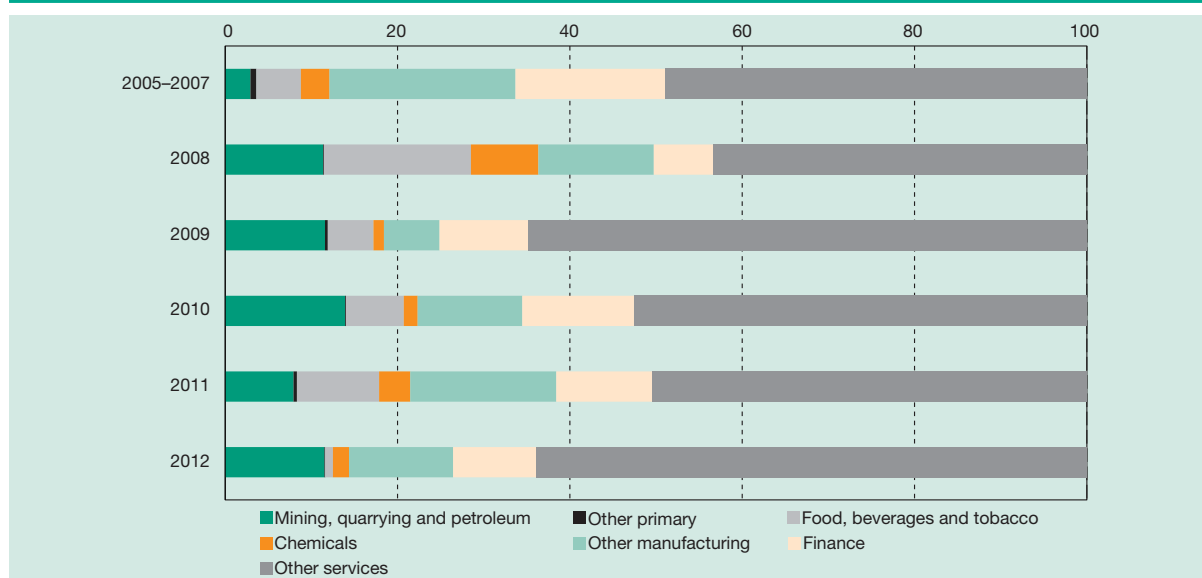
Year	Gross M&As				Net M&As			
	Number of deals		Value		Number of deals		Value	
	Number	Share in total (%)	\$ billion	Share in total (%)	Number	Share in total (%)	\$ billion	Share in total (%)
1996	932	16	42	16	464	13	19	14
1997	925	14	54	15	443	11	18	10
1998	1 089	14	79	11	528	11	38	9
1999	1 285	14	89	10	538	10	40	6
2000	1 340	13	92	7	525	8	45	5
2001	1 248	15	88	12	373	9	42	10
2002	1 248	19	85	18	413	13	28	11
2003	1 488	22	109	27	592	20	53	29
2004	1 622	22	157	28	622	17	76	33
2005	1 737	20	221	24	795	16	121	26
2006	1 698	18	271	24	786	14	128	20
2007	1 918	18	555	33	1 066	15	288	28
2008	1 785	18	322	25	1 080	17	204	29
2009	1 993	25	107	19	1 065	25	58	23
2010	2 103	22	131	18	1 147	21	65	19
2011	2 020	19	153	14	902	15	77	14
2012	2 229	23	182	22	1 104	20	51	16

Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

Note: Value on a net basis takes into account divestments by private equity funds. Thus it is calculated as follows: Purchases of companies abroad by private equity funds (-) Sales of foreign affiliates owned by private equity funds. The table includes M&As by hedge and other funds (but not sovereign wealth 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.15. Cross-border M&As by private equity firms, by sector and main industry, 2005–2012**

(Per cent)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

Note: Not adjusted to exclude FDI by SWFs.

#### d. FDI and offshore finance

**Rising FDI in offshore financial centres (or tax havens) and special purpose entities challenges efforts to increase transparency in international financial transactions and reduce tax avoidance. This global issue requires a multilateral approach.**

Since the beginning of 2008, driven in large part by increased pressure on public finances as a result of the financial crisis, the international community has renewed and strengthened efforts to reduce tax avoidance and increase transparency in international financial flows. For example, improving tax transparency

and promoting information exchange have been key features of deliberations at G-20 summits since their inception. Significant pressure has been put on tax havens by the international community, on individuals and firms by governments, and on multinationals by activist groups to limit their facilitation or use of tax avoidance schemes.

#### Offshore finance in FDI flows and stocks: macro trends

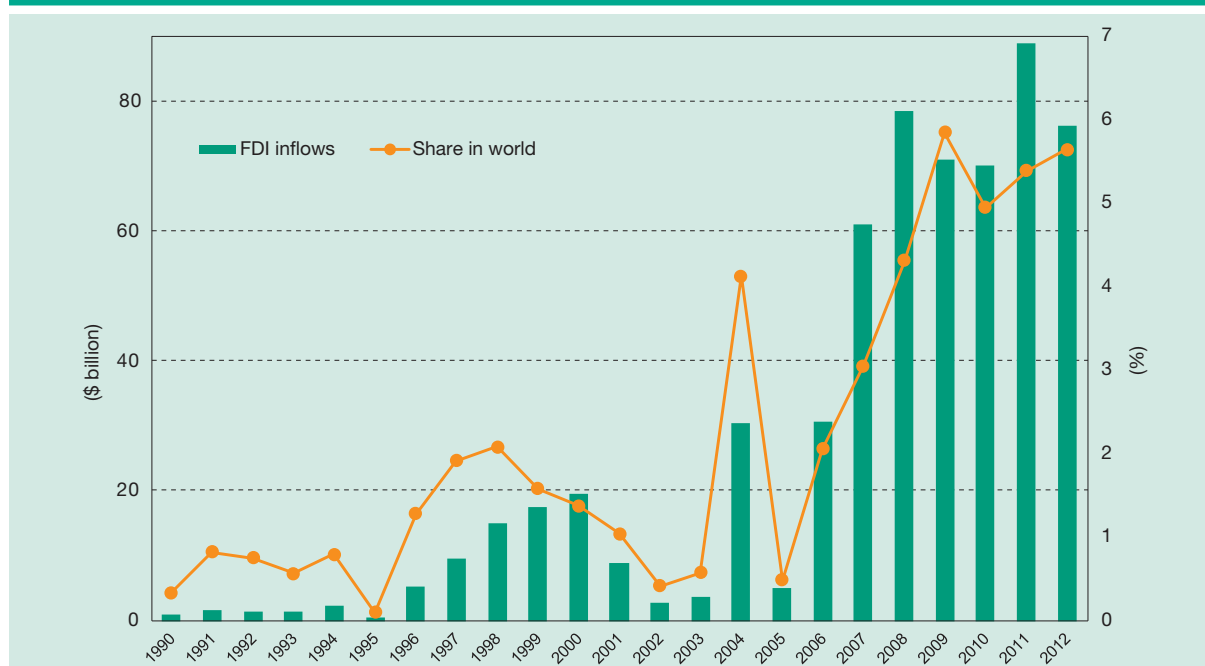
Offshore finance mechanisms in FDI include mainly (i) offshore financial centres (OFCs) or tax havens<sup>5</sup>

and (ii) special purpose entities (SPEs). SPEs are foreign affiliates that are established for a specific purpose (e.g. administration, management of foreign exchange risk, facilitation of financing of investment) or a specific structure (e.g. holding companies). They tend to be established in low-tax countries or in countries that provide specific tax benefits for SPEs. They may not conduct any economic activity of their own and have few employees and few non-financial assets. Both OFCs and SPEs are used to channel funds to and from third countries.

*Investments to OFCs remain at historically high levels.* In 2012 FDI flows to OFCs were almost \$80 billion, despite a contraction of about \$10 billion (-14 per cent) compared with 2011 (figure I.16).<sup>6</sup> Flows to OFCs have boomed since 2007, following the start of the financial crisis. The average annual FDI inflows to OFCs in the period 2007–2012 were \$75 billion, well above the \$15 billion average of the pre-2007 period (2000–2006). Tax haven economies now account for a non-negligible and increasing share of global FDI flows, at about 6 per cent.

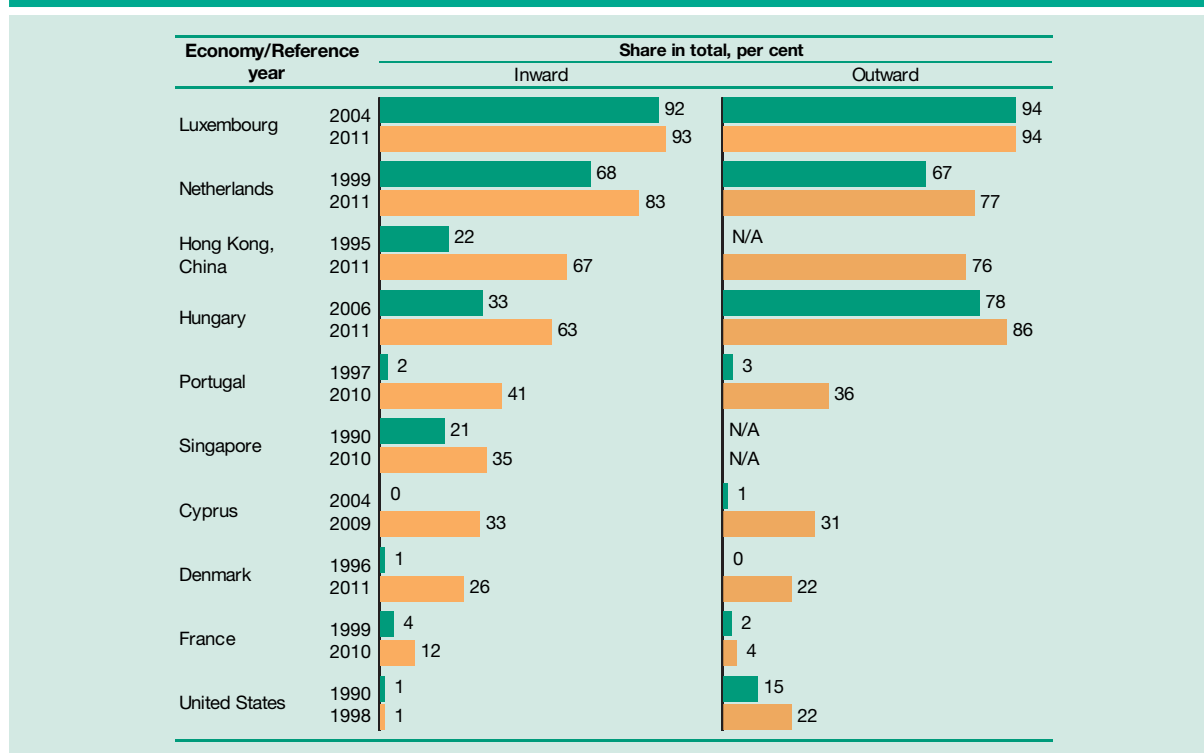
*FDI flows to OFCs do not stay there but are redirected.* A significant part of inflows consists

**Figure I.16. Value and share of OFCs in global FDI flows, 1990–2012**  
(Billions of dollars and per cent.)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

Figure 1.17. FDI stock in financial holding companies, selected economies



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

Note: Data for Hong Kong (China) in 2011 refer to investment holdings, real estate and various business activities.

of “round-tripping” FDI to the original source countries. For example, the top three destinations of FDI flows from the Russian Federation – Cyprus, the Netherlands and the British Virgin Islands – coincide with the top three investors in the Russian Federation (see also the discussion in chapter II.A.6). Such flows are more akin to domestic investments disguised as FDI. The bulk of inflows in OFCs consists of FDI in transit that is redirected to other countries.

Financial flows through SPEs in Luxembourg, the Netherlands and Hungary are not counted in UNCTAD’s FDI data. However, *relative to FDI flows and stocks, SPEs are playing a large and increasing role in a number of important investor countries* (figure 1.17). These entities play a role similar to that of OFCs in that they channel financial flows for investment and redirect them to third countries. Luxembourg and the Netherlands are typical examples of countries that provide favourable tax treatment to SPEs. Over the past decade, in most economies that host SPEs, these entities have

gained importance relative to FDI flows and stocks. This phenomenon is also increasingly involving countries where SPEs had historically played a marginal role, such as Portugal and Denmark. There are no data measuring the extent to which investment in SPEs is directed to activities in the host economy versus activities in other countries, but anecdotal evidence indicates that most is reinvested in third countries. For example, Austrian SPEs, which account for one third of inward FDI stock, are used mostly for investments in Central and Eastern Europe.

*The decision to locate investments in economies that host SPEs is driven by the tax treatment of SPEs and also by double-taxation treaties.* For example, Mauritius, which has concluded a double-taxation treaty with India, has attracted foreign firms – especially those owned by non-resident Indians – that establish holding firms in Mauritius to invest in India. As a conduit for SPE FDI, Mauritius has become one of the largest FDI sources for India.



Although tax considerations are the main driver for the use of OFCs and SPEs, there are other motivations, e.g.:

- They can be used for tax-neutral solutions, for example, for joint venture partners from countries with different tax regimes.
- They can be used for legal neutrality for shareholders dispersed across different jurisdictions.
- They can help firms from countries with weak institutions to set up an international business more easily and to gain access to international capital markets and legal systems.

### **International efforts to reduce tax avoidance and increase transparency, and their effects**

Concrete efforts to combat tax avoidance in international financial transactions, mostly promoted by the OECD, have generally focused on OFCs. However, FDI flows to OFCs do not appear to be decreasing, mainly for two reasons:

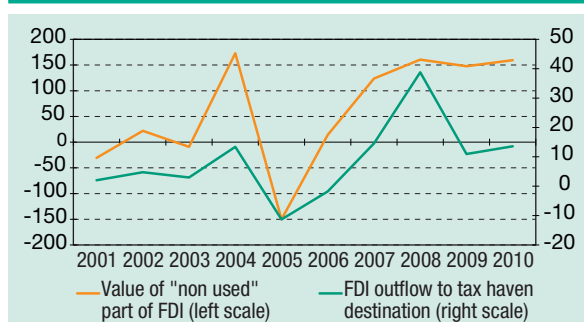
- A key driver of funds flowing to OFCs is the level of overseas cash holdings by TNCs that need to be “parked”. In fact, FDI flows into OFCs mirror the estimated levels of retained earnings by TNCs as shown, e.g. by the parallel effect of the 2005 United States Homeland Investment Act both on retained earnings by United States TNCs and on FDI flows to OFCs (figure I.18). Efforts since 2008 to reduce flows to OFCs

have coincided with record increases in retained earnings and cash holdings by TNCs.

- Any effect of initiatives to reduce flows to OFCs from some countries (OECD members) is being offset by the increasing weight of new FDI players in overall global outflows. FDI flows from the United States to OFCs, for example, decreased by two thirds from \$39 billion to \$11 billion in 2009, and FDI outflows to OFCs from Japan declined from \$23 billion to \$13 billion in the same year, but these reductions were compensated by increased flows from emerging outward investors.

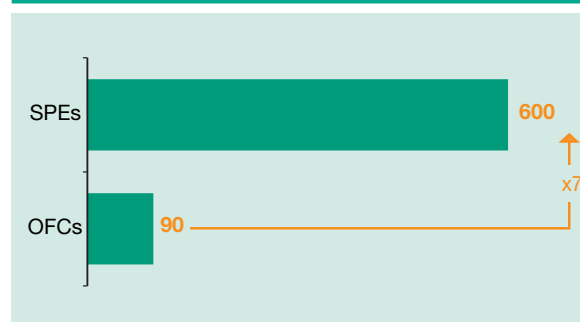
But OFCs are only a small part of the problem. Although most international efforts to combat tax evasion have focused on OFCs, flows through SPEs are far more important. Three countries alone – namely Hungary, Luxembourg and the Netherlands – reported more than \$600 billion in investment flows to SPEs for 2011 compared with \$90 billion of flows to OFCs (figure I.19) (As mentioned above, UNCTAD does not include flows to SPEs in these countries in global FDI flows statistics.) Any change in the use of SPEs, thus, would dwarf variations in OFC flows. And although this section covers only FDI flows and stocks (and not operational data), it is likely that transfer pricing schemes through lower tax jurisdictions not listed as OFCs and without the use of SPEs account for even more tax avoidance.

**Figure I.18. Investments in OFCs and retained earnings by United States TNCs, 2001–2010**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)). See also WIR11, box.1.2.

**Figure I.19. Estimated investment flows to SPEs and OFCs, 2011**  
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

Note: Include only flows to SPEs based in Hungary, Luxembourg and the Netherlands.

### **The way forward: policy considerations**

Possible policy responses are complex, but a number of observations can be made:

- *Tackling OFCs alone is clearly not enough, and is not addressing the main problem.*
- *Engaging emerging new outward FDI players is a must.* An assessment of the role of new outward investors should take into account that their use of OFCs is often not only for tax avoidance but for other potential benefits they cannot obtain in their home economies (e.g. easy company set-up, trade policy advantages, international investment agreements). Also, their relative use of sophisticated alternative tax avoidance mechanisms and SPEs is lower.
- *Tax avoidance and transparency in international financial transactions are global issues that require an intensified multilateral approach.*
- *Ultimately, moves to combat tax avoidance through OFCs and SPEs must go hand in hand with a discussion of corporate tax rate differentials between countries, the application of extraterritorial tax regimes, and the utility of triggering tax liabilities upon repatriation of earnings.* Without parallel action on those fronts, efforts to reduce tax avoidance through OFCs and SPEs remain akin to swimming against the tide. Such a discussion could also include transfer pricing mechanisms beyond OFCs and SPEs, including radical solutions to distribute tax revenues fairly across the operations of TNCs based on real value added produced (e.g. based on a formula including sales, assets and employees, in a unitary approach).
- Policymakers could have a useful discussion on a list of “acceptable” or “benign” non-tax drivers of use of OFCs (and SPEs). That would help focus any future measures on combating the malign aspects of tax avoidance and lack of transparency.
- Finally, investment flows to and from OFCs and SPEs requires attention from policymakers, and monitoring such investment flows is important. International organizations recommend that the data-compiling countries collect detailed information on transactions by SPEs and make

it available separately from traditional FDI data. However, *data remain scarce and the visibility of sources and destinations of FDI funds is marginal.* Further research will be helpful in improving transparency on the issue.

## **2. Global FDI prospects in 2013–2015**

### **a. General FDI prospects**

FDI flows in 2013 are expected to remain close to the 2012 level, with an upper range of \$1.45 trillion. As investors regain confidence in the medium term, flows are expected to reach levels of \$1.6 trillion in 2014 and \$1.8 trillion in 2015 (figure I.20). This scenario is based on various leading indicators, as well as the results of UNCTAD’s World Investment Prospects Survey 2013–2015 (WIPS), an econometric model of forecasting FDI inflows (WIR11), and data for the first four months of 2013 for cross-border M&As and greenfield investment values.

Responses to this year’s WIPS (box I.2) support this scenario. According to this year’s WIPS one half of all respondents remain neutral about the global investment outlook for 2013. However, their expectations for 2014 and 2015 improve sharply (figure I.21). When asked about their intended FDI expenditures, half of the respondents forecast an increase over 2012 levels in each of the next three years. Among the factors positively affecting FDI over the next three years, the two mentioned most were the state of the economy in the BRICS and the United States.

Similarly, the econometric model shows that FDI flows in 2013 are projected to remain almost at the same level or increase slightly at best, reaching their pre-crisis level. Several international organizations and research institutes forecast slightly higher FDI in 2013. For example, the IMF’s current *World Economic Outlook* estimated a moderate increase in net FDI inflows in emerging economies to \$477 billion in 2013 from \$446 billion in 2012 (IMF, 2013). Estimates of net FDI inflows from the Institute of

**Global FDI flows in 2013 are expected to remain at the 2012 level. As investors regain confidence, flows will rise in 2014–2015. However, significant risks remain.**

**Figure I.20. Global FDI flows, 2004–2012, and projections, 2013–2015**  
(Billions of dollars)



Source: UNCTAD FDI/TNC database (<http://www.unctad.org/fdistatistics>).

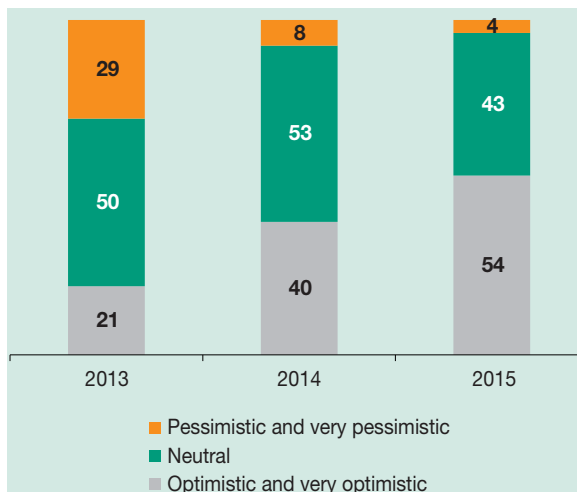
International Finance for 30 emerging economies are \$517 billion in 2013 compared with \$499 billion in 2012 (IIF, 2013).

*Firm-level factors also support the UNCTAD forecast.* Annual TNC profits in 2012 were lower than in 2011 but remained at high levels (figure I.22). There is an indication that in the first quarter of 2013, the level of cash holdings of the largest TNCs has been lower than that in the same period last year, as companies are using part of their available cash to acquire companies abroad. Data on greenfield investment and cross-border M&As in the first few months of 2013 have not indicated an upward trend. This may be translated into higher levels of investment in the near future.

However, significant risks to this growth scenario remain. Factors such as structural weaknesses in the global financial system, the possible deterioration of the macroeconomic environment, and significant policy uncertainty in areas crucial for investor confidence might lead to a further decline in FDI flows.

When asked about the principal factors affecting FDI flows in the medium term, TNCs in the survey

**Figure I.21. TNCs' perception of the global investment climate, 2013–2015**  
(Percentage of respondents)



Source: UNCTAD survey.

Note: Based on 159 company responses.

put the state of the EU economy at the top of their worries, followed closely by political factors, such as the adoption of austerity policies, the rise of trade protectionism, and sovereign debt concerns.

### Box I.2. World Investment Prospects Survey, 2013–2015: methodology and results

The aim of the WIPS is to provide insights into the medium-term prospects for FDI flows. This year's survey was directed to executives among the largest 5,000 non-financial TNCs and professionals working in 245 national and sub-national investment promotion agencies (IPAs). Questions for TNC executives were designed to capture their views on the global investment climate, their companies' expected changes in FDI expenditures and internationalization levels, and the importance their companies give to various regions and countries. IPAs were asked about their views on the global investment climate and which investor countries and industries were most promising in terms of inward FDI.

This year's survey results are based on 159 and 64 validated responses by TNCs and by IPAs, respectively, collected by e-mail and through a dedicated website between February and April 2013. TNCs in developed economies accounted for 79 per cent of responses, while TNCs from developing and transition countries represented 21 per cent of responses. In terms of sectoral distribution, 66 per cent of respondent TNCs were classified as operating in the manufacturing sector, 27 per cent in the services sector, and 7 per cent in the primary sector. For IPAs, 69 per cent of respondents were located in developing or transition economies and 31 per cent were located in developed economies.

Source: UNCTAD.

A number of countries have also implemented a significant number of policies that regulate or restrict investment, bringing the share of such measures to a recent high, although investment liberalization and promotion remained the dominant feature of national investment policies (chapter III).

#### b. FDI prospects by sector/industry

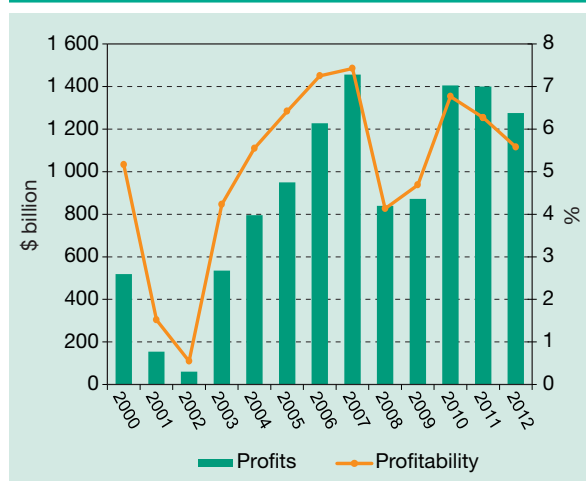
Reflecting the general trend shown by the WIPS survey, TNCs across all major sectors are cautious about the international investment climate in 2013 but more optimistic in the medium term. Short-term FDI plans vary across sectors and industries, with

**FDI expenditures are set to increase, but short-term concerns about the global investment climate are common across industries. Certain manufacturing industries face gloomy short-term prospects.**

respondents from some manufacturing industries such as leather, stone, clay and glass products and metals, as well as from transportation services and metal mining indicating falling investments in the short term. In contrast, more than half of the TNCs active in the remaining manufacturing industries and in the trade and other services industries already foresee an increase in their FDI budgets in 2013. By 2015, almost half of TNCs in all sectors expect to see an increase in their FDI expenditures, in line with their rising optimism for the global investment environment.

On the host country side, the view from investment promotion agencies (IPAs) for inward FDI differs by region (figure I.23). IPAs in developed economies anticipate good prospects for FDI in business services, such as computer programming and consultancy. African IPAs expect further investments in the agriculture sector, while Latin American

**Figure I.22. Profitability and profit levels of TNCs, 2000–2012**  
(Billions of dollars and per cent)



Source: UNCTAD, based on data from Thomson ONE.

Note: The number of TNCs covered in this calculation is 3,039. Profitability is calculated as the ratio of net income to total sales.

IPAs emphasize the extractive industry, tourism and services. Asian IPAs refer to prospects in a wider range of industries for inward FDI, including agriculture, oil and gas, food products, construction and transport. Transition economy IPAs have high expectations for the machinery and textiles industries, most probably positioning themselves as major suppliers to Western European TNCs.

**c. FDI prospects by home region**

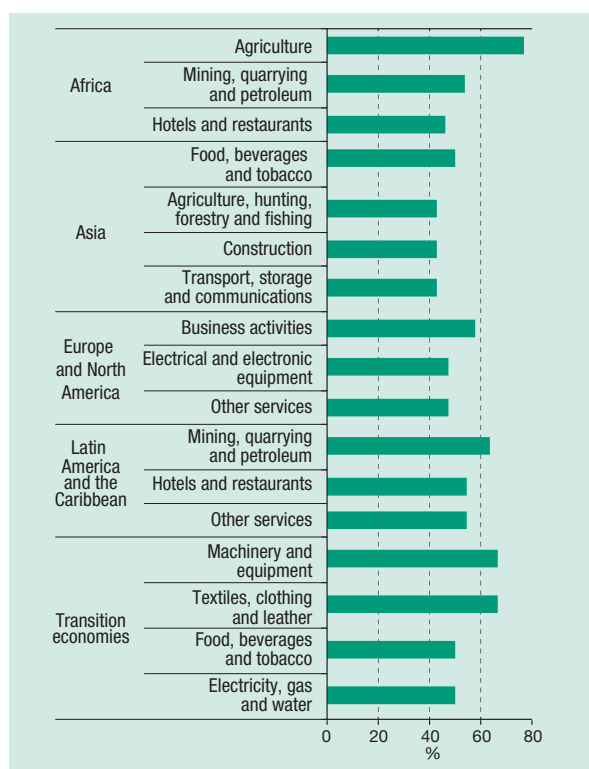
**FDI expenditures are set to expand from both developed and developing home countries.**

Despite uncertainties for 2013, more than half (57 per cent) of respondents from developing countries and about 40 per cent of those from developed countries forecast an increase in their FDI expenditures over 2012 levels. Differences across the two groups of countries

exist, however, when comparing medium-term prospects. In particular, less than 4 per cent of developed-country TNCs expect their FDI budgets to decline in 2015, compared with almost 12 per cent of TNCs from developing countries. A possible trend in the medium term therefore could be a shift back towards developed-country TNCs as main outward investors.

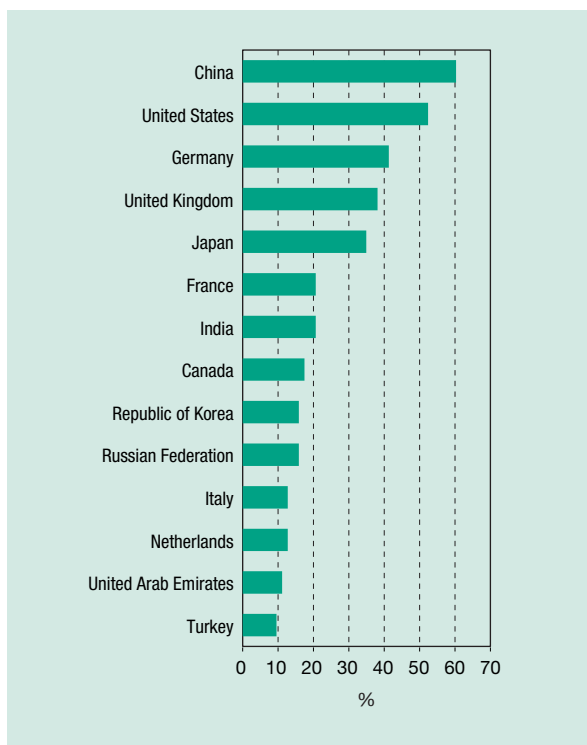
Perhaps anticipating such a prospect, IPAs largely see developed-country TNCs as the most promising sources of FDI in the medium term (figure I.24), although developing economies are becoming more important as investors. Indeed, this year, 60 per cent of IPA respondents ranked China as the most promising source of FDI, thanks largely to the rapid increase of its outward FDI in recent years. The United States, Germany, the United Kingdom, Japan and France ranked as the most promising

**Figure I.23. IPAs' selection of most promising industries for attracting FDI in their own country, 2013–2015**  
(Percentage of IPA respondents)



Source: UNCTAD.  
Note: Based on 64 IPA responses. Aggregated by region of responding IPA.

**Figure I.24. IPAs' selection of most promising investor economies for FDI in 2013–2015**  
(Percentage of IPA respondents selecting economy as top source of FDI)



Source: UNCTAD.  
Note: Based on 64 IPA responses.

developed-economy investors, underscoring their continuing role in global FDI flows. India, the Republic of Korea, the Russian Federation, the United Arab Emirates and Turkey (for the first time) are also seen as major developing country sources of FDI, while Brazil fell out of the ranking, most likely because of last year's slower outflow activity.

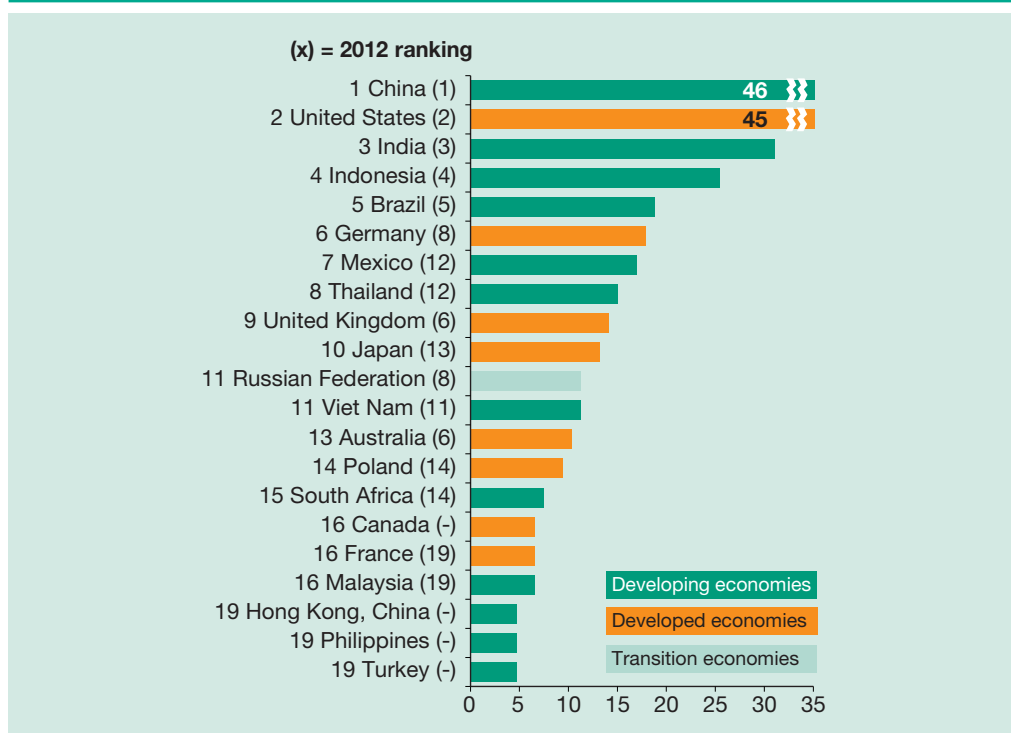
#### d. FDI prospects by host region

##### Developing economies will continue to experience strong FDI inflows in the medium term.

For the medium term, IPAs – regardless of location – exhibited rising optimism in terms of FDI inflows, although those in developing and transition economies were most optimistic. This optimism is not unwarranted. TNCs that respond to the survey have increasingly ranked developing

host regions as highly important. The ranking of the top five host economies is the same as last year, with China leading the list and cited by 46 per cent of all respondents, followed closely by the United States, cited by 45 per cent. Developing countries make up four of the top five host economies (figure I.25). Six of the top 10 prospective host countries also come from the developing world, with Mexico and Thailand appearing for the first time. Among developed countries, Japan jumped three positions largely because of reconstruction efforts after the 2011 tsunami, and recent expansionary monetary policies have together increased the country's attractiveness for foreign investment in the medium term. At the same time, Australia, the Russian Federation and the United Kingdom slipped down the rankings from last year's survey, while Germany gained two positions.

**Figure I.25. TNCs' top prospective host economies for 2013–2015**  
(Percentage of respondents selecting economy as a top destination)



Source: UNCTAD survey.

Note: Based on 159 company responses.

## B. INTERNATIONAL PRODUCTION

### 1. Overall trends

**TNCs' internationalization process grew at a slower pace in 2012, with foreign affiliates' value added and exports rising only moderately.**

International production continues to expand, with all indicators of foreign affiliate activity increasing, although at a slower rate than in earlier years (table I.3). Sales rose 7.4

per cent over 2011, continuing their recovery from the lows during the crisis. Employment of foreign affiliates rose by 5.7 per cent, reaching 72 million, while exports of foreign affiliates remained relatively stable in 2012 registering only a small increase of 0.6 per cent. Likewise, value added and assets of foreign affiliates, increased slowly – by 5.5 and 4.3 per cent, respectively, over the previous year. This state of affairs reflects weak economic conditions around the world (section A.1.d). Sluggish economic growth in developed countries affected both developing and transition economies in 2012, through a sharp deceleration in demand from key advanced economies and the end of investment booms in some major emerging market economies.

Global trends in international production are reflected in the internationalization levels of the world's largest TNCs. Data for the top 100 TNCs, mostly from developed economies, show that their internationalization in 2012 slowed. Foreign sales of the largest 100 TNCs in the world declined 2.1 per cent in 2012, while their domestic sales – largely in developed economies – remained stable (table I.4). Likewise, foreign employment and foreign assets stagnated, while their domestic employment and assets increased by 6.8 and 5 per cent, respectively. These data reflect both a change in strategy by the top 100 TNCs that seems to focus more on domestic production and a change in the composition of the top 100 in 2012.

In 2012, some long-established companies significantly reduced their assets (both total and foreign), slipping out of the global top 100 TNC list (e.g. Bayer AG, Nokia OYJ and ThyssenKrupp AG). This enabled some more active corporations from developing and transition economies (e.g. Hon Hai Precision Industries, Vimpelcom Ltd, and América

Móvil SAB) to enter the global ranking for the first time.

In fact, data on internationalization indicators for the largest 100 TNCs headquartered in developing and transition economies reveal a strong internationalization effort with steep increases in foreign assets and sales. The foreign assets of TNCs from these economies rose 19.7 per cent in 2011, a rate faster than that of the largest 100 TNCs and almost double the remarkable 11 per cent increase in domestic assets (see table I.4). In 2011, their foreign sales increased by more than a third with respect to the previous year, easily surpassing the growth in domestic sales. The only area where this trend did not hold was in employment, where the growth of domestic jobs slightly outpaced that of foreign jobs in 2011. This trend suggests that while TNCs from developing countries and transition economies are quickly internationalizing their operations, the core of their production process is still based at home.

The importance of the largest TNCs in the universe of TNCs is declining slowly. Their share of all TNCs' foreign assets in 2011 was down to 9.3 per cent, compared with 12 per cent a decade earlier, though their share of foreign affiliates' employment increased marginally from 13.7 per cent in 2001 to 14.4 per cent in 2011. The largest 100 TNCs' share in foreign global sales increased sharply, however, from 13 per cent to 21 per cent over the same time period. The decrease in foreign assets coupled with the increase in foreign sales largely reflects the importance of non-equity modes; i.e. a rising share of foreign production is controlled through contracts rather than direct ownership.

By contrast, the largest 100 TNCs from developing and transition countries are strengthening their position within the TNC universe. Their share in global production is rising: the foreign assets share rose from 0.8 to 1.6 per cent between 2001 and 2011, that of foreign sales went up from 0.9 to 5.9 per cent, and that of foreign employment increased from 1 to 8 per cent during the same period.

Some differences also emerge when comparing M&A deals (figure I.26). The majority of M&A deals by the 100 largest TNCs were conducted in developed economies (just over 300 cross-border

M&A purchases in developed countries against fewer than 100 in developing and transition economies in 2012), while the majority of M&A purchases by developing and transition economies took place in other developing and transition economies (nearly 120 in 2012 against 70 in developed economies). Data suggest that the 100 largest TNCs conduct both vertical and horizontal investments<sup>7</sup> (with variation by year). The 100 largest TNCs from developing and transition economies engage significantly more in vertical investment, both in developed countries (more than 20 vertical purchases against fewer than 10 in 2012) and in developing and transition economies.

Both the largest TNCs and the TNCs from developing and transition economies implement the largest number of greenfield projects in developing and transition economies. In these host economies, TNCs from developing and transition economies tend to establish proportionately more new affiliates than the largest TNCs. By contrast, nearly half of greenfield ventures in developed countries take place through expansion, and the largest TNCs engage more in co-location than the 100 TNCs from developing and transition economies (figure I.27).

**Table I.3. Selected indicators of FDI and international production, 1990–2012**

Item	Value at current prices (Billions of dollars)				
	1990	2005–2007 pre-crisis average	2010	2011	2012
FDI inflows	207	1 491	1 409	1 652	1 351
FDI outflows	241	1 534	1 505	1 678	1 391
FDI inward stock	2 078	14 706	20 380	20 873	22 813
FDI outward stock	2 091	15 895	21 130	21 442	23 593
Income on inward FDI <sup>a</sup>	75	1 076	1 377	1 500	1 507
Rate of return on inward FDI <sup>b</sup> (per cent)	4	7	6.8	7.2	6.6
Income on outward FDI <sup>a</sup>	122	1 148	1 387	1 548	1 461
Rate of return on outward FDI <sup>b</sup> (per cent)	6	7	6.6	7.2	6.2
Cross-border M&As	99	703	344	555	308
Sales of foreign affiliates	5 102	19 579	22 574	24 198 <sup>c</sup>	25 980 <sup>c</sup>
Value added (product) of foreign affiliates	1 018	4 124	5 735	6 260 <sup>c</sup>	6 607 <sup>c</sup>
Total assets of foreign affiliates	4 599	43 836	78 631	83 043 <sup>c</sup>	86 574 <sup>c</sup>
Exports of foreign affiliates	1 498	5 003	6 320	7 436 <sup>d</sup>	7 479 <sup>d</sup>
Employment by foreign affiliates (thousands)	21 458	51 795	63 043	67 852 <sup>c</sup>	71 695 <sup>c</sup>
<i>Memorandum:</i>					
GDP	22 206	50 319	63 468	70 221 <sup>e</sup>	71 707 <sup>e</sup>
Gross fixed capital formation	5 109	11 208	13 940	15 770	16 278
Royalties and licence fee receipts	27	161	215	240	235
Exports of goods and services	4 382	15 008	18 956	22 303 <sup>e</sup>	22 432 <sup>e</sup>

Source: UNCTAD.

<sup>a</sup> Based on data from 168 countries for income on inward FDI and 136 countries for income on outward FDI in 2012, in both cases representing more than 90 per cent of global inward and outward stocks.

<sup>b</sup> Calculated only for countries with both FDI income and stock data.

<sup>c</sup> Data for 2011 and 2012 are estimated based on a fixed effects panel regression of each variable against outward stock and a lagged dependent variable for the period 1980–2010.

<sup>d</sup> 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 1998–2012, the share of exports of foreign affiliates in world export in 1998 (33.3 per cent) was applied to obtain values.

<sup>e</sup> Data from IMF, World Economic Outlook, April 2013.

*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, Cyprus, the Czech Republic, Finland, France, Germany, Greece, Hungary, Israel, Italy, Japan, Latvia, Lithuania, Luxembourg, Norway, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, the United Kingdom and the United States for sales; those from Cyprus, the Czech Republic, France, Israel, Japan, Portugal, Romania, Slovenia, Sweden, and the United States for value added (product); those from Austria, Germany, Japan and the United States for assets; and those from Australia, Austria, Belgium, Canada, Cyprus, the Czech Republic, Finland, France, Germany, Greece, Hungary, Italy, Japan, Latvia, Lithuania, Luxembourg, Macao (China), Norway, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States for employment, on the basis of the shares of those countries in worldwide outward FDI stock.



**Table I.4. Internationalization statistics of 100 largest non-financial TNCs, worldwide and from developing and transition economies, 2010–2012**

Variable	100 largest TNCs worldwide					100 largest TNCs from developing and transition economies		
	2010	2011 <sup>a</sup>	2010–2011 % Change	2012 <sup>b</sup>	2011–2012 % Change	2010	2011	% Change
<b>Assets (billions of dollars)</b>								
Foreign	7 285	7 634	4.8	7 698	0.8	1 104	1 321	19.7
Domestic	4 654	4 897	5.2	5 143	5.0	3 207	3 561	11.0
Total	11 939	12 531	5.0	12 842	2.5	4 311	4 882	13.2
Foreign as % of total	61	61	-0.1	60	-1.0 <sup>c</sup>	26	27	1.5 <sup>c</sup>
<b>Sales (billions of dollars)</b>								
Foreign	4 883	5 783	18.4	5 662	-2.1	1 220	1 650	35.3
Domestic	2 841	3 045	7.2	3 065	0.7	1 699	1 831	7.8
Total	7 723	8 827	14.3	8 727	-1.1	2 918	3 481	19.3
Foreign as % of total	63	66	2.3 <sup>c</sup>	65	-0.6 <sup>c</sup>	42	47	5.6 <sup>c</sup>
<b>Employment (thousands)</b>								
Foreign	9 392	9 911	5.5	9 845	-0.7	3 561	3 979	11.7
Domestic	6 742	6 585	-2.3	7 030	6.8	5 483	6 218	13.4
Total	16 134	16 496	2.2	16 875	2.3	9 044	10 197	12.7
Foreign as % of total	58	60	1.9 <sup>c</sup>	58	-1.7 <sup>c</sup>	39	39	-0.3 <sup>c</sup>

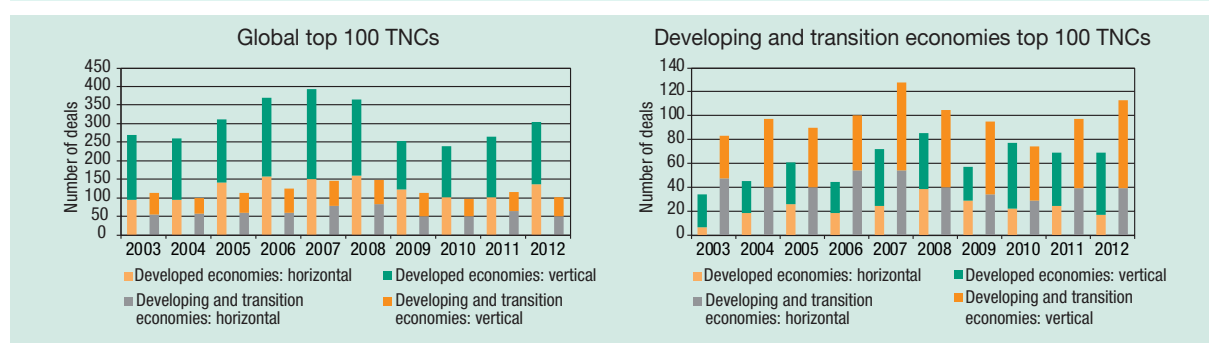
Source: UNCTAD.

<sup>a</sup> Revised results.

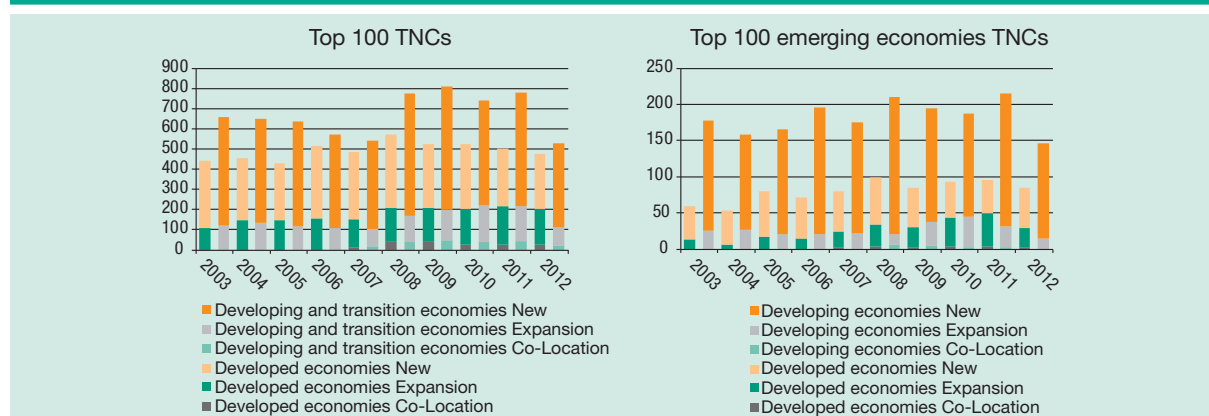
<sup>b</sup> Preliminary results.

<sup>c</sup> In percentage points.

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. Complete 2012 data for the 100 largest TNCs from developing and transition economies were not available at press time.

**Figure I.26. M&A cross-border purchases in developed, developing and transition economies by largest TNCs: number of horizontal vs vertical investments, 2003–2012**

Source: UNCTAD.

**Figure I.27. Global top 100 TNCs greenfield projects by region and type, 2003–2012 (Number of projects)**

Source: UNCTAD.

## 2. Repositioning: the strategic divestment, relocation and reshoring of foreign operations

**Many TNCs reprofiled their investment overseas through divestment. Reshoring and relocation of foreign affiliates are important elements of corporate divestment strategy.**

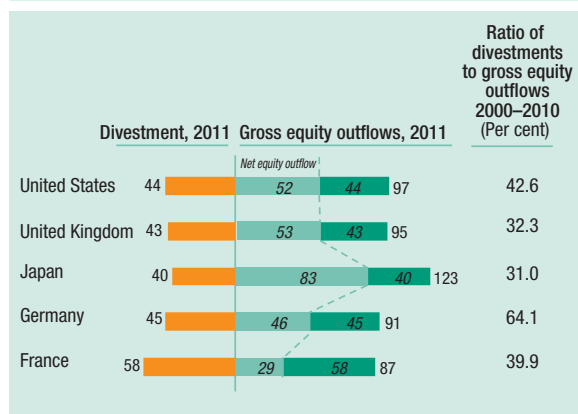
A decline in global FDI outflows may result from fewer (or smaller) global investment projects and also from divestment decisions by TNCs (box I.3). In some cases, divestment from a location is part of a TNC's repositioning of operations internationally to reflect changing patterns

of demand or locational competitiveness. TNCs can relocate either to a third country or to their home country (reshoring). TNCs engage in reshoring of activities when costs associated with offshoring become high or the distance between markets or activities is disadvantageous.<sup>8</sup>

Divestments are a constituent element of TNCs' international strategies, representing an aspect of their positioning of assets and activities in a dynamic global economy. Divestment decisions may involve the complete or partial sale of foreign affiliates by parent firms to local or third-country firms, or reduce equity investment by parent firms in their foreign affiliates, or complete closure of affiliates. Divestment can also be partly or purely financial. Where an operation in a host country is closed, this may be accompanied by the reshoring of operations or activities back to a TNC's home country and/or their relocation from one host country to another.

Although data on divestment are scarce, evidence shows that it is a significant phenomenon. France, Germany, Japan, the United Kingdom and the United States are among the few countries that report statistics on divestment as a part of their FDI dataset. For these countries, the scale of divestment is significant, ranging from one third (Japan) to two thirds of gross equity outflows (France) in 2011. For example, in the United Kingdom, gross equity outflows were \$95 billion in 2011, but equity divestment from the country was \$43 billion, which means that net equity outflows were only \$53 billion (figure I.28). The scale of divestment varies over time, depending on factors such as the business cycle,

**Figure I.28. Equity divestment in 2011 and its ratio to gross equity outflows, 2000–2010, from France, Germany, Japan, the United Kingdom and the United States**  
(Billions of dollars and per cent)



Source: UNCTAD, based on information from the Banque de France; Deutsche Bundesbank, Bank of Japan, United Kingdom Office of National Statistics and United States Bureau of Economic Analysis.

corporate strategies and the business environment. Over the period 2000–2010, for instance, the ratio of equity divestment to gross equity outflows for France was only 39.9 per cent, far lower than the 2011 figure (67 per cent) (see figure I.28).

Repositioning decisions may arise from a major realignment of locational factors. For instance, many United States manufacturing TNCs are reconsidering the location of some international operations because four trends – rising wage costs in developing countries, a weak dollar, technological advances such as 3D printing, and falling energy costs in the economy (arising from the extensive exploitation of shale gas) – are improving the United States' manufacturing competitiveness. As a whole, however, most repositioning decisions are more modest, reflecting the ongoing evolution of the world economy, GVCs and TNC strategies.

If divestment is linked to relocation (to a third country) or reshoring (back to the home country), it is not synonymous with a decline in the number of overseas operations by a TNC. Similarly, under the best circumstances for a host economy, if another company invests in the operation that the TNC is divesting from, divestment may not result in loss of local employment or productive capacity. However, this may not be the case: full closures or

### Box I.3. TNCs' strategic repositioning and divestment

TNCs adopt dynamic strategies towards the global configuration of their activities and, for this reason, divestment and new investments go hand in hand. TNCs govern a complex internal system of interlocking value added activities positioned across countries. This system evolves continuously, with expansion in one sector or territory sometimes accompanied by contraction in another. The composition and organization of value added activities by a TNC change continuously to respond to exogenous environmental, technological and social factors, as well as new endogenous strategic priorities. The key forms of strategic positioning are defined below.

**Offshoring** Offshoring is the process of transferring part or all of the value added activities conducted by a TNC from the home country to another. When it engages in offshoring, the TNC maintains ownership over activities conducted overseas. This differs from offshore outsourcing, which involves purchasing products or services from another firm located overseas.

**Divestment** Divestment is the process of reverse investment, involving capital withdrawals and reduction in the stock of assets TNCs hold abroad. Divestment can involve either full or partial withdrawals of foreign assets. It is difficult to measure globally because FDI statistics are recorded on a balance-of-payments basis. National statistics do not report the magnitude of divestment explicitly because they record only *net* flows or stocks.

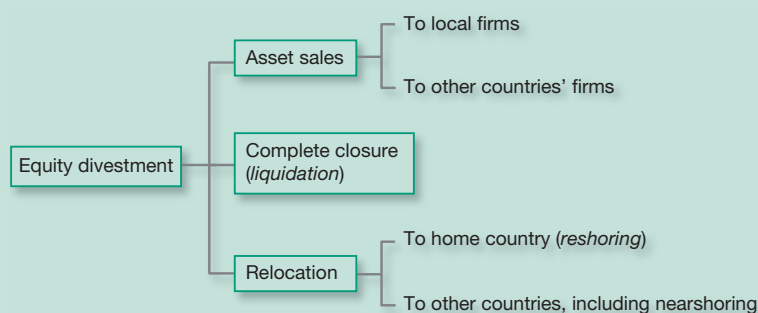
**Relocation** Relocation is the movement of existing assets, resources and people from one location to another. It can be linked to divestment. TNCs may decide to relocate all or part of value added activities in response to new environmental conditions or to reflect new strategies adopted by the firm. Relocation can take place within a host country, across borders to a new host country or back to the home country of the TNC.

**Reshoring** Reshoring is the process through which a TNC relocates all or part of value added activities conducted abroad back to the home country of the TNC.

**Nearshoring** Nearshoring is the process of positioning all or part of the value added activities in a country that is geographically, economically and culturally close to the country of origin of the TNC.

In terms of operational elements, equity divestment involves asset sales, liquidation and relocation (box figure I.3.1).

Box figure I.3.1. Structure of equity divestment



Source: UNCTAD.

scaling down of operations can lead to losses in employment, local incomes, tax receipts, etc. As TNCs continue to give a proportionally greater role to NEMs, as opposed to affiliates in their international production networks, divestment or reshoring may be further intensified. For instance, the impact of reshoring information technology (IT) services away from a host country partner is similar to that of

divesting an affiliate, and with less cost for the TNC, which may make such decisions more likely. It is therefore incumbent on host country governments to be aware of TNCs' positioning, divestment and relocation strategies (including reshoring), both in general and in how they are likely to affect the host country.

Over the period 2000–2011, divestment was more than 30 per cent of gross equity outflows for Japanese TNCs (see figure I.28). The main reason for affiliates' closures – in those cases where data are available – is their strategic decision to relocate operations to other countries, including reshoring to Japan. Indeed, relocation appears to be a significant feature of Japanese TNCs' positioning and divestment strategies. According to a survey by Japan's Ministry of Economy, Trade and Industry, in 2011 about half of divested affiliates were relocated either back to Japan or other countries (figure I.29). Another survey, by Toyo Keizai, shows that relocation to third countries is rising: in 2011–2012, one quarter of all divested firms were relocated to third countries, compared with one tenth a decade ago. These two surveys reveal that one half of relocated firms are involved in reshoring for Japanese TNCs.

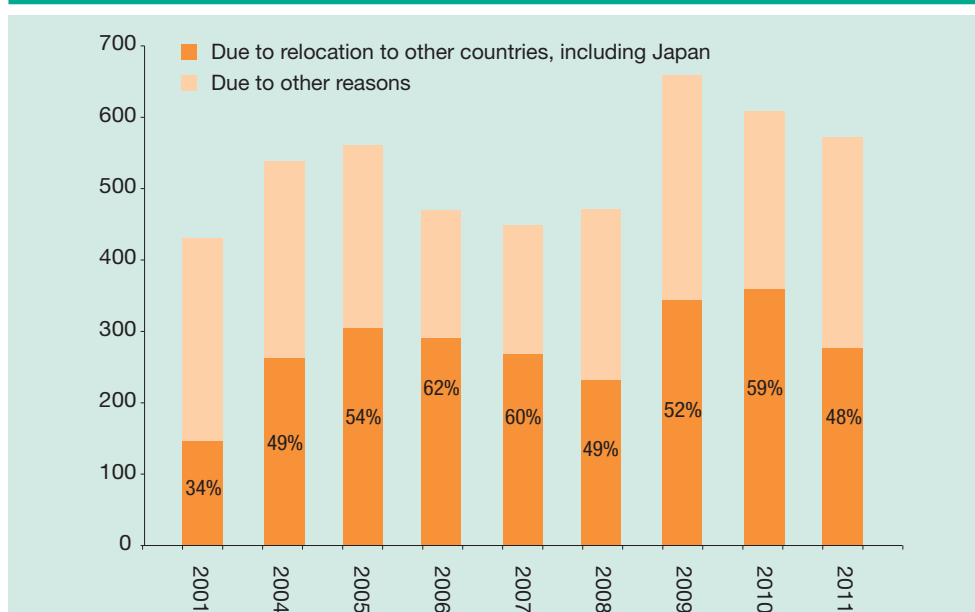
A number of factors can drive divestment decisions. Some relate to changes in global or regional TNC strategies, others to evolving environments in host markets, or to the industry-specific economic environment. (For some examples explaining the recent reshoring of manufacturing operations back

to the United States, see table I.5.) Apart from changes in financing operations, TNC strategies that drive divestment include:

- evolving global or regional strategies; for instance to reorganize, restructure and/or downsize with the purpose of raising efficiency through a reconfiguration of international production networks of the TNC;
- changes in market servicing decisions, for instance by moving away from direct production to the use of NEMs; or
- the poor performance of foreign affiliates (a survey of 500 Japanese foreign affiliates involved in divestment strategies in 2011 shows that 15 per cent of them were closed because of poor performance (Japan, METI, 2013)).

Divestment can also occur following changes in host country environments, for instance when significant cost savings can be gained by relocating (such as relocation from higher- to lower-cost countries), or when local operating conditions become unfavourable (including policy shifts or rising competitive pressures). Firms can decide to divest when local competitive pressures are too

**Figure I.29. Number of Japanese foreign affiliates closed, 2001 and 2004–2011**



Source: UNCTAD, based on data from Japan, Ministry of Economy, Trade and Industry.

high. For instance, the divestment ratio tends to be high in the United States, where foreign affiliates' profitability is low (the rate of return to FDI in 2011 was 4.8 per cent).

Finally, industry- and technology-related factors can drive divestment decisions, which result from dynamic changes occurring through the industry life cycle or industry-level consolidation (as industries mature). High-tech knowledge-based industry segments quickly reach a stage of maturity or require different types of technology. These shifts in technology may lead to divestment decisions.

There are a number of policy implications to draw from the divestment activities of TNCs. For host economies, the key questions are about the type and strategy of investment conducted by TNCs; whether divestment leads to a sale (capital divestment) or a closure (liquidation) of the foreign affiliate; and the reasons behind divestments. Companies may decide to divest because locational advantages offered by the country are no longer favourable.

Host governments therefore need to consider how attractive their country is to new investment as much as to existing firms. As countries develop, it can be expected that low value added types of activities will relocate to countries that offer cheaper factors of production. Divestment of certain segments of GVCs, in this case, may reflect the development objectives of host governments. But this should go hand in hand with a shift towards higher value-added types of activities. When a divestment is driven by shrinking opportunities worldwide, often coupled with financial difficulties faced by TNCs, host governments may consider intensifying their aftercare services with a view to retaining FDI in the country.

Research on divestment is in its early stages, in part because data are insufficient. Further research and detailed data on divestment are required because it is a significant phenomenon and entails a number of implications for policymaking.

**Table I.5. Selected cases of reshoring of manufacturing operations to the United States, 2010–2013**

Company	Reshored from	Comments
ACE Clearwater Enterprises	Hungary, China	The company, a maker of complex formed and welded assemblies for aerospace and energy generation, reshored mainly because of quality control issues.
Altierre Digital Retail	China	The company makes digital displays and signs for retail stores. The reshoring introduced automation processes in order to make labor an insignificant part of overall production costs and demanded skilled workers.
Bison Gear & Engineering Corp.	China	The company's end products, gear motors, are used in products from ice machines to solar panels. Reshoring to make motors in-house enabled the company to respond quickly to changes in demand.
Farouk Systems	Republic of Korea, China	A manufacturer of hair and spa products had various reasons to move operations, from the climate to the international mix of residents to the accessibility of the city. The company realized it could manufacture products in the United States at costs comparable with those abroad.
General Electric Appliances	China	The company manufactures dishwashers, refrigerators and heaters. Labour savings were eaten away by an inability to carry appropriate inventory levels as well as by inconsistent delivery schedules, resulting in overall costs that were 6 per cent higher than in the United States.
LightSaver Technologies	China	The company produces emergency lights for homeowners. It found that manufacturing in the United States was 2 to 5 per cent cheaper after accounting for the time and trouble of producing overseas, although manufacturing alone was 30 per cent cheaper in China.
NCR Corporation	India, China and Hungary	The company returned part of its ATM production to a new manufacturing facility in order to be close to customers and innovate directly on-site with them. It was not seeking the lowest cost manufacturing location but reshoring realize other benefits: decreased time-to-market, improved internal collaboration and lowered current operating costs.
Neutex Advanced Energy Group	China	By reshoring, the company was able to automate LED manufacturing processes, thus cutting workforce numbers and improving quality control. In addition, language barriers were eliminated and the company gained greater control of product delivery.
Offsite Networks	China	Rapid improvements in technology made it more affordable for the company to manufacture locally. This meant that labour costs, which had driven the search for cheaper workers overseas, would be a smaller percentage of total costs. In addition, other costs in China, such as shipping, had been increasing.
Pigtronix	China	A producer of pedals that create electric guitar sound effects discovered that it could not adequately monitor quality at Chinese factories. It also faced an erosion of benefits from having capital tied up in products that spent a week in transit and then piled up in inventory.
SolarWorld	China	A builder of solar panels committed to western labour and environmental standards that were not matched by its Chinese site. Labour accounted for less than 10 per cent of total costs, and close to half of the savings on labour from using Chinese workers was lost to higher shipping costs. The other half, or more, was made up for by the higher labour productivity in the United States.

Source: UNCTAD, based on information from the Reshoring Initiative. Available at <http://www.reshorennow.org/resources/library.cfm#> and company websites.

## C. FDI INCOME AND RATES OF RETURN

FDI income amounted to \$1.5 trillion in 2011 (the latest year for which most countries have data), broadly equivalent to the amount of FDI inflows. The rate of return on FDI was 7 per cent in the same year, with higher rates in developing and transition economies than in developed countries. Reinvested earnings accounted for about one third of total inward FDI income and almost the same share of FDI flows during 2005–2011.

In a globalized economy, for home economies, FDI provides opportunities for TNCs to earn profits on economic activities conducted outside the TNC's home economy. For host economies, FDI income represents the return on direct investment positions that accrues to TNCs acting as direct investors. Part of this income may be used by TNCs as additional sources for their capital expenditures in host economies, and the rest is repatriated to home or other countries. In some cases, these returns from host countries constitute a significant share of the total return to TNC capital.

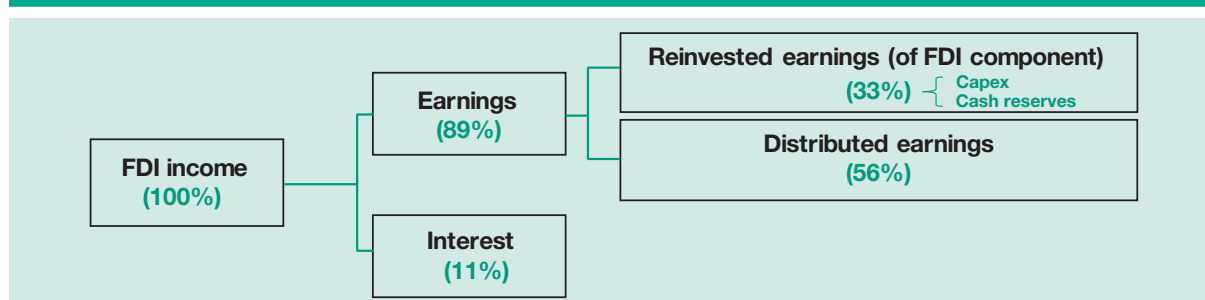
FDI income consists of earnings (profits) on equity investments in direct investment enterprises (or foreign affiliates) plus interest income on debt between direct investors (or parent firms) and direct investment enterprises, and between fellow enterprises. Earnings constitute a very large share of FDI income (figure I.30). Earnings can be further distinguished between reinvested earnings, which represent a component of FDI flows, and repatriated (distributed) earnings. Reinvested earnings are earnings retained within the host economy. They are composed of capital expenditures (capex)

(earnings used to acquire or upgrade physical assets) and cash reserves.

Because of the growth of FDI, FDI income has become an increasingly important component of the balance of payments, contributing significantly to FDI itself, and can play an important role in the overall economy as a source of domestic income or as an income outflow. From a host country perspective, FDI income is one of several benefits that can derive from the activities of TNCs. FDI is a potential source of capital formation, employment, technology transfer and industrial upgrading; thus, short-term income deficits have to be strategically offset against long-term capacity-building. In addition, rates of return on direct investment often exceed returns on other types of investment and vary significantly among regions of the world. Variations in the level of reinvested earnings, repatriated earnings and the rate of return on FDI raise questions about the characteristics of FDI and the impact of tax and other FDI-related policies.

This section addresses some key empirical issues related to recent major trends and salient features of FDI income, mainly from the host country point of view. Subsection 1 reviews trends in FDI income by income component at both global and regional levels. Subsection 2 focuses on rates of return on FDI by region and country. Changes in rates of return during and after the financial crisis are also addressed. Subsection 3 evaluates FDI income in the context of the balance of payments. The last subsection concludes by summarizing the results and discussing some FDI policy implications.

Figure I.30. Structure of FDI income, 2005–2011



Source: UNCTAD.

Note: Figures in parenthesis show the distribution share of total inward FDI income during 2005–2011.

## 1. Trends in FDI income

### a. General trends

**Global FDI income was \$1.5 trillion, almost equivalent to FDI inflows. It increased for all three groups of economies, with the largest increases in developing and transition host economies.**

Global FDI income increased sharply in 2011 for the second consecutive year, after declining in both 2008 and 2009 during the depths of the global financial crisis. FDI income rose to \$1.5 trillion in 2011 from \$1.4 trillion in 2010, an increase of 9 per cent (figure 1.31). FDI income, a component of the balance of payments, accounted for 6.4 per cent of the global current account.

The fall in FDI income in 2008 and 2009 suggests that foreign affiliate operations were severely affected at the outset of the global downturn. This is consistent with sharp declines in the corporate profits in many economies. By 2010, however, global FDI income had surpassed the previous peak reached in 2007. For developed economies, FDI income generated by investing TNCs has not

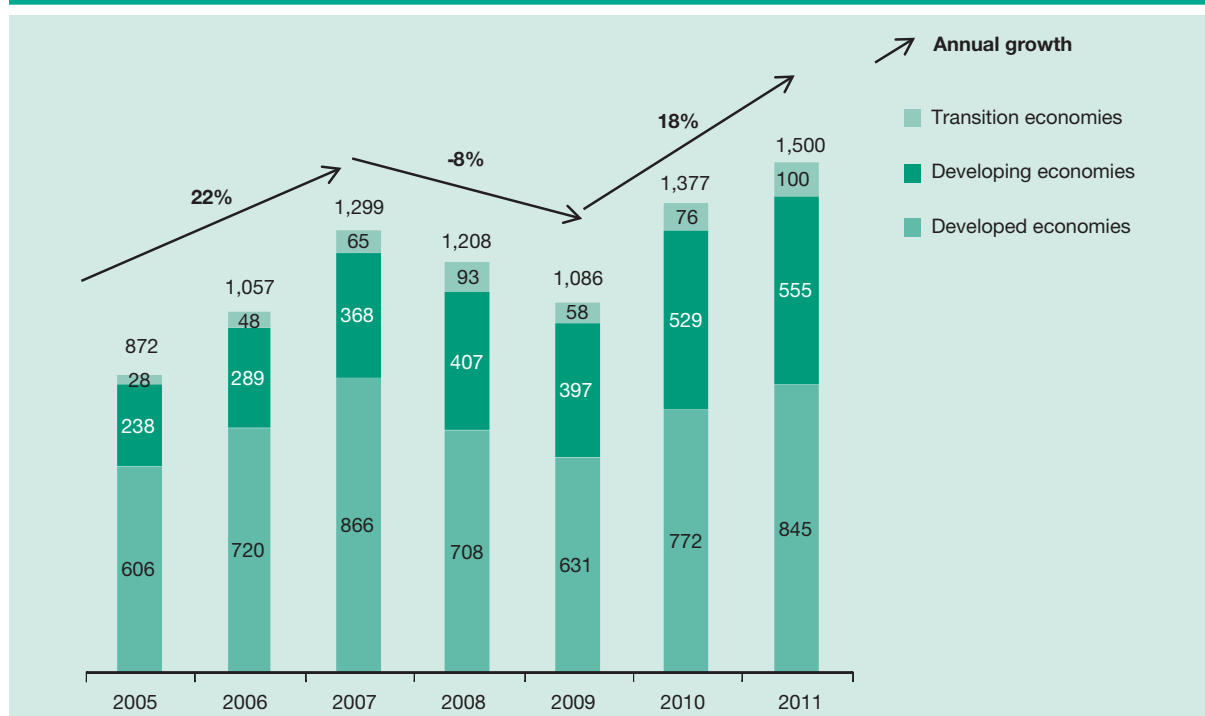
completely recovered to its pre-crisis 2007 level, primarily because of slow growth in the EU that reflects the region's continuing sovereign debt crisis. For developing economies, FDI income declined modestly in 2009 before growing strongly in 2010, especially in East and South-East Asia. For transition economies, FDI income declined sharply in 2009 but rebounded strongly in 2010 and 2011.

### b. Rates of return

Rates of return on FDI<sup>9</sup> or FDI profitability can be compared across regions, by direction of investment, and with other types of cross-border investment. For instance, for the United States, the cross-border portfolio rate of return was 2.7 per cent, while the FDI rate of return was 4.8 per cent in 2011 – the latest year for which data are almost complete. FDI rates of return can also

**Globally, FDI rates of return declined to less than 6 per cent in 2009, but have recovered since then. In 2011, rates of return were highest in developing and transition economies, at 8.4 and 13 per cent, respectively.**

**Figure 1.31. FDI income by region**  
(Billions of dollars)



Source: UNCTAD based on data from the IMF Balance of Payments database.



be compared with rates of return for investment conducted by locally owned corporations in host economies (on a country-by-country basis). In the United States, the rate of return on inward FDI is lower than that of locally owned entities (for 2011, 4.8 per cent as against 7.5 per cent<sup>19</sup>), but this varies from country to country. There are a number of reasons why rates of return may be different between FDI and locally owned firms in a host economy. They may include firms' characteristics (such as length of operations), possession of intangible assets, transfer pricing and other tax minimization strategies, and relative risk.

In 2011, the global rate of return on FDI was 7.2 per cent, up slightly from 6.8 per cent in 2010 (table I.6). Rates of return have decreased since 2008 in developed economies. In developing and transition economies, FDI rates of return are higher than those in developed economies, and vary over time and by region. For example, while the global average rate of return on FDI for 2006–2011 was 7.0 per cent, the average inward rate for developed economies was 5.1 per cent. In contrast, the average rates for developing and transition economies were 9.2 per cent and 12.9 per cent, respectively. For instance, in Africa and transition economies, natural resources, extractive and processing industries consistently contribute to higher rates of return. At the individual country level, therefore, many such economies rank

high in the list of the top economies with the highest rates of return, and all but one of the 20 economies are developing or transition economies (figure I.32).

**Figure I.32. Top 20 economies with highest inward FDI rates of return, 2011**  
(Per cent)



Source: UNCTAD, based on data from the IMF Balance of Payments database.

**Table I.6. Inward FDI rates of return, 2006–2011**  
(Per cent)

Region	2006	2007	2008	2009	2010	2011
<b>World</b>	<b>7.3</b>	<b>7.2</b>	<b>7.7</b>	<b>5.9</b>	<b>6.8</b>	<b>7.2</b>
<b>Developed economies</b>	<b>6.3</b>	<b>6.1</b>	<b>4.6</b>	<b>4.0</b>	<b>4.6</b>	<b>4.8</b>
<b>Developing economies</b>	<b>9.7</b>	<b>9.8</b>	<b>9.7</b>	<b>8.7</b>	<b>9.0</b>	<b>8.4</b>
Africa	10.0	13.4	15.8	10.8	8.9	9.3
Asia	9.5	9.1	8.9	8.8	9.8	8.8
East and South-East Asia	9.7	9.3	9.1	9.2	10.5	9.2
South Asia	14.2	12.9	10.6	8.6	8.5	8.8
West Asia	3.9	3.8	6.7	5.4	4.9	5.1
Latin America and the Caribbean	10.2	10.3	9.9	7.6	7.1	7.1
<b>Transition economies</b>	<b>14.5</b>	<b>12.0</b>	<b>16.5</b>	<b>10.7</b>	<b>10.8</b>	<b>13.0</b>

Source: UNCTAD, based on data from the IMF Balance of Payments database.

### c. Reinvested earnings versus repatriated earnings

Reinvested earnings are a major component of FDI flows in the financial account of the balance of payments. It is important to note, however, that reinvested earnings can be used by TNCs either to (i) acquire or establish new foreign affiliates or to increase capital expenditures at existing affiliates, or (ii) to retain as cash holdings. In fact, TNC affiliates around the world have accumulated record levels of cash and other short-term assets from their reinvested earnings (section A).

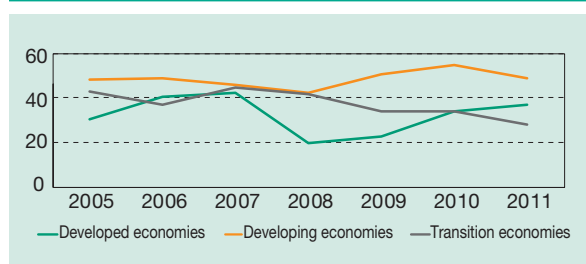
At the global level, in 2011, \$499 billion in FDI earnings were reinvested in host countries (table I.7), while \$1 trillion were repatriated to home or other countries. The share of reinvested earnings in total

**One third of inward FDI income is retained within host countries as reinvested earnings that are a major component of global FDI inflows.**

FDI earnings varies over time; it was one third in 2006 and 2007, 20 per cent in 2008 at the onset of the financial crisis, before returning to one third in 2011. Over the 2005–2011 period, the share of reinvested earnings in total FDI earnings averaged 32 per cent. In 2008 reinvested earnings on inward FDI for developed economies fell even more sharply than total earnings (figure I.33).

Since 2009, the share of reinvested earnings is highest in developing countries, reaching 49 per cent in 2011 (figure I.33). This share has declined slowly in transition economies since 2007, perhaps reflecting investor concerns with business prospects in some parts of the region.

**Figure I.33. Share of reinvested earnings in FDI earnings, 2005–2011**  
(Per cent)



Source: UNCTAD, based on data from the IMF Balance of Payments database.

## 2. Impacts of FDI income on the balance of payments of host countries

In the balance of payments, direct investment income is a component of the broader category of primary income, which includes compensation of employees and other types of investment income. Payments of income on inward FDI reduce the current account surplus or increase the deficit, while diminishing the capital resources available to the host economy.

**FDI income can be retained in the host economy or repatriated. Financial flows related to FDI income have an impact on the current accounts of countries.**

Reinvestment of earnings (or reinvested earnings) – one of the components of direct investment financial flows – is a major source of FDI inflows, with variation by region and over time. In 2011, at the global level, reinvested earnings accounted for 30 per cent of worldwide FDI of \$1.65 trillion. Over the period 2005–2011 reinvested earnings as a share of FDI averaged 23 per cent, with a low of 14 per cent in 2008 as the global financial crisis started, and a high of 32 per cent in 2010.

Developed economies were host to almost 50 per cent of global inward FDI flows in 2011, of which 22 per cent was financed through reinvested earnings. Reinvested earnings financed 39 per cent of inward FDI in developing countries in 2011 and 31 per cent in the case of transition economies (figure I.34). Over the period 2005–2011, the

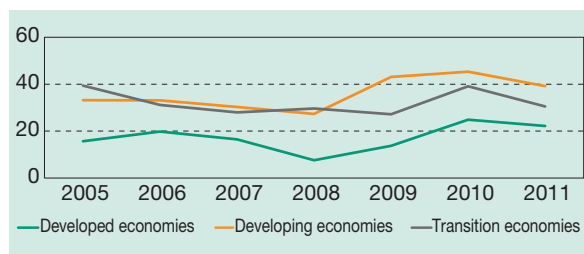
**Table I.7. Inward FDI reinvested earnings, 2005–2011**

(Billions of dollars)

Region	2005	2006	2007	2008	2009	2010	2011
<b>World</b>	<b>258</b>	<b>378</b>	<b>470</b>	<b>277</b>	<b>291</b>	<b>477</b>	<b>499</b>
<b>Developed economies</b>	<b>161</b>	<b>253</b>	<b>312</b>	<b>109</b>	<b>112</b>	<b>219</b>	<b>260</b>
<b>Developing economies</b>	<b>86</b>	<b>109</b>	<b>131</b>	<b>130</b>	<b>161</b>	<b>235</b>	<b>214</b>
Africa	7	9	13	17	13	15	11
Asia	59	72	85	86	116	189	166
East and South-East Asia	55	65	75	74	105	175	148
South Asia	3	6	8	10	9	12	12
West Asia	1	1	1	2	2	3	5
Latin America and the Caribbean	21	28	32	27	31	30	37
Oceania	0	0	0	0	0	0	0
<b>Transition economies</b>	<b>11</b>	<b>17</b>	<b>28</b>	<b>37</b>	<b>18</b>	<b>23</b>	<b>25</b>

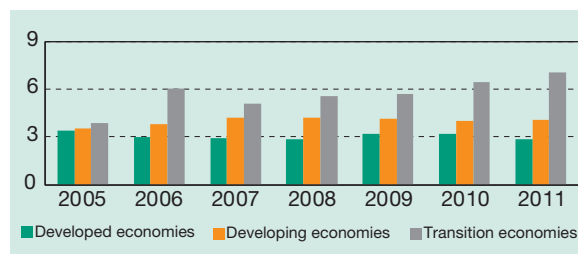
Source: UNCTAD, based on data from the IMF Balance of Payments database.

**Figure I.34. Share of inward FDI flows financed through reinvested earnings, by region, 2005–2011**  
(Per cent)



Source: UNCTAD, based on data from the IMF Balance of Payments database.

**Figure I.35. Share of repatriated earnings in current account total payments, by region, 2005–2011**  
(Per cent)



Source: UNCTAD, based on data from the IMF Balance of Payments database.

average share of reinvested earnings in inward FDI was the highest for developing countries at 36 per cent, followed by transition economies at 32 per cent, while the share for developed economies was at a much lower 17 per cent. (Among developed economies, the share for the EU is lower than that of other countries at 12 per cent.) Differences among regions may reflect differences in rates of return on FDI, tax treatment, the financing requirements of TNCs and the range of financing sources available.

Another means through which FDI income has an impact on the current account in the balance of payments is through repatriated earnings. The share of repatriated earnings in the current account total payments is, on average, about 3.4 per cent (figure I.35). This share is lower for developed economies (repatriated earnings accounted for 2.9 per cent of total payments in 2011), than for developing and transition economies (4.0 per cent and 7.0 per cent, respectively). The share varies significantly by country. For instance, it was relatively high for Kazakhstan (24 per cent), Nigeria (18 per cent), Yemen (17 per cent) and Colombia (13 per cent). Differences result from the different sectoral composition of FDI (repatriated earnings are more common for FDI in extractive industries), differences in tax systems and TNCs' own financial decisions.

### 3. Policy implications

The magnitude of and trends in income generated by FDI have a number of implications for policymakers:

- FDI income is significant, comparable to the annual flows of global FDI. FDI income represents a return on foreign investment which also generates value added in host countries, contributes to GDP, creates jobs and income for workers, and yields fiscal revenues. It is the surplus generated by foreign affiliates after payment of factor costs and taxes.
- The high rates of return on FDI that can be observed in some countries that attract FDI predominantly in extractive industries have at times raised concerns about excessive rents for foreign firms. Although rates of return fluctuate – e.g. they rise and fall with commodity prices – and must be considered case by case, a number of fiscal tools are available to policymakers to ensure that a fair share of rents on resources accrues to the domestic economy (UNCTAD, 2012). Ultimately, from an investor perspective, returns are a compensation for risk. Policymakers need to consider country, industry and project risk factors when assessing rates of return.

**Policies should be developed and promoted that encourage greater use of foreign affiliates' reinvested earnings for capital expenditures and other activities that support host country economies.**

- High rates of return, in some cases, coincide with high shares of repatriated earnings in total FDI income. This is partly a function of the industries where this occurs: FDI projects that require high upfront investments in economies that provide relatively little opportunity for follow-up investment in the same industry will see higher shares of repatriated earnings. This has raised concerns in some countries of the potential negative long-term effects of FDI on the balance of payments. The data have shown that in most countries the magnitude of income transfers relative to total current account payment is limited, also due to the export-generating effects of FDI.
- Profits generated by foreign affiliates and repatriated earnings are a more general concern for policymakers, to the extent that they may be perceived as “income leakage” for the domestic economy. Although value added created by foreign affiliates contributes to a country’s GDP, the surplus generated by foreign affiliates (after tax) is not part of the country’s gross national income. A key policy objective should be to maximize the reinvestment rate in order to keep as much of the rents as possible on FDI in the domestic economy and generate further productive capacity for development.
- Finally, earnings retained in the economy do not automatically translate into capital expenditures. For host countries of FDI, the same measures that promote investment will help maximize the extent to which retained earnings are reinvested. In addition, some countries adopt targeted incentives to facilitate reinvestment.

## Notes

<sup>1</sup> Greenfield projects data refer to announced greenfield FDI. The value of greenfield projects indicates the capital expenditure planned by the investor at the time of the announcement. Although these data provide an important indicator of investor feeling about the launch of cross-border expansion investments, they can be substantially different from the official FDI data as reported, as companies can raise capital locally, phase their investments over time and channel their investment through different countries for tax efficiency. In addition, the project may be cancelled or may not start in the year it is announced.

<sup>2</sup> SWF Institute Fund Rankings, updated February 2013. Accessed on 13 March 2013 at [www.swfinstitute.org/fund-rankings](http://www.swfinstitute.org/fund-rankings).

<sup>3</sup> *The Economist*, “The state advances”, 6 October 2012.

<sup>4</sup> UNCTAD research suggests that this number is still very small as a proportion of all SOEs (*WIR11*, p. 31).

<sup>5</sup> For the purpose of this report, the countries and territories falling into this group include Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahrain, Barbados, Belize, the British Virgin Islands, the Cayman Islands, the Cook Islands, Dominica, Gibraltar, Grenada, the Isle of Man, Liberia, Liechtenstein, Maldives, the Marshall Islands, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, Seychelles, Tonga, Turks and Caicos Islands, US Virgin Islands and Vanuatu. Based on OECD, “Towards Global Tax Co-operation”.

<sup>6</sup> FDI flows to OFCs are likely to be underestimated as many OFCs do not report FDI data. For example, data on FDI inflows to the British Virgin Islands are collected from home countries that report investments there. This estimation method tends to underestimate the level of flows.

<sup>7</sup> An investment is horizontal if the target company operates in the same industry as the acquiring TNC and thus has the same primary SIC code at the two-digit level. A vertical investment is a purchase of a company operating in another industry.

<sup>8</sup> “Outsourcing and offshoring: Here, there and everywhere”, Special report, *The Economist*, 19 January 2013.

<sup>9</sup> Annual rates of return are measured as annual FDI income for year divided by the average of the end-of-year FDI positions for years t and t-1. For this study, rates of return have been calculated only for those countries that reported both FDI income and positions for a given year. Rates of return by sector are not provided in this report because FDI income data by sector are not readily available for most countries.

<sup>10</sup> Data from United States Department of Commerce.